

# INEKO

Institute for Economic and Social Reforms

## Seminar Bulletin - Corporate Governance

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Institute for Economic and Social Reforms

## Seminar Bulletin - Corporate Governance

**František OKRUHLICA**

**Faculty of Business Management, University of Economics, Bratislava**

### **OWNERS' STRATEGY IN ENTERPRISES – CONCEPTIONS AND REALITY**

Today's economic status of the Slovak Republic helped to recognize that former expectations of the transformation process were fulfilled only partly. The past ten years have been too short for so serious system changes and, at the same time, it has been negatively influenced by non - standard conditions. We knew that the privatization process is the only means of transformation of our economy. As the transformation proceeds the question of "corporate governance" comes in the foreground. It shows the significant factor of rising competitive advantage both of enterprises and macroeconomic environment. The success of corporate governance depends on the quality of institutional environment as well. This is valid both for transition economics and for developed market economics with a better basis. It is positive that we can help the effort of the organizations such as OECD, International Monetary Fund, or World Bank to solve these problems. In this contribution I would like to point out how the expectations of owners' job in their enterprises were fulfilled.

#### **Application of the model of corporate governance as an important assumption of transformation.**

The problem of Corporate Governance is connected with the level of ownership relations in capital companies while the ownership rights are exercised.

Because there were not enough experiences of practical use of Corporate Governance, it was necessary to find good solutions and ask the other countries for experience as soon as possible. That is why we first used the experiences from developed market economics for setting the basic rules of the corporate governance system, delegating competencies and responsibility of external and internal members of statutory bodies and of management in executive bodies.

Similarly in the case of the structure of governing the company there are differences among the countries with developed market economies. Ownership and corporate governing in the **U.S.A.** and **United Kingdom** is called Anglo-Saxon or Outsider model. In this system the corporate governance is connected in the so-called Board of Directors. The decision-making is concentrated in the top management, mainly in the hands of Chief Executive Officer-CEO.

The ownership was historically dispersed among many institutional investors, higher position of an owner was acknowledged in the sense of law and the claims to publish information were carried out. Laws do not allow the concentration of ownership and are against possible tendencies of financial institutions to dominate industrial enterprises, they also protect minor owners (for instance The Bank Holding Company Act, The Investment Company Act or The Securities Exchange Act). Therefore the enterprises get the necessary investing capital for their development in the sensitive capital market which significantly shortens the investment horizon.

On the other hand, the **European system (represented by German model)** and **Japanese system** are characterized by a very narrow union of financial and industrial capital, where important banks or family investors usually stand at the head. These investors in managing companies interfere with strategy management plans and personal changes. The Japanese model is based on the capital connection [so called cross share ownership] among the groups of manufacturing companies, business firms and financial institutions constituting together a conglomerate that has common, coordinated interests. Especially the European ownership model of great a amount of shares and influence connected with it

allowed financial institutions to get important information about enterprises. In this system, companies get the main financial sources through bank credits. In this way, banks strengthen their position to become also creditors. In contradiction to Anglo-Saxon unitary system, the European system was developed from the so called Dual insider system with two governing bodies-Board of Directors and Board of Supervisors.

In the process of transformation of transitive economics it means also in former Czechoslovakia and in Slovakia the European dual model of corporate governance has been developing for a long time. The privatization process itself had the basic philosophy of transformation that the known and responsible owner restructures his enterprise. No risks coming from the structure of owners were not considered. Though different results of the authors Claessens and Djanko (1999) on one side and Walsh and Whelan on the other side) show that the concentration or dispersion of owners in Czech enterprises was not of main importance for their economic results. Of course, the authors had to analyze other criteria such as, for instance, branch appurtenance, object of business, position on the market, etc.

The corporate governance model, which was accepted in our country has been very free legislatively and some reforms are needed. The chief organ of the company is the general assembly where owners decide all-important questions concerning the company. Because owners meet once a year and not all of them take part in the meeting, the main responsibility is transferred to elected administrative bodies. In this manner the suppositions for strategic acting of owners' representatives in these bodies were created - the partner's relationship with executive management and also the role of consultants and lobby.

I would like to mention very briefly the main role of elected corporate governance bodies. First of all, the Board of directors has to manage the company. Its duty is to take care of owners' interests and other interested groups. It should initiate building long competitive advantages of enterprise and help to fulfill strategic plans, for instance, to lay down visions, aims of strategy and then take part in the regular control and feedback. Independence enables administrative bodies to appreciate strong and weak aspects, chances and threatens or enterprise competitive advantages. The most important strategy task is to prepare the company for every situation that can likely happen. They should have strategic foresight. From the very beginning all the owners should pay attention to managing risks, financial strategy, especially to managing financial flows and liquidity, restructuring, developing human resources, technologies, inside and outside communication and also legal conscience and ethics. The above - shown amount of necessary knowledge and skills, as Klírova (1999) states lays great claims on the members of the enterprise administrative body. Fulfilling these conception unables the owner to create an equivalent partnership towards top management. Thus, if the owner is responsible for a long enterprise vitality, he must guarantee its restructuralization via resources which do not threaten these aims - capital market, foreign investors, etc.

### **Why is not the owner or management successful in corporate governing in Slovakia?**

Instead of solving the question of restructuralization of the management sphere by a change in the central planned economy into market economy a reverse process is under way. Although we can say that the accompanying feature of this transition must be also eliminating ineffective and non- competitive enterprises from the market, the so long-term ignorance of financial insolvency in the Slovak economy brings a shortage of own resources and undercapitalization. According to J. Borovsky (2000) more than 50% of Slovak enterprises suffered a loss in the economic income in 1998. His analyses of financial insolvency showed that 33.9 % of enterprises (expressed in the absolute number –12 283 subjects) are at a loss and they must announce bankrupt. Another risky group is 21.6% of enterprises with a negative economic result. This is because of high undercapitalization which was compensated by growing expensive foreign sources, mainly in the form of bank credits. The so-called “healthy group“ involves less profitable enterprises. This group incorporates the majority of enterprises with foreign investments, which have more own sources.

It is obvious from this analysis that many enterprises which were privatized by non- standard methods in the last period were not restructuralized but, on the contrary, they were more burdened with privatization credits. Owners did not understand the key importance of owner's strategy and strategic management implemented by managers and often by the only person. Therefore it is possible that the owners of Slovak enterprises did not exert a strong enough pressure on the top management to create together the strategy of the long-term competitive advantage by getting resources from foreign investors also at a price of lowering their own influence on the corporate governance. The entry of foreign investors brings not only a cheap source of financing investment development but also new markets, new enterprise culture and

know-how of the corporate governance. The macroeconomic aspect in the process of incorporation of Slovakia into challenging economic competitive conditions of the European Union is not negligible.

To be objective, it is important to mention that a role of the state is not always successful in relation to the corporate governance. The state did not create legislative conditions which could allow the dynamic development of healthy enterprises on the one hand and the exclusion of losing enterprises because of the bankruptcy and liquidation on the other.

## Conclusion

When carrying out transformation of the Slovak economy in the future it will be extremely important to create the respective institutional and regulatory conditions for corporate governance in the way that the OECD council is preparing its program. There are five principles concluded: The principle of responsibility of the members of administrative bodies, the principle of owners' rights, equal treating with shareholders, inclusive of minor and foreign ones, role of participants and the important principle of publishing information.

The entry of foreign investors and implementation of the principle of responsibility of members of the administrative bodies will evoke an enormous pressure on the qualification and skills of members of the Board of Directors as well as the Board of Supervisors.

The point in question is legal conscience, comprehension of strategies, especially the financial strategy, to cope with internal communication, but also with external relations for the benefit of the presentation of information and transparency.

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## Seminar Bulletin - Corporate Governance

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### **RELATIONSHIPS BETWEEN OWNERS AND CORPORATE GOVERNANCE BODIES FROM THE VIEWPOINT OF THE LAW OF BUSINESS CORPORATIONS**

#### **1. Introduction**

An essence of the corporate governance problem<sup>1</sup> is identified by the economy in separating the ownership from the corporate management (control), which leads to a loss of the interest unity between an owner and persons managing and possessing the corporation.<sup>2</sup>

In terms of the law the business corporation is an independent legal subject possessing the corporation (inclusive of promoters', partners' or shareholders' deposits in the corporation). By establishing the corporation, special legal relationships among its associates will arise – in the joint-stock company between shareholders and the company on the one hand and between the company and persons managing the company on the other. It follows that in considering the formal and legal aspects there does not exist a direct legal relationship between economic proprietors and corporate governance bodies. The economic proprietor, i.e. the associate or shareholder has the commitment relationship with the corporation, the contents of which is the right toward the corporation, particularly the right to have a share in the corporation profit and liquidation residue in case of its dissolution, and also the right to participate in accordance with the legally defined manner in managing the corporation and in keeping all obligations towards the corporation, mainly the obligation to repay the deposited amount into the basic corporate capital. The commitment-based legal relationship between the corporate governance members and the corporation defines rights and obligations of the members of these bodies in exercising the corporate governance. Whilst the contents of the legal relationship among associates, shareholders and the corporation is determined by the law (in the Slovak legal order it is primarily the Commercial Code<sup>3</sup>), the contents of the legal relationship between the corporate governance members and the corporation can be to a certain extent modified – versus the legitimate legal regulation – by an agreement of the individual members of bodies with the corporation, or by the partnership contract in the limited liability company, or Articles of Association in the joint-stock company.

#### **2. Influence of economic owners on the management of corporations according to the Slovak law**

Associates or shareholders can legally and efficiently assert their economic-ownership interests by employing their right to participate in the general assembly. Here they display their will by voting; however, the general assembly is the corporate body and therefore its resolutions express the will of the joint-stock company created by one of its bodies, namely for the corporation and its bodies in a commitment way. Thus the will of shareholders is transformed through decisions of the general assembly into the will of the joint-stock company.

In adopting the decisions of associates or shareholders in the general assembly the principle of majority is valid, resolutions of the general assembly are accepted by the absolute majority of voices of associates or shareholders, some of them are accepted by the law or the partnership contract of the limited liability company or designed by the qualified majority of voices according to the Articles of Association of the joint-stock company<sup>4</sup> when the number of associates' or shareholders' voices depends principally on the amount of their deposit, or in the joint-stock company it depends on the particular value of shares which the shareholders possess in their assets. The associates or shareholders who dispose in the general

assembly of the necessary majority of voices, are able due to the “weight“ of their voices to enforce their will in the general assembly and in this way to transform it into the will of the corporation. Thus the majority principle of creating the will in the corporation is determining the potential influence of individual shareholders on the governance of the joint-stock company.

As regards the possibility to intervene in the corporate management by associates or shareholders, the legal regulation of the general assembly competence is from the legal aspect decisive.

The Commercial code is laying down the minimum competence for the general assembly; by the partnership contract of the limited liability company or by the Articles of Association of the joint-stock company the competence of the general assembly versus the legitimate legal regulation cannot be reduced<sup>5</sup>, but it can be expanded to decision-making on the next questions. The legal regulation does not impose any limitations to the competence of the general assembly in the partnership contract or in the Articles of Association and therefore it is possible for associates or shareholders to reserve the decisions practically on any question.<sup>6</sup> In this way, the Slovak legal regulation gives a relatively large space to associates and shareholders in order to participate in the corporate management through decision-making in the general assembly. It depends only on associates or shareholders who have at their disposal the required majority of voices needed for approval of the partnership contract or Articles of Association, and on the fact to what extent they want to interfere in the corporate business management. A wide space offered by the Slovak legal regulation to associates and shareholders is reduced by the character of the general assembly. The latter will meet regularly at small intervals, the summoning and holding of the general assembly being a formalized process regulated by a cogent legal regulation.

According to the Slovak legal regulation the general assembly is entitled to elect and recall members of the corporate bodies (in the joint-stock company the competence to elect and recall members of the board of directors can be shifted to the board of supervisors in accordance with the Articles of Association) when for the recall no reasons must be indicated. Within the framework of the nonmandatory legal regulation the partnership contract or Articles of Association can modify, to a relatively large extent, internal relationships in the corporation and the decision on changes in the partnership contract or in the Articles of Association is in charge of the general assembly, which, again, enables associates or shareholders to define rules for the corporation functioning.

The position of shareholders in the joint-stock company strengthens the obligation of the board of directors in the joint-stock company to conform to principles and instructions approved by the general assembly. In connection with the possibility of extending the general assembly competence in the Articles of Association of the joint-stock company the Slovak legal regulation is creating in this way the space for the active influence of managing the joint-stock company by its shareholders.<sup>7</sup> The number of shareholders and their structure determine to what extent the shareholders can take advantage of the possibilities of legal regulations. As for the joint-stock company with a dispersed ownership of stocks, the practice in such corporations has shown that shareholders do not exploit a relatively wide space offered by the Slovak legal regulation. This space is employed only by those who command the corporation - mainly an established shareholders majority. Thus, a relatively large possibility for shareholders to influence the business management of the joint-stock company by means of decisions taken in the general assembly strengthens the position of the majority shareholders in the joint-stock company. The negative phenomenon is that this fact results in constituting the space for the misused position of the majority shareholders to the detriment of the whole joint-stock company and minority shareholders.

### **3. Relationship of members of the corporate governance bodies**

In the limited liability company, an agent or agents are appointed to run the business and the limited liability company does not need to constitute the board of supervisors as a control body due to the fact that then the control power falls within the competence of associates. In the joint-stock company, the running of business is in charge of the board of directors which makes decisions on all problems which, in the case of competence competence of the general assembly by the law or Articles of Association. The competence of the control body is always assigned to the board of supervisors which and if it has also the competence to elect and recall members of the board of directors, fulfils also some corporate governance functions.

The basic legal framework of the relationship of members of elected corporate bodies is given by the general legal regulation in § 66, part 2 of the Commercial code, according to which this relationship

adheres to adequate regulations of the mandate contract<sup>8</sup> in arranging some corporate affairs providing that the other designation of rights and obligations does not follow from their agreements with the corporation or from the other provisions of the Commercial code adjusting their obligations.

From among the mandatary's obligations arising from the mandate relationship is the obligation to act professionally in furnishing various affairs, to carry out the activity, to which he committed himself in conformity with the mandant's instructions and in agreement with his interests, with which the mandatory is or must be acquainted and is obliged to inform the mandant about all circumstances that were found by him in arranging some affairs and that may have an influence on the change of the mandant's directions.

The special legal regulation in § 194, part 5 of the Commercial code is formulating that members of the board of directors in the joint-stock company should perform their competence with an appropriate care versus the general obligation of the mandatory to perform the activity, for which he committed himself. The regulation in § 194, part 5 of the Commercial code incorporates also the obligation of members of the board of directors to follow principles and instructions approved by the general assembly. According to this article, members of the board of directors are obliged to preserve the secrecy concerned with confidential information and facts, the disclosure of which to third persons could do a harm to the corporation.

The obligations of statutory bodies arise also from special rules and regulations, e.g. according to the Act on Bankruptcy and Settlements<sup>9</sup> all persons who are competent to act in the name of a debtor are obliged to submit the proposal for bankruptcy and settlements in the name of a debtor who has been continually in the postponement for 60 days.

Furthermore, for the members of elected corporate bodies is valid a strict rule against competition, which can be extended or tighten up in the limited liability company by the partnership contract versus the legitimate legal regulation and, on the contrary, in the joint-stock company it can be adjusted, as desired, by the Articles of Association, i.e. the application of the prohibition of competition can be excluded. According to the special legal regulation valid for the joint-stock company the stipulated obligations of members of the board of directors have the character of the cogent legal regulation in executing their competence. As for the adequate application of the legal regulation of the mandate contract, which determines the basic contents of the relationships of members of the elected bodies to the limited liability company and the joint-stock company, it is necessary to point out to the nonmandatory character of the norm in § 66, part 2 of the Commercial code. The members of these bodies, i.e. an agent of the limited liability company or members of the board of directors of the joint-stock company can agree the mutual rights and obligations of these companies with a certain discrepancy, if the special cogent legal regulation does not specify it in the other ways. This implies that there exists the possibility of determining the rights and obligations differently from those arising from the adequate application of the mandate contract when the different negotiation of the contents of the legal relationship between members of the board of directors and the joint-stock company need not always correspond to corporate interests.

In this connection it is interesting who takes decisions in the corporation on the contents of the agreement with a member of the elected corporate body. The legitimate legal regulation does not deliver a decision on these questions in the competence of the general assembly<sup>10</sup>, or in the competence of the board of supervisors. This means that if associates and shareholders do not deliver - after their decision made by the qualified majority of voices – the decision on the approval of such an agreement anchored in the partnership contract of the limited liability company or in the Articles of Association, the contents of the agreement between the member of elected corporate bodies and the limited liability company is determined by an agent, or if the corporation has more agents, by agents having the majority of voices, and in the joint-stock company by its board of directors also with a majority of voices.

The Slovak legal regulation of business corporations does not adjust separately the responsibility of members of the elected corporate bodies. According to the provision of the Commercial code, in which is formulated the responsibility for a damage caused by a breach of obligations in § 757, are valid similar provisions in § 373 and others. Members of the elected corporate bodies are then responsible for a damage caused by a breach of obligations specified by the Commercial code in virtue of the legal form of responsibility for a damage adjusted in the Commercial code which determines the objective responsibility for a damage.<sup>11</sup>

The provision in § 757 of the Commercial code is defining the application of both the commercial and

legal regulation of responsibility for a damage in cases of the breach of obligations according to the Commercial code, i.e. in the case of the breach of obligations by a member of the board of directors of the joint-stock company towards the limited liability company when the obligations are determined to a member of the board of directors by a special legal regulation within the legal regulation of the joint-stock company or within the obligation arising from the adequate application of the mandate contract for members of the corporate bodies. However, if obligations of the members of corporate bodies are - with respect to the nonmandatory provision in § 66, part 2 of the Commercial code – adjusted by means of the agreement with a corporation differently from the legal regulation of the mandate contract, or if the partnership contract of the limited liability company or the Articles of Association of the joint-stock company will define the next obligations for members of the board of directors, one cannot exclude that his or her responsibility will be agreed in the contract between the corporation and the member of the elected corporate body differently from the nonmandatory legal regulation of responsibility for a damage stated in the Commercial code, the contents will depend, as a rule, on the question, which of the corporate bodies will take decisions on this matter.

In practice, the assertion of claims, arising from the responsibility for a damage, towards members of the corporate governance bodies from the aspect of the corporation is problematic. The decisions on exerting claims, resulting from the responsibility for a damage, towards agents of the limited liability company or agents of the board of directors in the joint-stock company is not delivered by law in the competence of the general assembly. From this fact it follows that the decision on exerting the responsibility for a damage towards a member of the elected body in terms of the corporation lies in the competence of the agent of the limited liability company or the board of directors of the joint-stock company, which, however, excludes the possibility that claims of the corporation towards members of the elected bodies will really be put into effect.<sup>12</sup>

The Slovak legal regulation does not afford practically any possibilities to minority associates or shareholders to assert their interests in relation to corporate governance bodies providing that it does not do that in the interest of the whole corporation or of all its associates or shareholders. Then the general nonmandatory legal regulation of duties of the members of corporate governance bodies together with the factual impossibility of its enforcement constitutes the space for misusing the position of the members of these bodies for the own benefit to the detriment of interest manifested by the corporation and its associates or shareholders who do not have at their disposal possibilities experienced by majority shareholders in the general assembly.<sup>13</sup>

#### **4. Conclusion**

The Slovak legal regulation of instruments for active influencing the management of the business corporation from the aspect of economic proprietors and from the viewpoint of the competence, rights, obligations and responsibility of members of the corporate governance bodies is not very different for limited liability companies and the joint-stock companies.

In this sphere, the legal regulation is corresponding rather to a model of the limited liability company based on the assumption that associates are not passive in managing the corporation. In the joint-stock company with a greater number of shareholders, mainly small ones (investors), who dispose of such a number of voices in the general assembly that they do not have the possibility and usually even the interest to actively influence the governance of the corporation, this implies that the relatively strong position of economic owners - shareholders does not ensure the corporate governance in the interest of the whole joint-stock company and of all its shareholders; on the contrary, in the commanded corporation it provides the space to majority shareholders to prefer their own interests before those of the corporation as a whole and its all shareholders.

Therefore it is necessary that the legal regulation determined, on the basis of the unambiguously cogent legal regulation, the obligation of members of the corporate governance bodies to act always in the interest of the corporation as a whole and to inhibit the preference of interests of individual shareholders or members of the corporate governance bodies. In relation to corporate shareholders this means an application of the principle of equal dealing with shareholders that are in relation to the corporation in equal conditions (an equal type and the respective value of actions).

An effectiveness of the legal regulation of obligations of the members of corporate governance bodies is conditioned by their enforcement. This requires that in the case of the passive corporation also the

shareholder was entitled to demand for this corporation the fulfillment of obligations or the compensation of damages caused by a breach of duties by members of the corporate bodies. The enforcement of rights by shareholders assumes that the legal order guaranteed for a shareholder an access to the economic information of the corporation, to the decisions and actions of elected corporate bodies, namely in the form of informational obligations of the corporation towards shareholders and the public or by employing the possibility to initiate the control audit of the corporate economy.

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<sup>1</sup> The corporate governance problem of business corporations refers to the so-called stock corporations – the limited liability company and joint-stock company which constitute corporate governance bodies consisting of persons who do not need to be and generally are not associates or shareholders of the corporation. So far as the terms „business corporation“ or „corporation“ will be used in this contribution, they are thought to be capital business corporations. With regard to the fact that the Slovak legal regulation of the limited liability company and joint-stock company is based on legal principles in the sphere of corporate governance, the individual business corporations in this contribution differ one from another only when the respective problem in the legal regulation is differently solved for each type of the corporation.

<sup>2</sup> This topic was an object of the main part of the contribution by A. Marcinčin presented at the foregoing seminar entitled “Corporate governance“ in Bratislava on 17 December, 1999, p.20).

<sup>3</sup> Law No 513/1991 in the Collection of Laws in wording of the subsequent rules.

<sup>4</sup> Legal regulations usually set down the two-third- or three-fourth majority of voices as a qualified majority from among the present associates or shareholders; in the Slovak legal order it is the two-third majority of voices from all associates in the limited liability company and the two-third majority of voices from shareholders present in the joint-stock company.

<sup>5</sup> Exceptions are only the choice and removal of members of the board of directors in the joint-stock company, for which the legal regulation in § 187, part 1, letter c) of the Commercial code admits that the Articles of Association can determine that they can be elected and recalled by the board of supervisors in the joint-stock company

<sup>6</sup> Compare, for example: Pelikánová, I.: Comments to the Commercial code, part II, Linde Prague, Inc., Prague 1995, p. 530.

<sup>7</sup> The Slovak share law inspired by the German law represents a dual organization model of bodies of the joint-stock company. By comparing the German and Slovak legal regulations of the competence of the individual joint-stock company's bodies essential differences can be derived, especially in the matter of relation between the general assembly and the board of directors of the joint-stock company. For comparison, in the case of the German organization model of the joint-stock company its board of directors is electing the board of supervisors which can recall members of the board of directors only for serious reasons, especially for a heavy breach of duties, incapability to execute the business corporate management properly, and in the cases when the general assembly will express distrust to the board of directors providing that it was stimulated by real arguments. The board of directors manages the joint-stock company on its own responsibility, the general assembly cannot give instructions to the board of directors and also cannot reserve decisions for itself on some problems of the business management. Its influence is implemented by means of the Articles of Association, the approval of which is exclusively in the competence of the general assembly, it takes decisions on the object of activity of the joint-stock company, on its dissolution without liquidation or with liquidation, and on increasing and decreasing the company's fixed assets. The co-decision of the general assembly in some other affairs is possible only on the initiative of the board of directors in the joint-stock company.

Arguments of the German doctrine in justifying the independence of the board of directors are based on the economic view of control of the joint-stock company and on functions of the joint-stock company which can be summarized as follows:

- the ownership of stocks can bring prosperity only within the proper organizational structure, shareholders are uninformed and incompetent to make decisions on current problems of controlling the joint-stock company,

- only the stable management can ensure the prosperous joint-stock company and consequently the dividends to shareholders,
- besides the fact that often changeable structures cannot assure the long-term progress of the joint-stock company, they manifest also some short-time negative impacts in the form of a fall of the stocks exchange,
- the stable structures with a perspective development of the joint-stock company are preferred also by institutional investors.

For the benefit of preserving the today's possibilities of integration into business management it is possible to use at present mainly two arguments in Slovak conditions. They are:

- legal-political – from the economic aspect the shareholder is an owner of the joint-stock company, after the forty-year absence of private ownership the Slovak society is sensitive as far as questions of decreasing the

influence of shareholders on the administration of the property of the joint-stock company is concerned,

- economic – the structures of shareholders existing in Slovakia are only being created, the necessity of restructuralization in many corporations requires a gradual stabilization of the structures of shareholders -

investors, inclusively foreign investors, to have the possibility of establishing the new managing bodies of the

joint-stock company.

With regard to the above-indicated legal-political and economic arguments it is questionable whether the adaptation of relationships between the board of directors and the general assembly to a clear form of the dual model is inevitable. However, an increased independence of the board of directors on the general assembly is not possible without the more precise definition of duties of the members of the board of directors, without adoption of special legal regulations of the responsibility of members of the board of directors and without legal instruments permitting one to exercise claims arising from the responsibility for a damage also by shareholders, if this is not accomplished by the joint-stock company. In the absence of such a legal regulation the possibility of recalling members of the board of directors is the only means that can be used by shareholders in the case when members of the board of directors do not fulfil their duties. On the other hand, the possibility of recalling members of the board of directors by the general assembly is in practice a very weak instrument to compel the fulfillment of duties by members of the board of directors, primarily due to the informational barrier between shareholders and corporate governance bodies of the joint-stock company, and also due to inflexible sessions of the general assembly. On the contrary, such a situation in the commanded joint-stock company stimulates the board of directors to give priority to majority shareholders to the detriment of the joint-stock company as a whole, minority shareholders and also creditors. Therefore, in maintaining the existing relationship model between the board of directors and the general assembly the corporate governance is assumed to be more effective providing that some alterations and supplements to the legal regulation of duties and responsibility of the members of the board of directors are made.

<sup>8</sup> § 566 of the Commercial code.

<sup>9</sup> § 66 g No 328/1991 of the Collection of Laws on the bankruptcy and settlement in wording of the next regulations.

<sup>10</sup> The general assembly takes decisions by the law on the application of the disposable profit and thus it takes decisions on the share of members of the corporate bodies in the profit when the share in the profit is, however, only one of the potential prerequisites of the agreement between the members of corporate bodies and the corporation which is adjusting their rights and obligations.

<sup>11</sup> In the case of the objective responsibility for a damage a blame of the person neglecting his or her duties is not examined.

<sup>12</sup> The provision in § 199, part 2 of the Commercial code is laying down that the board of supervisors appoints his member representing the corporation in judicial procedures and in the procedures of other bodies against the member of the board of directors; the legitimate legal regulation does not give, however, the competence to the board of supervisors to decide on making claims to members of the board of directors. Therefore the exertion of the corporate claims arising from the responsibility for a damage in the case of a breach of legal obligations by members of the board of directors of the joint-stock company

is conditioned by a will of the majority shareholders who have such a majority of voices that they can enforce the wording of the Articles of Association - delivering decisions on the exertion of responsibility for a damage to members of the board of directors – into the competence of the general assembly and subsequently to decide, in the particular case, on this matter. Then the corporation is represented by a designated member of the board of supervisors.

<sup>13</sup> In the commanded corporations, members of the corporate governance bodies act as an “elongated hand” of the majority associates or shareholders and their actions comply, as a rule, with instructions of the majority shareholders.

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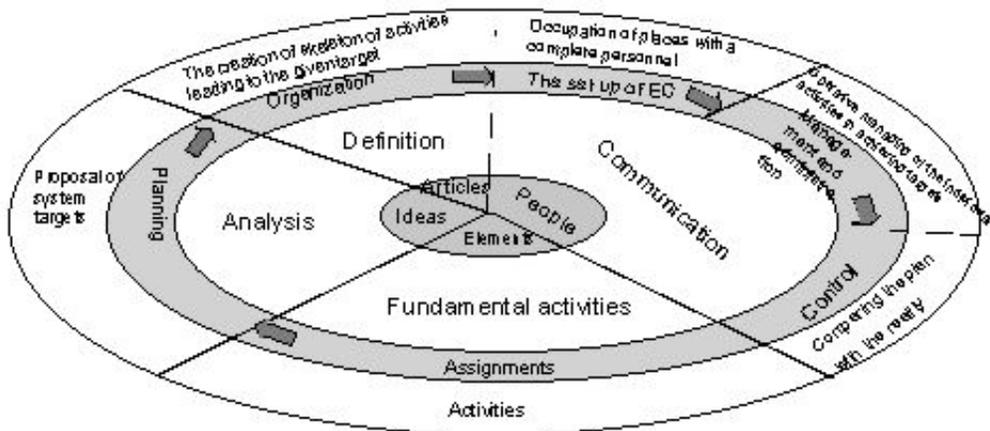
# INEKO

Institute for Economic and Social Reforms

## Seminar Bulletin - Corporate Governance

Peter Kollárik  
Siemens, Bratislava

Fundamental parts in the managing process



## Globalization and its influence on the concern and its activities in the Slovak Republic

### Disinvestments

- KABLO Bratislava
- SKT
- VAC Horná Streda

### Acquisitions/co nsolidation

- Landis & Staefa (Electrowatt)
- SNI + FUJITSU
- Mannesmann → SACHS

Socialism ◀ ▶ market economy

The basic law of Socialism:

*Continuous satisfaction in the increasing needs of the population*

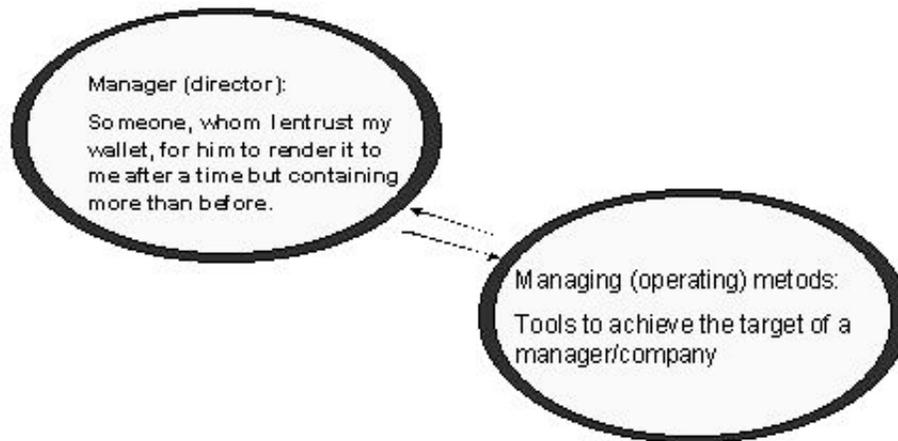
The basic target of market economy:

*Continuous satisfaction in the increasing needs of the population*

Difference:

- in the market economy targets are treated seriously

## Manager, managing methods



## Classical process of management

Planning

Organization

Exploitation/set up of personal resources

Management/Administration

Control

## Organization

- plane , transparent matrix structure
- easy ways in decision-making
- decentralization of authority
- division managing
- process organization
- Project - Management
- Key Account Management
- system 4 eyes

## Strategic and operative control as a basis of the company management (eg.Siemens, Ltd)

- Adjustment of strategy on the Slovak market with the parent company at least once a year
  - Situation on the market, competition, mid-term market progress
  - Result: catalogue of targets and precautions
- Quarterly planning session
  - Determination or actualization of the business plan
- Jour fixe monthly and quarterly
  - Up-to-date orders and projects, personnel, organization and processes, commercial situation, actual topics, quality management
- Quarterly meetings of economic experts
  - ASSET management, purchase, special up-to-date topics

## Fundamental tools for managing and personal resources

### **Managing tools:**

- a talk with the employee
- opinion survey of employee
- feedback in the upwards direction

### **Attributes in managing people:**

1. Excellent managing
2. Dialogue and agreement are a basis in the process of management
3. Managing of people is in accordance with the vision of our company

## Interview with the employee

- integrates some managing activities
- systematically: once a year, result in a written form
- content: in an opened friendly atmosphere
  - to upvalue the work of employee for the last period of time
  - to set the priority for the coming period of time
  - to estimate clear targets interlocked with rewards
  - to consider the ability of further development
  - to evaluate weak and strong sides of the employee
  - to openly speak about earnings and incentive
- target: to support the business strategy of the company

## The right reward

### Basic criteria of rewarding:

- size of the working position (reward according to HAY - method)
- level of rewarding in the particular position in the company
- level of rewarding on the labour market (payment studies)
- employee performance (valuation of the chief)
- employee potential (valuation of the wider leadership)

### Incentive - systems - performance interlocked with rewarding

- agreements about proportionate participation in the result (business men, leading staff) – commercial targets
- agreements about targets
  - Balanced Score Cards: targets focused on the customer, processes, cooperation and behaviour/know-how of the employee
- annual bonus in relation with the results of the company
- bonus for extra performance

## The right recruiting-quality personnel

1. **Plan** of quantitative and qualitative needs of employees

2. **Personnel marketing**

mainly contact with universities and secondary schools (job opportunity centers, home and foreign student's practical training, diploma students, sponsorship, trained companies, cooperation with teachers, trainee programs)

3. **Investigation (seeking)**

job exchange placements on the internet/intranet, personnel companies, advertising, internal personal databank, contacts with students

4. **Choice**

(un)structured interview, Assessment Center, hearing, trial period, job placement for a certainty period

5. **Adjustment**

training plan, tutor

6. **Interview with the employee**

analysis of the work done so far, weak and strong sides, an agreement on targets for the coming period

## The employee placement stabilization

### - education

- seminars for the leading staff
  - communication, managing instruments, training situations in practice, individual or team feedback
- sale technique for aquiritors/sellers
- language course of instruction
- PC training
- special training
- a different type of the university study reimbursed by a company
- seminars at Siemens Austria, Germany
- trainee programs

### - social program

- awarding over the average amount in Slovakia, 13th salary
- compensation for a loss of salary during the incapability to work
- complementary additional pension ensurance
- company loans
- awarding during the work or life jubilees
- canteen allowance over legitimate claim
- culture, sport
- paid and unpaid leave over the framework of law during family events of employees
- awarding in the amount of a triple salary in case of retirement

## Planning and the potential support for key points in a company

### • **Verification of availability:**

- + subjective appraisal by the management, superior worker
- + objective analysis of the potential (AC)
- + inclusion in the team, induction
- + transient managing responsibility (eg. managing the project)
- + ascerting the employee's motivation within the interview

### • **Career possibilities:**

- + assignment expansion (job - enrichment) and competence (job enlargement)
- + job-rotation within the company, in Slovakia, on an international scale
- + managing the project, team
- + hierarchic procedure

## Keeping of statements

### *Balancing*

1. According to our legal regulations for the calendar year (HB I)
2. a) according to the laws of Germany for Siemens-financial year (HB II)
2. b) from 10th January, 2000 according to the US accounting US GAAP standards

### *communication systems:*

- SAP R/3 FI, CO
- information managing system MIK

## Management synergies within Siemens

### **Best practice sharing** within concern

international/ regional Siemens conferences and workshops at a level of chiefs and experts

### **Benchmarking**

**Shared Services** - potential for expense depression

**Know-how exchange** within the concern (knowledge management)

## EFQM – development in the way of Business Excellence

- basic principles of the model of self-rating:
  - customer orientation
  - supplier partnership
  - development in people's involvement
  - orientation to company processes
  - continuous improvement and innovation
  - results measurability
  - managing of people and team work
  - responsibility towards public and environment
  - engagement of every one = TOTAL

## Quality assurance

- models according to norms of ISO 9000 (in OSRAM QS 9000, VDA 6.1)
- Advantages of a foreign company:
  - possibility of consultancy
  - experience of foreign auditors
  - cooperation with ÖQS and DQS foreign national companies for quality (Österreichische or Deutsche Gesellschaft für die Qualität)
- trend: TQM (EFQM)- exceptional model and self rating
- TOP+
- 3i

## Consultation system as a tool for managing BSH Pumps and Drives, Ltd, Michalov

1. Dispatching (1 / day at 8:00 a.m. – meetings of foremen of production, maintenance, quality - results for the last 24 hrs.)
2. Program meeting (1 / month – meeting of production and logistics representatives - discussion of a detailed plan of production for a new month and perspective for half a year)
3. Production meeting (1 / week – meeting of production, technique and quality representatives - new products, problems, qualitative parameters)
4. Inforunde (1 / week – meeting of the info - managing staff discussing politics and company situation)
5. Controlling meeting (1 / month)
6. Management review (2 / year – meeting of the managing staff – analysis of qualitative and quantitative indicators, determination, evaluation and control of targets)

## Selected instruments and methods of managing SAM, Ltd, Michalovce

- MEFASS - system of estimating the quality of suppliers
- KAN BAN - system for the effective employment use and reduction of material resources
- Just in time production: 1 day at Michalovce, 3 days transport, 5 days the distribution centre in Germany
- material consumption according to the FIFO system (First in first out)
- R+H System - program for receiving orders, booking and material registration
- ProQuali - program for processing and evaluating data of quality
- flexible annual working time – working time accounts
- monthly quality meetings

## Precautions against ASSET-management

### 1.Claim decrease

Customer credit verification (external information from Intercredit, references, up-to-date information)

Differentiation of payment conditions according to the customer's paying behaviour in the SAP R/3 system

Continual monitoring of the account state progress

Request for payment

- automatically 1st, 2nd and 3d, request for payment
- a letter from the lawyer
- accusation
- claim selling to the third person

2. Increasing the state of subscribed payments (calculation, ...)

3. Extending suppliers' payment targets

4. Increasing the quality of commercial agreements with customers

5. Decreasing the state of tangible property

6. Evaluating and reducing supplies

## Financial management – an example of capital pooling of the group Siemens SK

Target: minimizing the expenses from financing within the Siemens group in Slovakia

Content: Refinancing within the Siemens group up to height of the defined credit scope, within the given liability

a) refinancing through common accounts (current account credit)

- minimizing total expenses of the current account credit group portfolio

b) Refinancing through fixed credits

- one or more corporations groups will provide their own free resources to the other corporation under the agreed interest conditions

Coordinator

- Performs a control of the competence and correctness of operations between companies

- gives information on regular meetings of economic managers about the results of pooling operations for the given group

## Financial management

### 1. Acquiring resources

external, internal - Siemens firm and concern

### 2. Resource utilization

payment discipline, minimization of the currency hazard

capital-pooling: minimization of expenses from financing within the Siemens group in Slovakia, operative chance of earning needed financial resources

### 3. Other monetary operations

spot and deadline operations, purchase of active securities, minimization of the currency hazard within the coordination of balancing the obligations and claims of the Siemens corporation group in Slovakia.

### 4. financing projects and central financial insurance

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## Seminar Bulletin - Corporate Governance

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### CORPORATE GOVERNANCE: THEORY AND PRACTICE IN THE CZECH REPUBLIC<sup>14</sup>

Intense discussion about opportunities to revive economic growth in the Czech economy is currently taking place in the press and technical periodicals. Many authors do not go beyond macroeconomic considerations and recommendations and overlook numerous standard pre-conditions affecting the results of macroeconomic processes. In this paper, let us therefore perform a microeconomic analysis of basic institutions in the business sector.

#### 1. Corporate Governance: Economic and Financial Theory

The use of the term “**corporate governance**” in the world technical literature may have been common since early 1990s, though not necessarily consistent. In its most specific meaning, the term describes a formal system of accountability of top management to company shareholders. In its broadest sense the term then denotes entire network of formal and informal relations within the corporate world and their effects on the society in general. In this paper, I am going to use the definition used in a comprehensive monograph of Keasey<sup>15</sup> who sees corporate governance as “structures, processes, cultures, and systems underlying successful operation of organizations.” Analysis of the same author was used in this chapter to provide the initial summary and classification of standard theoretical approaches.

In comparison with the simple scheme of governance of a company with a single owner and manager, “problems” with corporate governance appear with the first offering of shares of stock to outside stockholders. Such offering is necessarily connected to the creation of basic institutions for corporate governance. The process involves more than just creation of individual entities. It includes their functional establishment, i.e. specification of how members of the board of directors and the supervisory board are selected, specification of how they are made accountable to company shareholders, and how the board of directors is accountable to the supervisory board and independent auditors, etc. The basic problem of corporate governance, as pointed out as early as 1776 by Adam Smith, is then separation of ownership and executive decision-making in the company. Such separation permits, if not directly encourages, that company behavior differ from the ideal of profit maximization and cost minimization. However, recommendations on how to deal with the situation, differ. All the more so, as emphasized by Keasey in his monograph, because lack of general consensus on the definition leads to significantly differing analyses and solutions. Significant disagreements also abound on key issues such as if, and what limitations should be placed on the contractual freedom of the shareholders themselves—owners of the given resource—when they maximize their revenue from that source.

**The dominating academic opinion in the corporate governance theory is represented by the Principal and Agent Model, also known as the Financial Model.** It is based on the assumption that markets, particularly the capital market, managerial human resources market, and the market of control over corporate issues, provide the most effective limitation to managerial decisions. It also assumes that voting rights of the shareholders should definitely guarantee the use of corporate resources to maximize their value for shareholders. The model views any specific form of corporate governance as a result of free-participation negotiations among not only “insiders”—representatives inside the company (particularly managers and employee representatives) but also “outsiders”—representatives of parties outside the company itself. During the IPO to outsiders, the original sole owner and manager is able to raise the

marketability of claims to future company profits and therefore maximize the price of IPO shares, provided that future managers will be subject to special supervision, monitoring and responsibilities.

In a typical Anglo-American corporation with publicly traded shares, the "voice" of the individual stockholder is very limited. Nevertheless, access to highly liquid, functioning stock exchange markets (combined sometimes with mandatory stock option offer) gives the shareholder really unlimited and inexpensive opportunities to leave the company by selling his shares. In view of the relatively high transaction costs connected to collective events for shareholders—particularly small shareholders (such as organizing special one-time or permanent associations, e.g. OSMA – the Association for Small Shareholder Protection)—their departure from the company is more dominant than their "voice." Regardless of the restricted role of the shareholder's "voice" in this model, the right to vote on company issues (In the Anglo-Saxon countries, the usual rule is "one share—one vote.") remains one of the significant sources of power of the shareholder. There is agreement among most authors that shareholders should always have to right to vote on the issue of company acquisition.

**The competing theoretical approach known as the Stakeholder Model of Corporate Governance** reflects especially the German and Japanese microeconomic environments. As opposed to the Financial Model, it is based on the assumption that the ultimate function of the company is broader than maximizing the benefit to shareholders themselves. Therefore, the mission of the company should explicitly include to benefit groups with long-term relations to the company and stake in its success. Stakeholders can include employees, or sometimes also suppliers and customers. Decision-making in the company should therefore seek to properly protect their interests, possibly resulting in additional costs and some less-than-optimal changes in company behavior.

It has long been recognized that ethical behavior decreases costs of social association. In 1972, Arrow made a detailed analysis<sup>16</sup> of how telling the truth constitutes a public good: lying can bring personal benefits but, if it prevails, it increases the costs of information acquisition for all. Expressed more specifically, economic relations usually show characteristic signs of a cooperative game characterized by the prisoner's dilemma:

**Complete cooperation maximizes common benefit to all participants in a repeated game but "cheating" – i.e. using any contract deficiencies to gain benefit for some participant, remains the dominant strategy in a one-time game.**

The analysis shows that companies which have over long period earned good reputation for ethical cooperation are able to replace the unsatisfactory strategy of cheating by a strategy of cooperation. These relations, sometimes described as the external and internal "contractual architecture" of the company can become a source of significant competition advantages. In addition, companies with good reputation can enjoy advantages stemming for their attractiveness to possible contractual partners, whether customers, suppliers, or employees. The potential partners expect that the contract will strengthen their reputation also.

Ethical behavior, therefore, in no way contradicts theoretical results of the Principal and Agent Model or the Stakeholder Model of corporate governance. If ethical behavior represents a strategy which leads to maximization of long-term profits, then the shareholders—principals should encourage their managers—agents to adopt it. Nevertheless, ethical problems of shareholders appear in areas related to one-time opportunities because then cheating appears to be the most profitable strategy. In similar instances, there is a need to adopt such institutional arrangement or measures, which would put significant sanctions on cheating, or to consider specific application of the Stakeholder Model.

## **2. Corporate Governance and the Related Environment in the Czech Republic**

In their transition to the market economy, Central and Eastern European countries necessarily experienced problems in corporate governance. Most authors believe that the sole transfer of asset ownership from the state to the private sector neither creates conditions for better corporate governance, nor leads to increased effectiveness which would demonstrate convincing advantages of private ownership. Major problems include:

- The privatization itself is a one-time process and is often characterized by contradictory economic, financial and political goals, depending on various interest groups (domestic or foreign acquirers inside and

outside the privatized company, paid or unpaid transfer of state-owned assets to individual or collective investors).

- Through voucher privatization, the state administratively forced an issuance of shares of exceptionally high number—close to two thousand—companies and therefore their public tradability. It also created expectation with most people that a liquid and functioning market would be created quickly for all shares and allotment certificates of any, however small, investor. Due to the nature of the process, such expectation was not realistic with. The administrative rules applied in the centralized, "laboratory" phase of the distribution of shares were not even supported by institutional market framework. Such framework would have allowed for long-term internal interest in public tradability with at least some selected issuers (such as corporations) and willingness of investors to invest into such shares. For a long period, the state resigned from further development of stiff institutional and legal framework for the capital market and from encouraging relevant expectations with investors and managers.

- Therefore, for a long time, standard conditions for well functioning markets were lacking—particularly those for the capital market, labor market, and market with control over company matters.

- There was a lack of banking institutions which could be considered efficient by either the Anglo-Saxon or the German standard.

- Underdeveloped institutional and legal framework has then resulted in long-term absence of necessary conditions for effective corporate governance. For instance, most contracts are deficient or only enforceable with difficulty.

- Non-banking financial institutions as tools for collective investment (allotment or investment funds, pension funds and insurance companies) were created as crucial domestic "investors" mostly through redistribution of shares in the voucher privatization. However, being without monetary deposits, they were left without proper regulation or supervision for a long time. The political will was lacking to enforce the valid legislation. Monitoring and evaluation have been applied widely but ineffectively inside as well as outside companies (For instance, there is a lack of managers enforcing internal regulations within companies, which undermines the self-regulation process). Many accounting audits performed by local but also some foreign auditor companies are superficial, they lack important analytical notes, and fail to provide adequate guarantees about the soundness of accounting records. Ratings of creditability from established rating companies are lacking, and so outside investors continue to make decisions under conditions of significant uncertainty. In many cases there continue to be decisive advantages for investors with 'insider trading' information. Such unequal access to information is neither documented nor sanctioned.

- Registry commercial courts have exclusive permission not only to register new firms or changes in statutory organs of the existing ones but also to approve the amount of initial equity capital or its increase. Moreover, the same applies to all corporations and all private companies with limited liability. In comparison with most courts in other countries, the courts are therefore overloaded with minor tasks, act with great delays and even make the process difficult of increasing equity capital through public offering.

- All commercial courts are overloaded with small cases which should be settled by simplified action. The result is that important cases remain undecided for long periods.

- The legislation on bankruptcy is incomplete and difficult to enforce.

- Even payment of bills can only be enforced with difficulty due to inadequate legislative treatment of the institution of bailiffs.

In such a difficult environment, the models of corporate governance appear differently:

### **i) The Anglo-Saxon Model of Principal and Agent**

has so far encountered difficulties, which are hard to overcome. Trade liquidity has been negligible for small fragments of shares (1%) at "continuous" public markets. There have been no obstacles to company acquisitions but acquisitions premiums have been exceptionally high. Minority investors have not been properly protected. They could rely neither on sufficient access to information, nor on share in profits,

which they were entitled to. They have had no access to liquid markets, which would allow them unrestricted inexpensive sale of their shares. The "mandatory stock option offer" was introduced relatively late in cases of acquisition of at least 50% share in voting rights and has been troubled by incomplete definitions and contracts.<sup>17</sup> In this situation when alternative collective meetings, particularly of small shareholders (OSMA) carries high transaction costs, the only option left for the minority shareholder with differing opinion was a disadvantageous sale of shares in low-liquidity markets. As mentioned above, this model generally offers shareholders small "voice." This right has, however, been limited even more by requiring personal presence at shareholders' meetings, with no option to vote by mail, e.g. **The right to vote on company acquisition, which is never taken away from the shareholder in the Anglo-Saxon system, has been further restricted** by the fact that such decisions were often made at shareholders' meeting held in distant places with restricted and, for small shareholders, relatively costly access. It is no surprise that domestic and foreign investors were losing interest in investing in the Czech Republic. The same was true about issuers. Through the voucher privatization, close to two thousand issues of shares were made through IPOs of various-size companies (from small ones to around one hundred major ones). In the given slowly changing investment environment, the spontaneous trend continues to stop public tradability of many stocks. This trend appears not only where it can be expected (small and middle size companies) but also with a number of major corporations. In reality, it means lack of interest in the Financial Model of corporate governance.

## ii) Stakeholder Model

In the Czech Republic, the intention was to use explicitly this model in a limited number of cases such as partial privatization of big and small companies enjoying positions of natural monopolies (e.g. regional company for distribution of electricity, gas and water). Their major clients—towns and villages—were given registered (not to be traded publicly) shares proportionately to their number of residents. The total of shares thus distributed allowed the veto minority (34% in the Czech Republic) in order that their "voice" be strengthened. Most towns and villages suffered from poor cash flow and made spontaneous decisions to sell the shares to foreign investors. The reasons included limited protection of minority investors and their generally low influence (compared to the remaining passive majority of the state), low expected dividends, and the temptation to sell the shares to generous foreign investors.

## iii) Single-Owner Model

On the other hand, with many corporations, shares were acquired by one shareholder (an individual or a legal person), their public tradability was canceled and they were withdrawn from public markets. In other words, the model was adopted, extended and modified, of one owner who is also the manager. Such a scenario is typical for companies, which registered shares, which therefore cannot be publicly traded. In practice, such approach is seen as the most direct way to manage a company without using public financial markets while also reducing costs of issuing shares. Limited publication of economic results often makes the company out of reach to business partners as no sanctions are applied for failure to meet the minimum standard of information publication (such as publicizing closing financial statements in the official state Commercial Publication). Emphasis is then given to loans from banks as the only institutions, which perform monitoring. However, for the only owner who is also the manager of the company, the option is closed to increase marketability of claims to possible profit and to maximize the sale price of minority share capital to outside investors in public markets. Therefore, also the benefit of outside monitoring of the company and its managers is lacking.

## iv) Transient Model of the "Czech Third Approach"

In the Czech Republic the worst combination of the previous two models was also present—the Czech **"third approach" to corporate governance**. It worked for a number of years as a transient model (which usually develops from the first two models). The capital market and the market with control over company matters transformed into a bivalent form in which the only two options of company control are either "0" or "1". The market with "continuous" quantities of publicly tradable shares did not develop but rather the **market with share majorities**. Imperfections in the Czech legislation caused that, after acquiring at least 50.1% of shareholder voting rights, the majority owners had the impression that they were entitled to use not only 50.1% of profits but full 100% ("1") instead, including profit which should belong to other, i.e. minor shareholders.

**The one-round-only nature of privatization and deficiencies of most contracts and the institutional**

**framework in general** worked as an additional strong and rational incentive "to cheat" – i.e. to use any contractual "loopholes" in mostly unregulated environment for individual benefit. The tendency "to cheat" appears in such situation as a rational strategy in this one-time, not-to-be-repeated process. Many managers but also many companies which were created to manage assets or provide investment consultation services, distributed "other people's money" and invested to shares and allotment certificates to their own benefit. **Many executive and financial managers did not follow strict personal ethical guidelines and succumbed to this rational temptation allowed and strengthened by the rigid, imperfect and unenforceable legislation.**

### 3. Development of Initial Ownership Structure and Corporate Governance

In the period of transition to the market economy, the Czech microeconomic sphere was faced with the key task to transform state-owned companies to businesses seeking profit maximization. The tool, which was as seen most adequate to reach that goal was quick transfer of ownership. In addition to the standard method of privatization through sale (which was used mostly with small and mid-size state-owned companies), another method was used with mid-size and big shareholding companies—portion of their share capital owned by the state was distributed through voucher privatization.

#### Dominating ownership structures

The voucher privatization itself could be considered a form of artificial primary IPO which was used to distribute shares owned by the state (specifically by the National Property Fund) to private investors. However, the transfer of ownership to the hands of "voucher shareholders," who could only be Czech individuals or legal persons (investment and allotment funds) did in no way result<sup>18</sup> in finding the final owners or the necessary capital increase in undercapitalized companies. The quick creation of the market for more than 2000 publicly traded shares for more than six million small investors was burdened by significant implicit transaction costs. Numerous service institutions were spontaneously created such as 520 securities dealers, hundreds of funds and 153 investment companies. Despite expectations, the initial ownership structure of companies was not characterized only by dispersed owners. On the contrary, the core of the ownership structure was dominated by several institutional owners (funds) which were "outsiders"—having ownership from outside of the companies. In view of the Commercial Code and the above-mentioned institutional environment related to corporate governance, coalitions of these funds dominated at shareholders' meetings over disorganized (and usually absent) disperse owners who mostly did not use their voting rights.

As can be seen in Table no.1, in the analysis of effective votes in 919 Czech companies privatized in the 1st wave of voucher privatization (we excluded the votes of small shareholders who usually did not use their right to vote), a coalition of one to four funds had effective majority in 727 corporations from the very beginning. Before competing groups formed (all major funds usually strengthened their shares in companies of interest), these coalitions maintained their ability to control the governance of shareholding companies in their ownership.

**Table no. 1: Relative weight of key investors in companies after the 1st wave of voucher privatization (the percentages exclude all small investors who usually did not vote)**

<b>Investors</b>	<b>50%</b>	<b>40%</b>	<b>30%</b>	<b>20%</b>	<b>10%</b>
Foreign investors	33	40	45	45	51
Domestic direct investors	24	30	40	47	58
Shares of the National Property Fund held "temporarily"	56	88	135	173	293
Shares of the National Property Fund held "permanently"	3	7	11	11	21
Shares sold through banks	12	17	30	47	61
Additional restitution	4	6	7	11	52
<b>Investors</b>	<b>50%</b>	<b>40%</b>	<b>30%</b>	<b>20%</b>	<b>10%</b>

The biggest fund	146	231	442	737	895
Two biggest funds—cumulatively	473	644	782	974	916
Three biggest funds—cumulatively	669	760	847	892	918
Four biggest funds—cumulatively	727	790	860	897	918
Five biggest funds	754	809	867	900	918
Six biggest funds	761	817	869	902	918
Ten biggest funds	768	821	872	903	919

Source: Laštovička R., Marcinčin A. and Mejstřík M. (1995), "Corporate Governance and Share prices in Voucher Privatized Companies", in: *The Czech Republic and Economic Transition in Eastern Europe*, (Svejnar J. editor), New York, Academic Press

### Who was in control of these funds?

The dominant institutional owners were, however, dispersed in individual funds, which were themselves under control of some power groups. Such groups were either created around well-established financial institutions (particularly big state-owned banks and insurance companies) or they represented privately owned financial groups, which started accumulating their capital only in the voucher privatization process (see Table no.2 below for the most significant groups). As the author has shown in the book mentioned above, ownership relations inside some of the groups were not characterized by separable hierarchies but rather nontransparent mutually linked circles. Capitalization of numerous mother companies was low but could nevertheless be multiplied thanks to "daughters and grand-daughters" and thanks to open or hidden loans they gained using their power. Application of the financial pseudo-multiplier by the most aggressive groups with exceptional aspirations allowed for the appearance of phenomena described in world literature as capital bubbles and snowballs. Entirely inadequate protection of private property and stiff institutional structure did not encourage orientation toward effectiveness in corporate governance but rather made it possible for a number of company and investment fund managers to succumb to the temptation of the never-to-be-repeated opportunity to work with "other people's money." Most readers are aware which of the investment companies listed in Table no.2 were accused of unethical behavior, at the minimum.

**Table no.2: 14 biggest financial groups including the biggest investment funds in the first and second waves of voucher privatization**

Investment company within a financial group	Second Wave (defined the ranking)			First Wave		
	Investment points	%TFP	%TP	Ranking	%TFP	%TP
1.A-invest, Agrobanka	320	8.2	5.2	14.	1.8	1.3
2.Expandia, Chemapol	306	7.8	5.0	-	-	-
3.Harvard CC	292	7.5	4.7	3.	10.5	7.4
<b>4. OB Invest , CSOB</b>	<b>198</b>	<b>5.1</b>	<b>3.2</b>	<b>18.</b>	<b>0.8</b>	<b>0.7</b>
<b>5. KIS, Ceska pojistovna</b>	<b>187</b>	<b>4.8</b>	<b>3.0</b>	<b>6.</b>	<b>5.5</b>	<b>3.9</b>
6. IS podnikatel.	157	4.0	2.5	-	-	-
7. YSE	156	4.0	2.5	16.	1.2	0.8
8. Cesky kupon	152	3.9	2.5	21.	0.6	0.4
9. PPF	130	3.3	2.1	10.	1.9	1.4
<b>10. SIS, Ceska sporitelna</b>	<b>124</b>	<b>3.2</b>	<b>2.0</b>	<b>1.</b>	<b>15.6</b>	<b>11.1</b>
<b>11. IKS, Komerčni banka</b>	<b>124</b>	<b>3.2</b>	<b>2.0</b>	<b>5.</b>	<b>7.6</b>	<b>5.4</b>

12. MorCe IS	113	2.9	1.8	-	-	-
<b>13. PIAS, Investicni banka</b>	<b>98</b>	<b>2.5</b>	<b>1.6</b>	<b>2.</b>	<b>11.9</b>	<b>8.5</b>
14. CS Fondy	94	2.4	1.5	24.	0.8	0.7
<b>Top 14 fund groups</b>	<b>2451</b>	<b>60.1</b>	<b>38.2</b>	-	<b>77.6</b>	<b>55.4</b>
<b>Funds Total</b>	<b>3920</b>	<b>100.</b>	<b>63.5</b>	-	<b>100.</b>	<b>71.3</b>
<b>Total of Investment Funds</b>	<b>6170</b>	-	<b>100.</b>	-	-	<b>100.</b>

%TPF - % of the total number of points in funds; %TP - % of the total number of points in the 1st and 2nd privatization waves;

Ranking—ranking in the 1st wave of voucher privatization

### Failure of banks and roots of owner behavior

Those big state banks, which allowed for the creation of the biggest solidly managed funds and their administration companies (listed in bold in Table no.2), remained mostly in state ownership for a long time. The extensive portfolio of companies owned by their daughter companies then remained under indirect influence of the state bank policy and bank management appointed by the state. Clearly, that management anticipated in the short term what role the government expected the banks to play in the transformation of Czech companies. Such arrangement of bank ownership (which partly continues) affected assets of those banks with bad loans because it reduced caution in their business activities and brought about mostly ineffective placement of depositors' savings into inadequately risky projects. There was more than just giving loans to finance purchases of privatized companies. Particularly in the period 1994-1996, the biggest state-controlled banks (Commercial Bank, Czech Savings Bank) systematically gave out loans to transfer ownership between domestic investors and to solidify ownership shares in companies privatized through earlier voucher privatization. It was a serious failure of those commercial banks. Instead of working with their biggest debtors to improve their discipline and direct them toward restructuring, those debtors were surprisingly given more loans to finance a chain of acquisitions of companies whose shares were originally distributed for vouchers. Experience worldwide indicates that the resulting ownership bubbles usually burst with the first recession and that bad loans need to be covered by enforcing collateral contracts (which are often deficient) or written off, bringing financial loss to the banks.

The atmosphere of "unlimited acquisition opportunities" was no doubt encouraged by the above-mentioned "bivalent form" of governance in Czech corporations which made the power of the majority owner absolute. It escalated the conflict of interest inside banks and financial groups in their roles of owners and creditors. It is no coincidence that, out of fear of losing the majority, the otherwise respectable bank administrators of shares did not dare to start even one real IPO, which would bring fresh own capital from domestic and foreign sources and helped restructuring. Aside from few cases of increasing equity exactly according to the ownership structure of major owners, even the best companies had to rely on their own resources and outside capital for a long period. That slowed down the pace of innovation and increased capital costs. Company debt grew in adequately and so did sensitiveness to the level of and changes in interest rates.

It was possible to avoid such development, as can be seen from the experience of those countries, which solve similar problems of corporate governance institutions. Many companies never needed a dubious savior from among debt-ridden domestic companies motivated by their own big size, political weight but mostly one-time-only privatization opportunities. On the other hand, long-term interest of strategic but also institutional foreign investors in Hungary and Poland effected also prices of shares of stock. For instance, a Hungarian chemical firm doubled its capital in a successful IPO in international capital markets which led to lower costs of capital, quick restructuring, dynamic growth and also long-term increases in the price of its shares. Shareholders with longer-term goals who were willing to give up their majority are now able to receive better overall price, even adjusted for inflation, for their nominally equal number of shares diluted by the new issuance than if they had sold the majority and received the acquisition premium.

### 4. Foreign Investors with Direct and Portfolio Investment

One of the expected consequences based on the third model of corporate governance was a relatively

stable inflow of foreign direct investment (FDI) both to privatized companies and green-field projects, compared to the highly volatile amount of portfolio investment which in 1999 dropped by further \$1.4 billion. Results of our survey confirm that foreign owners had positive influence on restructuring of their companies (see below).

**Table no.3: Balance of Payments**

in billions of US\$	1992	1993	1994	1995	1996	1997	1998
<b>1. Current account</b>	<b>-0,3</b>	<b>-0,1</b>	<b>-0,7</b>	<b>-1,3</b>	<b>-4,3</b>	<b>-3,2</b>	<b>-1,0</b>
- trade balance	-1,9	-0,5	-1,4	-3,7	-5,9	-4,6	-2,6
- balance of services	1,5	1,0	0,5	1,8	1,9	1,7	1,9
<b>2.Capital and financial accounts</b>	<b>0,0</b>	<b>3,0</b>	<b>3,4</b>	<b>8,2</b>	<b>4,3</b>	<b>1,1</b>	<b>2,6</b>
- direct investment	1,0	0,6	0,7	2,5	1,4	1,3	2,5
- portfolio investment	-0,03	1,6	0,9	1,4	0,7	1,1	1,0
- long-term capital	0,3	0,8	1,1	3,4	3,1	0,9	-0,9
- short-term capital	-1,3	0,06	0,7	1,0	-0,9	-2,2	0,0
<b>3. corrections, exchange differences</b>	<b>0,2</b>	<b>-0,1</b>	<b>-0,3</b>	<b>0,6</b>	<b>-0,8</b>	<b>0,3</b>	<b>0,4</b>
<b>4. Decrease in the amount of hard currency reserves</b>	<b>0,08</b>	<b>-3,0</b>	<b>-2,4</b>	<b>-7,5</b>	<b>0,8</b>	<b>1,8</b>	<b>-1,9</b>

Source: *Bulletins and news issued by the Czech National Bank*

While the biggest instances of foreign direct investment were mostly related to a restricted number of privatization by sale (the changes in the number of cases and size of privatization by sale caused fluctuation of FDI in time), the voucher privatization inspired a great number of upper-middle-size strategic investors who gradually took over from their domestic owners many companies privatized through vouchers. The amount of foreign direct investment in company equity at the end of 1998 was listed by the Czech National Bank at \$12 billion (KC 357.5 billion) and if we include also reinvested profits and loans from mother companies, the number reached around \$13 billion. In comparison to the amounts of FDI in comparable countries, the amount is still low (Hungary has FDI in the amount of \$18 billion, including reinvestment of profits). The prevailing investment environment – imperfect institutions, slowly growing and later stagnating economy, as well as small incentives for investment (for the international competition), were not enough of a motivation to foreign investors either for more extensive investment or for green-field projects. Nevertheless, the latest development (FDI inflow of \$2.7 billion in 1998, and further \$5 billion in 1999), income from the privatization of the Czechoslovak Commercial Bank (around \$1.2 billion), and extensive strategic purchases of voting shares in electric and gas companies owned by towns and villages, all indicate significant increase of FDI into the Czech economy.

At the same time, it would be naive to believe that foreign investors with long-term goals always avoid the temptation of one-time-only advantages to be gained from rational use of inaccurate legislation, particularly that governing the capital market (e.g. setting prices of shares to be offered to minority shareholders as stock option).

## **5. Differences in Enterprise Restructuring and Corporate Governance**

According to our ACE<sup>19</sup> Research Project, **significant adaptive but also deep restructuring happens in selected sectors of the economy as a whole but also in those companies** which started to put greater emphasis on meeting demands of solvent domestic and foreign customers (customers tend to be solvent closer to the end of the production process—closer to the final consumer). Deeper financial restructuring can be expected only after new company owners push through their own business planning and support it by sufficient additional own capital. It was expected that adequate restructuring could lead to greater liquidity among companies and alleviate the problem of business-to-business debts.

Individual sectors of the economy and individual companies were restructured to varying degrees. Effects of **neglected restructuring** can be seen the most in the railroad companies and other not-yet-privatized networked sectors such as distribution of energy or gas. The result was exceptionally strong influence of the trade unions and lobbying groups in those unstructured sectors which, among other effects, raised salaries of all employees to match the inflation rate despite decreasing labor productivity and decreasing effectiveness. Experience in our country and neighboring Hungary and Poland shows that this infection spreading from unstructured sectors presents a permanent threat to negotiations on reasonable salary increases in other sectors. Negligible restructuring can be seen also in major Czech conglomerates (Chemapol Group, Škoda Plzeň, ČKD Holding) which witnessed further accumulation of debts because of continuing privatization and solidifying acquisitions financed by loans. The amount of their debts increased fast primarily because of a series of loan-financed company acquisitions done by their biggest debtors. Ensuing deterioration of their capital structure and relative increase in costs of capital caused them financial trouble. They reduced their real costs and cash flow by failing to pay creditors not only the principal amount but also the interest (thus reducing the cost of borrowed money to zero). Their tight budget was then disrupted by every sign of recession (such as a slow-down in government projects). In their efforts to prevent bankruptcy, the new conglomerates relied only on loopholes in the legislation in this "one-round-only game", on their big size, political influence, and risk diversification among their daughter companies. They did not have enough power left either for internal concentration directed toward key competencies, or for revitalization through reduction or sale of unmanageable daughter companies. Due to their financial weakness, most restructuring projects failed, development of new products was not completed, and trust of customers was shaken.

Thanks to temporarily improved macroeconomic situation and growth driven by domestic demand, particularly demand from towns, in 1995-1996, a number of companies undertook **adaptive restructuring** towards those domestic market segments which showed high demand increasingly covered by foreign imports. Nevertheless, a point came when monetary and fiscal restrictions had to correct this growth driven by domestic demand, which was linked to the growing foreign trade imbalance. Government spending decreased (savings packages of the government) and it was no longer possible to increase debts of towns because budget income did not increase *ceteris paribus* with the ensuing stagnation in GDP growth. Consequently, in 1995-1997, sources of business growth driven by domestic market were exhausted. Gradually, the so-called secondary insolvency increased (i.e. a company is not able to take care of its accounts payable because its customers are insolvent).

Many companies owned primarily by foreign entities responded to the demand and to market signals (GDP growth in OECD countries generated stronger demand) correctly—with deeper restructuring: reducing the number of employees and costs in general (including temporary decrease in real salaries followed by above-average and fast salary increases substantiated by sharp growth in productivity), new products and technologies, and more active marketing, supported by new "contractual architecture" etc. They raised their competitiveness substantially using factors other than price (e.g. cars VW-Škoda) and became engines for export-oriented growth. Sectors exporting products with high added value (machines, equipment) were selling most of their goods in highly competitive OECD markets. More stable growth in exports also had a positive effect on capital costs for exporters because they were able to borrow money cheaper in international financial markets, thanks to their mother companies.

In this regard, the Czech media figuratively speak about two-gear economy. The segment, which grows much faster is formed by companies owned mostly by foreign entities. Such companies are usually managed more effectively and underwent deeper restructuring. Profitability as measured by return on equity (ROE with pre-tax profit) reached in foreign-controlled nonfinancial companies more than 12% in 1997, compared to 3.7% in big private nonfinancial companies and 3.1% in state-controlled firms.<sup>20</sup> Similar huge gaps continued also in the first half of 1998.

What is most important from our point of view is that in the long term these companies have applied significantly more demanding "contractual architecture" in their relations with suppliers and customers than other companies throughout the entire Czech economy. Customers had to pay on time and suppliers had to supply products of audited quality "just in time" which was not possible without innovation and preceding investment. In other case, the supplier was dropped which meant involuntary departure from these "islands of stability" inside the stormy sea of Czech business. Certain warning can be inferred from recorded data, which show certain erosion of these spontaneously created "special zones" in the prevailing institutional and business climate. Payment discipline of big foreign-controlled companies

deteriorated significantly in 1997 (their overdue accounts payable almost doubled) and came closer to the Czech "business standard" in which companies decrease the cost of capital at the expense of their suppliers and therefore gain a competitive advantage.

## 6. Conclusion

Above, we stated our assumption that economic relations tend to take the form a cooperative game characterized by the modified prisoner's dilemma: Complete long-term cooperation maximizes common benefit to all participants, but "cheating," i.e. using any deficient contract for the benefit of a single participant, remains the dominant strategy in a one-round-only game.

Using examples of mostly foreign-owned companies, we attempted to demonstrate the hypothesis that firms which based their long-term reputation on ethical cooperation are able to replace the unsatisfactory strategy of cheating by a strategy of cooperation. These relations, called internal and external "contractual architecture" of a company, have no doubt become a source of significant competitive advantages. Moreover, such firms with good reputation have become "islands of stability" and enjoy advantages derived from their attractiveness to possible new partners, whether they are customers, suppliers, or employees. Their potential partners expect that any contract closed with the company will strengthen also their reputation.

It can be concluded then that ethical behavior in no way contradicts theoretical results of the Model of Principal and Agent or the Stakeholder Model. If ethical behavior is a strategy leading to maximization of long-term profits, then shareholders—principals should encourage their managers—agents to adopt it. Experience has confirmed that such behavior based on long-term goals was more often present in mostly foreign-owned companies which created islands of more complete contracts and more reliable customers and suppliers than has been until now common in the Czech economy.

Nevertheless, not even long-term-oriented foreign investors avoid one-time advantages to be gained by rational use of inaccurate legislation—particularly that regulating the capital market (e.g. at the expense of minority shareholders). Ethical problems of shareholders always appear in situations, which can be connected to one-time-only opportunities such as the privatization process accompanied by deficient contracts and less-than-perfect institutional framework. They also appear in situations characterized by the Czech "third approach" to corporate governance. In such cases, cheating based on the use of deficient contracts and inadequate legislative framework appears as the most profitable strategy which can, however, drain necessary capital out of companies, undermine their restructuring, and increase their indebtedness. Consequently, economic recession can burst holding bubbles, and cause the ensuing serious economic losses.

As we mentioned above, in such historic situations, the government needs to make its activities more dynamic, create such institutional arrangement, or take such measures which would introduce significant sanctions for cheating of managers but also cheating of owners. Already L. von Mises saw the basic institutional characteristic of a real market economy in that "the owner himself carries the responsibility because it is he who first suffers from damage caused by incorrect company management." This characteristic needs to be considered not only in the long term (enforcing bankruptcy legislation) but also in the short term (e.g. in the development of a revitalization program). Our results do, in fact, presuppose that the government views positively such privatization and investment contracts which are as complete as possible, particularly with solid foreign investors who show systematic long-term tendency toward more responsible corporate governance, even in the so-far underdeveloped Czech institutional framework.

The above mentioned arguments confirm the conclusion that the government may fail repeatedly and unnecessarily if it does not, in the long-term, take sufficient consideration of the analysis of microeconomic foundations for the national economy and for institutional changes. In a small and open economy, isolated macroeconomic support for growth through monetary and budgetary injections into aggregate demand can lead to prolonging the life of badly managed unstructured companies with rigid behavior rather than to their creative destruction. Mostly foreign-owned companies, on the other hand, are clearly more sensitive to other factors—changes in foreign demand, comparative advantages of capital investment and relative competitiveness and innovativeness which is tied substantially also to the available Czech human resources. These factors can undoubtedly be influenced by long- and short-term governmental policies. The decision to quickly privatize the remaining state-controlled banks to solid investors is a good example.

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<sup>14</sup> This paper is based on the original English version written for the "Analysis of the Czech Financial Market" conducted by the World Bank and presented at the conference "INVESTOR EXPECTATIONS IN A GLOBAL MARKETPLACE - The role of Corporate Governance - Can Central and Eastern European Companies Meet the Challenge?" organized by the Georgetown University, Woodstock Theological Center, USA, FSV UK, in Prague in November 1998

<sup>15</sup> Keasey K,Thompson,S.,Wright M. (1997), Corporate Governance: Economic and Financial Issues, Oxford University Press, New York

<sup>16</sup> Arrow, K.(1972), The limits of Organization, Norton, New York

<sup>17</sup> For critical review of the current legislative amendment see J. Dedic, "Ochrana akcionářů formou nabídky k převzetí", Burza, 65-66,1998, pp.12-14

<sup>18</sup> Mejstřík, M, Zemplinerová, A., Dervis A. (ed.) (1997), The privatization Process in East-Central Europe: The Evolutionary Process of Czech Privatization, Kluwer Academic Publishers, Dordrecht -Boston-London

<sup>19</sup> Zemplinerová A., Mejstřík ,M.(1998), Enterprise Restructuring and Corporate Governance,. under ACE Research Project P96-6171-R "Corporate Governance, Privatization and Industrial Policy

<sup>20</sup> See Statistical Year-Book of CR '98, Prague, p.182

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Institute for Economic and Social Reforms

## **Seminar Bulletin - Corporate Governance**

**David FRANKEL**  
Lawyer, USA

### **TRANSPARENCY IN BUSINESS IN USA: OVERVIEW OF PUBLISHING OF PRIVATE SECTOR INFORMATION**

It is a pleasure to be here today with you in Bratislava. Every time I visit Slovakia, I feel like I am coming home and this trip is no exception. Eugen Jurzyca and his colleagues at the Center for Economic Development continue to make the mistake of inviting me to speak at these seminars. By now I hope they have learned that as long as they keep inviting me, I will continue to accept their invitations.

Before I begin my talk today, I must make the usual disclaimer. My remarks today are my own personal views and are not the views of the United States Government or the agency in which I work, the Federal Trade Commission. I intend to try to keep my prepared remarks brief – not because I do not have a lot to say. Like any lawyer, I do. Rather, from my experience of speaking at these seminars over the years I have always found that the questions the audience asks always lead to a far more interesting discussion than when I use up all available time by speaking. As many of you know, I lived and worked in Czechoslovakia and in the Slovak Republic for almost three years in the early to mid 1990s. I therefore like to think that I know something about the conditions here and this allows me to better compare the situations in both our countries. I should add that I apologize beforehand for using the headset when you ask me questions in Slovak. While I understand most of what is being said, I want to make sure I understand 100 percent so I will not have any excuses when I say something silly.

In October 1997, I spoke at a seminar in the building organized by the Center for Economic Development in which I discussed two important laws in the United States concerning public access to government information. I understand that the Slovak parliament is now considering enactment of one of the laws I discussed in 1997, a freedom of information law.

Today, I want to talk about similar types of laws, but not laws that require the government to provide access to information. Instead, I want to talk about how the public in the United States is able to obtain information about private companies – or what is known in the Slovak Republic as stockholding companies. After all, most of the United States economy is in private hands and is not controlled by the government. Therefore, it is often critical for citizens to be able to obtain information about these companies in order to be able to make informed decisions about whether to purchase stock, sell it or maintain what they already own. This is a vast subject that I cannot hope to cover in only a few minutes. When I was a law student many years ago I took several courses that dealt with this subject. So, today I will cover some of the highlights of these laws to give you an idea about why they exist and what they provide.

The first type of law I want to mention is the incorporation statute. Every company in the United States must file a basic document in one or more of our 50 states (or the District of Columbia) that establishes that company. Every state has its own laws and procedures on how this is done, but the same general principles are used. The document contains the name of the company, the names of its original directors or persons who incorporated the company, and a registered agent who can be served with papers in the event someone wants to begin legal proceedings against that company. Some states also require that the names of the officers of the company also be listed. This document is called the “Articles of Incorporation” and it must be renewed each year. If there are any changes in the names of the officers, directors, or registered agent, those changes must be filed as well. The Articles of Incorporation and the annual

statements that update the Articles are filed in one or more states and are available to the public. Usually, a small fee is charged to search for and copy the document and send to whoever requests it.

The Articles of Incorporation are usually used by lawyers who want to bring a lawsuit against the company. For example, let us suppose that a Coca Cola delivery truck is in an accident and a pedestrian is injured. The injured person may want to bring a lawsuit against the truck driver and Coca Cola for her injuries, medical expenses, lost time from work, etc. The Articles of Incorporation would contain the information necessary to find the person who is required by law to accept legal papers filed against the company so the injured person could begin her serve her complaint on the company. Now I would like to turn to another type of law that is designed to get important information to the public – the securities laws. All companies in the United States may issue stock. Often, very small companies, like family-owned businesses, do not actually issue stock, even though they may do so. However, when companies need to raise capital they often try to sell stock to large groups of people or to the public. Before they may do so, our federal securities laws require that these companies make available important information about the company, its finances, its officers and directors, the industry in which it competes, and even how the global and U.S. economies may impact on the company.

The laws and rules that govern when, how and what information publicly-traded companies disclose in the United States are derived from a simple and straightforward concept: all investors, whether large institutions (like insurance companies, pension funds and mutual funds) or private individuals, should have access to certain basic facts about an investment prior to buying it. To achieve this, the Securities and Exchange Commission (“SEC”), an independent federal regulatory agency much like the agency I work in, requires publicly-traded companies to disclose meaningful financial and other information to the public. The disclosure of this information provides a common pool of knowledge for all investors to use to judge for themselves if a company's securities are a good investment. Only through the steady flow of timely, comprehensive and accurate information can people make sound investment decisions.

The genesis of this concept began with the Great Depression and the stock market crash of October 1929. In examining the causes of the Depression, the United States Congress determined that one significant problem was the speculation that was taking place by people purchasing stock without much reliable information about the companies. To solve this problem, Congress passed important new laws in 1933 and 1934. These laws were designed to restore investor confidence in our capital markets by providing more structure and government oversight. The main purposes of these laws can be reduced to two common-sense notions:

- Companies selling securities to the public must tell the public the truth about their businesses, the securities they are selling, and the risks involved in investing.
- People who sell and trade securities – brokers, dealers, and exchanges – must treat investors fairly and honestly, putting investors' interests first.

The SEC oversees corporate disclosure of important information to the investing public. Corporations are required to comply with regulations pertaining to disclosure that must be made when stock is initially sold and then on a continuing and periodic basis. The SEC's staff routinely reviews the disclosure documents filed by publicly traded companies. These documents include:

- registration statements for newly-offered securities;
- annual and quarterly filings (Forms 10-K and 10-Q);
- proxy materials sent to shareholders before an annual meeting;
- annual reports to shareholders;
- documents concerning tender offers (a tender offer is an offer to buy a large number of shares of a corporation, usually at a premium above the current market price); and
- filings related to mergers and acquisitions.

These documents disclose information about the companies' financial condition and business practices to help investors make informed investment decisions. Through the SEC's review process, the government checks to see if publicly traded companies are meeting their disclosure requirements and seeks to improve the quality of the disclosure. To meet the SEC's requirements for disclosure, a company issuing securities or whose securities are publicly traded must make available all information, whether it is positive or negative, that might be relevant to an investor's decision to buy, sell, or hold the security.

The SEC receives, processes and disseminates more than 500,000 financial statements each year. It does this through a sophisticated computer system known as EDGAR (Electronic Data Gathering Analysis and Retrieval). Thus, for example, every publicly-traded company files detailed quarterly and annual reports with the SEC. Everyone in this room may read any of these reports for several thousand U.S. publicly-traded companies merely by accessing the documents through the Internet. It is completely free to access this database. The web site address is <http://www.sec.gov/edaux/searches.htm>. Another database that I have not used much yet, but which I have been told is better than the SEC's EDGAR database is a privately-operated database with a web site address at <http://10kwizard.com>.

For your information, I have brought with me today two annual reports from companies in which I happen to own some stock. Every shareholder of any publicly-traded company receives such annual reports even if he or she owns only one share of stock. As I just indicated, reports containing this information are also readily available for free on the Internet.

While there are numerous types of violations of our securities laws, I will list a few that are particularly relevant to the topic of my talk today. The most obvious is the misrepresentation or omission of important information about securities. The next is the sale of securities without proper registration, such as without having filed the detailed disclosure documents required by our laws. Another important law is a prohibition on "insider trading." Insider trading is defined as the buying or selling of securities in breach of a relationship of trust and confidence while in possession of material and non-public information about a security.

Let me provide one simple hypothetical concerning insider trading. This is not a real situation; I just made it up for purposes of this seminar. Let us suppose that one year ago Bill Gates, the Chief Executive Officer of Microsoft, met with his lawyers who were defending Microsoft in the antitrust case that the Department of Justice and many states brought against his company. Let us further suppose that during the meeting, the lawyers told Mr. Gates that Microsoft was likely to lose the antitrust case and that Microsoft would likely be divided up into several smaller companies. If Mr. Gates then sold some of his stock or advised some of his close friends or family to do so without having first disclosed to the public the legal advice he was given, he would have engaged in insider trading. Those who also acted on this information without prior release of the information to the public would also have engaged in insider trading. This type of activity is strictly prohibited under U.S. securities laws. In fact, those who engage in it are routinely fined and frequently sentenced to prison. Let me repeat that the example I just provided about Bill Gates is not a real situation.

Individual stockholders have a right to sue those responsible for any money they may have lost by buying, selling or holding securities that may have lost value due to the dissemination of false or misleading information or the failure to disclose important information. This private right of action is in addition to the many cases brought each year by the SEC, the Department of Justice, and by state securities agencies.

I will turn now from government requirements that private companies disclose information to the subject of how private organizations also have similar requirements. I am sure everyone in this room has heard of the New York Stock Exchange or the NASDAQ exchange. These are private organizations and they receive no support from taxpayers. These stock exchanges have established criteria for companies that want to have their stock listed and sold through them. Among the rules established by these stock exchanges are rules requiring that listed companies share important information with the public in a timely manner. Companies may be "de-listed" or no longer permitted to have their stock sold on the exchange for violation of these rules. While I do not have time today to discuss the rules of these stock exchanges, I do want to provide you with their web site addresses so you may look at these rules when you have time. The New York Stock Exchange web site is <http://www.nyse.com>. The NASDAQ exchange web site is <http://www.nasdaq.com>.

Before concluding, I also want to advise you that in the United States, many of our 50 states also have securities agencies that enforce their own state's laws concerning securities and the dissemination of information to the public. While this topic might be interesting, I do not believe it is important for policy makers in a country like the Slovak Republic because I do not think there is a need here to consider more than one level of government regulation on this topic.

Let me conclude, then, by emphasizing that just like the right the public has to know about the activities of its government, it has a similar right to obtain timely, complete and accurate information about private

companies that sell their stock to the public.

As always, I would be happy to try to answer any questions you have. Again, let me thank Eugen Jurzyca for his kind invitation to speak at this seminar and I thank you for your attention.

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## Seminar Bulletin - Corporate Governance

**Andrej DUPAL'**

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### **TRENDS OF THE PRODUCTION MANAGEMENT IN SLOVAKIA A CORPORATE GOVERNANCE**

*„You should always ask how to do it better?“  
(G. Ch. Lichtenberg)*

The new age requires an increased effectiveness of the administration and management of enterprises - it calls for a new organization. As Rowan Gibson declares: „... When we undertake the Paris-Dakar Rally in a luxury limousine, we shall not get very far. We need an organization instrument, an entirely different type of the organization vehicle which is able to cope with a rough and uncertain entrepreneurial “country“ which we pass through. We need the vehicle reflecting conditions of the future information age and not of the past industrial age.“ Therefore it is undoubtful that the future cannot be the continuation of the past.

In the competitive struggle a decisive factor for the enterprise success is the target-oriented structure, planning and management of the material flow, including the respective information flow from suppliers to the enterprise and from the enterprise to a customer. The key position in solving these problems is held by production management.

An effective production development underlies the successful business activity. However, it demands to solve many principal problems, which must be tackled by a transition to the market economy. Although it is true that the business units have assumed a considerable autonomy, on the other hand they have an increased economic responsibility for the perspective production development and for their global prosperity. From the above-indicated facts it follows that the new orientation in production management is necessary, i.e. searching for new guaranties of the business success.

If the production in the past was superior to other business subjects (sectors), the situation nowadays has changed. The production served to many masters. The commercial sector requires short deadlines and small production orders with a high production quality, technical sector – the rapid introduction of new products and technologies, personal sector – the reduction of the number of employees or the wage increase, economic sector – the costs decrease and the growth of productivity. Moreover, besides internal pressures the production is affected also by external environmental factors induced, for instance, by the competition, market and customers and, of course, by the economics and policy.

The target orientation of infrastructural activities focused on the efficient support of production and on the mutually oriented communication in solving the real problems and requirements is almost an exception in present conditions of the expansion of entrepreneurial subjects. Only the system's approach can overcome the surviving opinion that the production is incapable, expensive, conservative, indisposed to accomplish necessary and essential changes.

In our contribution we shall pay attention to the four spheres of problems which are briefly summarized as follows:

- Business orientation of production management
- Contemporary aspects of the strategy of production development in Slovakia.
- Respecting the newer development trends in production management.

- Priorities of strategic tendencies in the development of production management in Slovakia.

## **Business orientation of production management**

The main objective of an enterprise in the market economy is to ensure its commercial and economic success. A decisive assumption of this are competitive products and services. The production is a basis of the preproduction process, which is a presupposition for the business prosperity. A key to solutions of the fundamental decisions within the business orientation (strategy) of competitive advantage is in production.

We shall specify the basic functions and interrelations of production management within the business orientation.

1. The business orientation needs a definite shift from the traditional, frequently technocratic production development to the commercial domination. It implies that the creation of the enterprise production program as well as the production development should be considered and derived mainly from requirements of the market and from its perspectives because the production results are capitalized only during the sale of finished products. An object of the business orientation of production management is to ensure the final production sale.
2. The entrepreneurial attitude assumes the new managerial thinking and behavior. The business activity has two contradictory aspects: it affords chances but it takes also some risks. The former should be increased and the latter decreased by management. It needs new, competent and qualified managers who are able not only to run the enterprise effectively according to market rules but also to exert the business activity.
3. It requires also the new and broader understanding of production, mostly as a production system. In this sense production management comprises not only the traditional production activity but also preproduction stages where the crucial possibilities of its improvement are displayed together with postproduction services completing the functioning of the production system. Only in this connection can management of the production system fulfil its economic, developmental, commercial and other business functions.
4. An important function is to ensure the perspective enterprise production program. The creation of such a production strategy assumes to organize prognostic works, prospective studies, marketing analyses and the other professional activities that will prepare the qualified production strategy with an appropriate time horizon. The strategic production management should be an integral part of the enterprise strategy where production strategy occupies its relevant position. The strategic production management needs to be characterized in context of the following dimensions of decision-making:
  - product/market conception,
  - resource conception,
  - conception of creating the competing position.
5. Furthermore, it assumes to ensure the flexible adaptation of marketing results production. This is guaranteed by the production complying with market and customers requirements. Marketing analyses are invariably confronting prognostic conclusions of the strategic production development with a particular market situation, inclusive of competition results, which permits one to guarantee the business success on domestic and foreign markets.
6. The function of the business orientation of production management consists in transferring new research and development findings to production itself, i.e. to both products and production-technical basis. In practice, the long-term problem of the insufficient implementation of scientific-technical development has been known. It is not the automatic process. It is necessary that the production management anticipated the concrete material, financial, personal, stimulative and motivational presuppositions for development and implementation of the scientific knowledge into production. Only in this way will be the business market activity possible.
7. An important function is also to secure the purposeful implementation of production development management as an integral part of the business production management. The production development management has two kinds of mission: the flexible ensurance of changeable market and customers

demands on the one hand and the ensurance of dynamic development of the respective enterprise. This assumes a permanent expansion of the lucrative production and an increase of the economic effectiveness in the whole production system through the in-house production management.

8. The functional mission of the business production management involves also the personnel development. In the production management the personnel work has been missing so far. Nevertheless, an important content of the production management are not closely understood production – technical problems but mainly those people who are active within the whole management production process, starting from marketing up to services offered to a customer. The role of man as an intellectual source requires everywhere and at all levels where objective conceptions and decisions are adopted the application of the respective method, system precautions, control methods, etc.

9. An unseparable part is the production quality development. At present the quality is the crucial business phenomenon on world markets. Management is an integral part of the production management. The production management role consists in the integration and qualified control of all components influencing the quality as a main bearer of the commercial success, and also in the contribution to further continual advancement and improvement in accordance with a dynamism of the business activity. To express it metaphorically, the quality has become at present the so-called universal instrument of payment on the world market. In the sphere of quality the production management has not only the topical but also the perspective role because in business conditions the retardation of the product quality implies the enterprise exclusion from the market and its replacement or occupation by a stronger and more competent competition.

10. The present production management cannot manage without exploiting the computing technique. It assumes the organization and ensurance of the flexible production system where preproduction stages, robotized production, service production processes and quality control are integrated by a computer network.. It is necessary that current instruments applied in the real production system were considered an organic part of the up-to-date business production management.

11. The humanization of work and the solution of social aspects in production cannot be avoided. The point in question are principle questions despite the fact we are not aware of them. This applies to the basic production but also to neglected (in our conditions) service production processes (remark: the 60 per cent volume of manipulation operations is implemented in the Slovak industry manually and the health-service and hygienic questions of protection or securing biological needs for the production-and service-engaged workers are disregarded).

12. The solving of ecological problems in production comes nowadays to the fore. This function results not only from the necessity to solve these problems on a worldwide scale but mostly from domestic problems existing in this sphere. Consequently, the environmental problem-solving is a vital question for every entrepreneurial subject and its production management. The permanent consideration of environmental engineering is part of the business orientation of production management.

13. The business orientation of production management involves also optimization of the logistic enterprise chain. This applies especially to subjects and activities such as purchase and supply, production up to the storage and sale of final products. Thinking and acting in compliance with logistics means today searching for the economy in time, cutting of costs, endeavoring for efficient interconnection among supplying, manufacturing and commercial activities, and applying the flexible organization structure within which the logistic process takes place.

14. The orientation to international development trends in production, to integration processes and international co-operation is also of great importance. The present business activity in production has very little prospects of success without the international context.

15. The business orientation assumes an interconnection between the production management and other enterprise corner-stones. The financial, commercial, innovational, personal, technical, investing and the other kinds of management are penetrating into production management and then in turn they exert the feedback influence on the production management results. Finally, such a two-way penetration is the methodological "springboard" for investigation of the position of production management in the practical business activity.

## Contemporary aspects of the strategy of production development in Slovakia

The main content and mission of the production development strategy should be increasing and creating the background for the production system development, creating the active production development strategy and thereby ensuring the successful business.

We shall outline some basic spheres, which should be respected and improved in the production development strategy in Slovakia.

1. Prosperity of the entrepreneurial unit as a whole depends, to a large extent, on the quality and level of the in-house production management, the substance of which is effectiveness and quality. The business orientation requires the reevaluation of problems concerned with the in-house production management and with the implementation of principal changes in its functioning. An active business system created primarily by the corresponding in-house economic mechanism, respective institutional framework and explicit economic rules is very important.

Efficient conceptions of the in-house production management, mainly an experience obtained from the Bata system lead today to the modern management theory oriented to production processes and based on the high-technology support, autonomy of decisions and on the integration of the production system.

For the optimum functioning of the internal development mechanism it is necessary to create primarily these assumptions:

- to ensure the internal business environment,
- to apply and respect fundamental features and principles of the internal production management,
- to tailor an organization of the in-house management to market requirements,
- to apply the value relations among divisions (profit-centers),
- to achieve the self-financing of in-house divisions,
- to ensure an engagement in the really achieved results,
- to strengthen the independence of divisions (profit-centers) and look after the balanced distribution of power and responsibility,
- to improve the information system and thereby relations among individual sections,
- to devote an increased attention to economic aspects, that is to say to the evaluation of organizational units in the in- house production management.

The system also assumes:

- Establishment of workplaces and working conditions in which people would be satisfied.  
The guru of the KAIZEN system, Imai Massaki says: Western managers very often overlook the workplace as a source of profits. They lay stress on fields such as the financial management, marketing, business, research and development. However, if we want to solve arising problems we must be in a close contact with the every-day reality...“The managers who do not keep in contacts with workplaces, they often overlook their possibilities and do not employ existing sources.
- The clear economic rules affecting employees already at the moment of taking their decisions.
- The formulation of tasks in such a way to attract and evoke employees to solve the problems successfully.

The systematic evaluation of working results and their comparison with a surrounding environment accomplished especially with the orientation to the optimal performance and work quality.

2. Development processes in the production management are based, above all, on the internal substance of its innovation, or in other words, on the growth and application of the scientific knowledge, but they are enforced also by a change in the economic conditions.

The most significant external factors influencing these changes involve: transition to the business-type production management, increase of competition and market pressure, enhancement of the proportion of the so-called intelligence productions, internationalization and globalization of markets, research, production of all business units, enormous advancement in the informatics and computing technique. Internal factors include the improvement of production management by means of systems of planning and

managing the production.

They allow us to follow:

- high probability of adhering to stipulated terms,
- even utilization of capacities,
- high state of supplies,
- high supplier's promptness and disposal,
- high flexibility,
- low costs,
- appropriate supply of information,
- high readiness of raw-materials,
- increase and ensuring the certainty of planning.

The above-mentioned factors should be respected and production management should be adapted so to comply with the latest trends in the business „world“ and to infiltrate them in own conditions and the way of implementing the tasks and problems in this sphere.

3. The strategic development of production cannot manage today without an application of the logistic approach.

In the last decade the logistics has become the more and more frequent conception. At present it has been recognized as an independent discipline and its employment is very efficient. To be brief, its objective is the optimal control of the whole material flow not only inside the business unit but also within the chain, starting from raw – material sources and ending with a final customer. However, its functioning depends on the communication, that is to say on the control of the appropriate information flow inside individual links of the logistic chain and among them. As an aim should serve the all-round satisfaction of the final customer. In other words, logistics brings into relation goods, people, production, transport, storage capacities, and also information, and follows whether they are on the right place, in the right amount and quality, and for the right price.

Logistics lays stress on integration of those fundamental activities or processes which constitute the core and contents of the enterprise logistic chain. The most important integration questions are:

- Interconnection and coordination of the management of those crucial processes from which is composed the whole production process of the particular product.
- Interconnection among purchase, material supply, production and sale of finished products.
- Interconnection among activities associated with the preparation of new products and processes.
- Conception of developing a novel production system.
- Organizational ability to cope with integration problems.

The basic attributes of the logistic approach should be seen in terms of these postulates:

- a) It should be an effort or orientation to a customer to secure a short time of delivery, flexibility of production, quality supply and adequate postsalable services,
- b) The logistic production management in business units should be apprehended as part of the philosophy or conception of its control,
- c) Attention will have to be paid also to logistic costs and to the logistic cost account, which is an important instrument of the control and management.

It is inevitable to link up the development of logistics in the enterprise with the perfect reparation and implementation of logistic proposals (projects), the choice of which should be systematically explained in the form of answers to these principal questions:

- Will the logistic project give an advantage in the contents with competition?
- Will the logistic project permit the development in the sphere of enterprise business activity and will it allow the achievement of advantages by virtue of the contest in short-term or long-term time horizon?
- What will be the position of the business unit versus competition partners after introducing the logistic

project and who will have the chance of acquiring or retaining the advantage?

- Is the logistic process oriented to a decrease of costs and to optimization of the production process and the whole logistic chain?

4. In the dynamic competition environment the formation of the end-use properties of new products being stimulated by a valuable invention – when the business unit gains a goodwill of customers owing to its good ideas – appears to be inevitable –.

The business unit can be successful and prosperous only if it is able to ensure the permanent innovativeness of production and if it is able to promptly arrange the qualified, flexible preparation of production, within which the research and development are in a position to promptly react to incentive market requirements and to assure the new claims of customers.

The preproduction preparation should fulfil a dignified role and function of this “foreground“ of the production because only in this way the production and technological innovations can stimulate the production system development, which is - from the aspect of the business unit – an important assumption for its further development. The innovation should be planned and well organized.

This needs:

- Strategic planning of the research and development.
- Mutual interconnection between individual innovative programs and objectives of the business unit.
- Flexibility of these programs towards technological changes, changes in the enterprise policy and in the market development.
- Clearly defined aims of the innovative policy.
- Inevitable and adequate sources for accomplishment of the objective aims.
- Creation of the background, working and other conditions to initiate stimuli and innovation in the production.
- Convenient communication network and favorable co-operation between subjects which participate in the management of innovations in the business unit.
- Adequate co-operation in verifying research and development results with other participating subjects within management innovations.

5. An integral part of the development processes of production is the technological strategy. An effective coping with the processing aspect of production management implies the perfect adoption of the technological procedure or technological process. It is necessary to regard the technology for one of the fundamental elements of the production system within the business unit. The latter is the strategic source of development (dynamism) of the business subject. Modern technologies are developed in response to numerous needs and requirements of the market and customers - a key to new opportunities of the business unit. The business situation may be successfully managed only by means of the flexible strategy based on the carefully considered business plan with a clear technological trend.

The most significant questions of technological strategy of the business unit include:

- In which modern technologies should the firm take interest and when they should be introduced?
- How to control the transition from one technology to another?
- How to prepare the business unit for a technological change?

In this connection it is necessary:

- a) to concentrate on such technologies which reflect the technical potential of the business unit the best,
- b) to improve the efficiency of research and development processes and of the preproduction stages,
- c) to ensure the interconnection of technical, economic and technological programs with market and customers needs,
- d) to develop fundamental strategies based on the up-to-day technologies being already possessed by a business unit or being an objective for their adoption.

A rapid growth of the technological development based on the scientific knowledge predetermines that the

choice and application of technological solutions in the business unit should result not only from professional considerations of the technical character but also from those of the economic character. The choice cannot be restricted only to own research and development sources (the present economic reality requires even the reevaluation of a lot of principle questions concerned with the strategic orientation) but it has to emphasize a wide range of possibilities of technological transfer within the international scope.

6. An important assumption of the strategic-development plans in the business unit is considered the quality. Without the high quality it is impossible today to make more challenging markets and reach more distinct economic results. In the business economics an important role is played not only by the products quality but also by the quality of services, engineering equipment and other production conditions, by the quality of the managerial system, personnel, especially managers, etc.

An effort for establishing a good market position urges business units to increase the products quality. However, it is to be noted that the typical consumer's conception of the quality does not correspond to new business conditions it is associated only with technical parameters and technical standards and does not comply with new business conditions. The present time lays down the much higher demands on business units. The firm must detect and fulfil the customers requirements, to assure the product and service quality and to solve the complexity of management quality in all activities and levels.

7. An important aspect of the production development strategy in business activity is also the solving of ecological problems concerned with production. This follows not only from the necessity to solve them on the world-wide scale but especially from own, domestic problems existing in this sphere. The environmental problem-solving is an important question of each business subject and its production management. The permanent maintenance of the environmental engineering principles should become an integral part of the business orientation of production management.

On the basis of the environmental evaluation of influences on the environment the formation of the efficient preventive system for environmental care is necessary. This demands to find out ecologically significant factors in the business unit and also to elaborate studies revealing the existing environmental situation. In connection with the production system the estimation of changes and requirements for ensuring the ecologization in future, as well as the summarization of the effects on the present and future environment are nowadays inevitable.

### **Application of newer development trends in the production management**

The business orientation of production management in Slovakia assumes to acknowledge or apply the so-called newer systems, i.e. conceptions of controlling the production.

- MRP systems (associated with the planning of material needs or of all production sources),
- JIT (just in time),
- OPT (optimized production technology),
- BOA (effective management ),
- KAIZEN (permanent and continual improvement),
- LEAN PRODUCTION (slim production),
- BENCHMARKING (comparative management),
- REENGINEERING

The above - indicated solutions and some other new managerial procedures allow one to improve and develop production management in the business strategy. They will be described below.

### **MRP systems**

They are essential representatives of the so-called pure centralized systems of planing and managing the production. They can be characterized by the ideal possibility to centralize all decisions concerned with the implementation of production, i.e. to earmark the production orders with respect to their amount, article, and exact terms for their processing in individual workplaces. An object of the production is to realize the targets of planning. The central point permanently receives reports or information about the current state of the production system since it has to arrange and ensure continually its course of action. It often has an exact processing model at disposal, which reflects the real course of production and thus permits one to

except adequate decisions.

In their genesis, they have been gradually developed as MRP I (planning of materials), MRP II (planning of production sources) and the present MRP III designated as the Synchro-MRP or adaptive MRP system. Their advantage is not only in the support of the in-house production management but also in that that they represent the information and controlling system ensuring data processing for all spheres of the enterprise activity.

## **JUST IN TIME or KANBAN**

They form the basis for newer development trends of the in-house production management. They synthesize essential features of the modern management involving the synchronization of partial processes into the continual formation of new, end-use values and the flexible adaptation to customers' requirements. In essence, they assure the production without reserves, which causes a decrease of costs, the production without defects – which increases the quality, without temporal losses – which enables one to take advantage of the production potential of the firm and the production without a loss of customers because the course of production is based just on their requirement.

Is among them a difference? The majority of authors endorse an opinion that JUST-IN-TIME is an analog of the KANBAN system. However, they cannot be extracted from the context, i.e. from the conditions of the management production system of the company where they were developed and where they are applied. Their common feature is that the aim of JIT and KANBAN is to complete the delivery to customers in the required volume, structure, parameters and parameters exactly and in due time.

At present JIT undergoes a lot of essential changes. As a matter of fact, this regards more the application of the Japanese version of elements or of accompanying systems such as:

- POKA – YOKE – against errors,
- SMED (Single Minits Exchange of Die) – an efficient system for an exchange of tools in the production,
- TQC (Total Quality Control) – control of all firms' functions, not of those related to production,
- simplified material flow,
- strong firm's partnership relations with suppliers,
- personnel education,
- co-operation with the customer in providing regular services,
- perfect overview of possibilities to improve the production management,
- application of other progressive methods and solutions.

## **OPT (Optimized production technology)**

The system was developed as a reaction to the present practice used in the allocation of production tasks. It is oriented to the so-called "narrow" spots, which are a decisive assumption and key to increasing the total output of the business unit. Also, they determine the continual production time, supplies of the unfinished production and the exploitation of production equipment. The system works in several steps:

1. It carries out the classical distribution of production tasks in the workplace (similarly like MRP) and makes balances of production capacities..
2. It distributes workplaces into "narrow" spots and other ones. The narrow spots will divide the material flow into two parts – the part in front of the narrow spot, the so-called uncritical part, and workplaces following after the narrow spot, the so-called critical part.
3. Then decisions are made about the distribution of tasks assigned to narrow spots. In the first stage, the process is under way in the direction from narrow spots along the material flow so that the distribution could not cause the emergence of other narrow spots. The deadlines for filling orders are substituted for those stipulated in accordance with the exploitation of narrow spots.
4. At last the calculated deadlines for filling orders are compared with required ones. If there is an agreement, the distribution is accepted. If not, capacities of the narrow spots must be enhanced and the process repeated.

The system calls for the trouble-free operation of narrow spots and a rapid removal of potential failures; it is recommended to staff workplaces with the best workers and it is suitable to build up the reserves of semi-products in front of the narrow spot.

### **BOA (effective management)**

It represents the concept of the in-house production management convenient for the two-stage production. Its aim is to eliminate queues in front of workplaces. They are often uncontrollably increasing and cause the long, continuous loss of time in the production system. In the BOA system, a key to the control of the length of continuous losses of time in production is in the regulation of the input of production tasks into the production system.

The working system which can include individual workplaces, a group of workplaces, operation, production sector, etc. are described by the so-called "funnel" model in the BOA system. It forms the basis for construction of the continuous diagram.

The production system can produce only so many products how much it is permitted by the production capacity. For this reason it is necessary to decrease the work in progress, namely reserves. The average continuous time of the produced task is then defined as the ratio of the average reserve of work to the average performance of the system.

Average continuous time (in days ) = Average reserve (in hours ) / Average performance (in hours/days)

The above-indicated relation is the basis for applying the state of workplaces as a command variable.

### **KAIZEN (Kai – change, Zen – better)**

It has been used mainly in the recent period, it is associated with the way of thinking and acting of the Japanese chief executives and workers. This implies primarily the orientation to a customer with increasing the quality of products, processes and services.

From the factual point of view it is characterized by:

1. System in everything – in the workplace and in the management. It is necessary to separate everywhere the substantial things from unsubstantial, to work systematically and according to some system.
2. System organization beginning with the preproduction preparation and continuing to production, works and management.
3. Systematic keeping of cleanliness, systematic service, maintenance, security.
4. Systematic control of operations, spare parts, products, results and mainly quality control.
5. Losses, which must be removed immediately, namely temporal and financial, losses of every individual in the team and in the whole system.

In introducing the KAZEIN system it is necessary to meet these principle requirements:

- It is necessary to devote attention to each improvement even in the case when it is less important.
- KAIZEN is accessible to everyone. All employees can and should participate in it.
- Each improvement considered should be exactly and thoroughly analyzed before its implementation.

The system is built on the firm's attributes arising from the improvement of the system through the own initiative, possibilities and disposals, and from the drawing of own sources and financial means. It is a set of various techniques and management. The substantial attributes include:

- care of the customer,
- total quality control,
- groups of quality,
- care of the tangible investment property (total maintenance),

- working discipline,
- proposals of improvement,
- co-operative relations,
- assurance of „just-in-time“,
- productivity increase,
- mechanization and automation,
- new products continual development.

### ***LEAN PRODUCTION (Slim production)***

The main principle of the conception of LEAN PRODUCTION is saving in all spheres of the in-house production management – starting from the purchase or supply to the development of products and production processes up to the production itself and distribution.

The LEAN PRODUCTION subsumes a large number of fundamental elements, which are from the aspect of the system (conception) functioning inevitable. They are:

- orientation to a customer,
- small number of production stages,
- maximum economization of sources,
- increase of productivity and work quality,
- total quality control,
- KAIZEN as a process of the permanent improvement,
- systematic assurance of the maintenance of machines and equipment,
- assurance of “just-in-time“,
- application and improvement of the KANBAN system,
- constant co-operation with suppliers, businessmen and customers,
- more autonomy and responsibility transferred to the working group,
- orientation to the project management,
- suitable information logistic system,
- flexible production,
- assurance of the integration of a logistic chain,
- permanent elimination of the reasons of losses and rejects,
- effective distribution channel.

The afore-said Lean Production does not provide the general direction for the solution of problems associated with the conception of managing the production in the business unit. Every enterprise is obliged to search for its own route within this conception, its own way of implementing the tasks and problems in this sphere.

### **BENCHMARKING (Comparison management)**

It is the next trend of improving the in-house production management. This method is based on the comparison of own indicators with competitors or with the best enterprises in its field. BENCHMARKING means literally a leveling mark, that is to say the comparison equivalent. Its priority consists in a relatively rapid acquisition of the best managerial solutions, namely by excursions and the study of the tried and tested knowledge from the top firms. The possibility of adopting successful managerial solutions in a short way is obviously the main reason, for which this way of the management improvement gains supporters.

However, it is necessary to know how to choose the convenient enterprise to make comparison analyses and, furthermore, to choose the method for acquiring the new knowledge and qualified employees who are able to elaborate comparative studies and adapt the obtained results into the in-house production management.

### **REENGINEERING**

It is focused on the principle reevaluation and radical reconstruction (redesign) of processes in such a way to achieve the dramatic improvement considered from the viewpoint of the critical measures of performance such as: rate and flexibility, quality, time, costs, services.

Reengineering as an essential, dramatic and radical change of the existing comprehension and organization of business units (processes) is in fact the solution of the system task aimed to increase their functional abilities expertised like an open system of four basis aspects:

1. Competent aspect: What sources and properties are inevitable for the required level of the production system functioning?
2. Structural aspect: How to arrange material and information flows among individual production processes in order that the exploitation of existing sources could be optimal?
3. Functional aspect: How to integrate individual components (sources) into major units (processes) to reach minimal costs for the performance of production activities?
4. Integration aspect: How to ensure the management of individual production systems in the firm to achieve the maximum level of its competitive ability?

### **Priorities of strategic trends in the production development in Slovakia**

Slovak enterprises have not succeeded in fulfilling their strategic development plans after the ten-year process of economic transformation into the market economy either. Most of our enterprises are insolvent. It is impossible to solve it by operative steps because it requires strategic solutions. In our opinion, the priorities of strategic trends in the production management development in Slovakia can include:

**1. The requirement for purposeful and all-round preparation of the implementation of production strategy of the business units, particularly in the form of the previously elaborated realization projects.** In accordance with these projects and from the viewpoint of the system it is possible to assure the implementation of strategic changes. In implementing the production strategy is not, however, sufficient to create assumptions only at an enterprise level but it is necessary to create also macroeconomic assumptions which have often limited so far the business activity. This applies primarily to the more extensive and more prolonged production strategy which cannot be ensured without the national-economic measures at the level of the center. It is particularly the credit, tax, monetary and the other policy, legislative and foreign-economic measures which will stimulate the entrepreneurial activity. They include also the so-called regulatory barriers or measures which manifested and have been manifesting in various forms:

- limitations in the business activity,
- discrimination of enterprises, their making advantageous and disadvantageous,
- obstacles and complications at the entry into the market,
- obstacles at the output from the market,
- unequal conditions in the privatization.

**2. In making the corporate governance effective to solve of problems of the effective business system (approach), proficiency in the production management, and consideration of social aspects.**

Serious mistakes made at the beginning of the privatization in Slovakia showed themselves to a large extent. A lack of proficiency of the majority of privatizing persons caused serious failures in the effectiveness of the business-economic subjects and thereby of the economics. In the end, this is an impact of the present unemployment. For instance, one of the most effective branches of the national economy acknowledged also on the world scale, mechanical engineering, "lost" the three fourths of employees. The present state of Slovak enterprises is documenting that only 5 % of enterprises achieve the after-tax profit. An effective corporate governance requires that owners should be besieged by the professional personnel and managers who are able to undertake business according to market rules and to respect also the so-called social aspect (remuneration, re-qualification possibilities, participation in the enterprise ownership, employment). In most cases this fact was absent. The concern was oriented to an entirely different direction.

**3. The requirement of restructuralization and diversification of the production.** This problem has

been known and discussed for a long time, but it is still unsolved. In relation to the world economy of the Slovak Republic the proportion in the gross domestic product (GDP) amounts approximately to 0.012 % and the proportion in the world export to about 0.15 %. These relations suggest that the Slovak republic is more or less dependent on the export performance, inasmuch as almost 65 % of GDP must be exported and changed into the form of the final exploitation. As for the GDP structure, the orientation towards the sound investment into the production is necessary and towards the consumption it is less essential. It is also necessary to mention that the steady inclination to import is still persisting, which causes the basic structural disequilibrium in the Slovak economy. To make the foreign trade more dynamic, the creation of conditions corresponding to the structural change of the industrial production for export is inevitable. An increase in the export performance of the industrial production should be conditioned by the implementation of underlying development targets by a structural change in the assortment of production as well as in the growth of its effectiveness. It is paradoxical that only today some voices have been raised at the parliamentary and the governmental level to revive the production.

**4. The solution of the complex of problems – the low competitiveness of our products and enterprises on foreign-trade markets.** Every business subject should give priority to the quality of its products and to services associated with their application. If business subjects want to be successful in their activities, they must produce and market with high-quality products and also to offer adequate services. An efficient system of the quality management is an assumption to meet the needs and expectations of customers and, at the same time, to consider and protect the business subjects' interests. It should involve people, production and supporting instruments and methods of its implementation and improvement.

**5. The present problem – production in the position of the passive “performer“ of requirements superimposed by sales and other managerial subjects.** This is partly the reaction to the previous dominant position of production in most of our enterprises and partly the consequence of the mechanical transfer of foreign findings into enterprises comprising also marketing-management conceptions. They often affect the dominant marketing position not always for the benefit of the marketing management. Recently, the function of finances, to which is everything, that means also the production, subordinated, has been playing an increasingly important role. The development production management cannot entirely adapt to the indicated tendencies. It is necessary to issue from the reality that basic “cornerstones“ in the enterprise are production, marketing, finances and personnel policy which should co-operate between one another.

**6. The further building of joint international enterprises, international integration, capital participation inclusive of foreign partners, mainly the foreign capital should be the priority.** It is to be noted that various forms, modes and kinds of the entry of foreign capital have already been applied in the transforming economy of the Slovak Republic but there is still a lack of the foreign capital and investments. As for the direct foreign investment and the other capital and financial transfers, these are in Slovakia absolutely and relatively the lowest in comparison with other countries of CEFTA. The existing entries were more of the speculative and profitable character and accomplished without any system. It is necessary to point out to the fact that conditions for the entry of the foreign capital were not in the past permanently created. The potential investors were missing the non-complicated economic and social-political environment as well as the clear unchangeable criteria for the entry of the capital. With regard to the existing situation in most of the industrial enterprises the creation of the proinvestment environment for direct foreign investments into processing and mainly into industrial branches is today unavoidable.

**7. The unequivocal priority for Slovakia is to spare every effort for the entry into OECD and the European Union.** The efficient steps to reach this aim were made by the present government. The entry will enable one to create important conditions and assumptions for liberation of the capital market, financial and other services, public acquisition, conditions for the standardization and harmonization of taxation, elimination of technical obstacles and physical barriers, extension of the environment for further business activity and co-operation of our business subjects with foreign ones. This can become a significant stimulus not only for the introduction of discipline, order, culture and economic behavior of the business subjects but also a stimulus for their more effective governance and, in general, for further development of the Slovak economy.

