Chapter 1
Corporate Governance in Transition Economies

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Introduction

Corporate governance issues are especially important in transition economies, since these countries do not have the long-established financial institution infrastructure to deal with corporate governance issues. Before the fall of the Berlin Wall and the collapse of the Soviet Union, there was no need to discuss corporate governance issues because all enterprises were owned by the state and there were no shareholders. All that has changed since 1989. This chapter discusses how transition economies are dealing with corporate governance issues and the extra obstacles they have to overcome due to a lack of established financial institution infrastructure.

Corporate governance has become an important topic in transition economies in recent years. Directors, owners and corporate managers have started to realize that there are benefits that can accrue from having a good corporate governance structure. Good corporate governance helps to increase share price and makes it easier to obtain capital. International investors are hesitant to lend money or buy shares in a corporation that does not subscribe to good corporate governance principles. Transparency, independent directors and a separate audit committee are especially important. Some international investors will not seriously consider investing in a company that does not have these things.

Several organizations have popped up in recent years to help adopt and implement good corporate governance principles. The Organisation for Economic Cooperation and Development, the World Bank, the International Finance Corporation, the U.S. Commerce and State Departments and numerous other organizations have been encouraging governments and firms in Eastern Europe to adopt and implement corporate codes of conduct and good corporate governance principles.

The Center for International Private Enterprise (2002) lists some of the main attributes of good corporate governance. These include:

- Reduction of risk
- Stimulation of performance
• Improved access to capital markets
• Enhancement of marketability of goods and services
• Improved leadership
• Demonstration of transparency and social accountability

This list is by no means exhaustive. However, it does summarize some of the most important benefits of good corporate governance. All countries, whether developed or developing face similar issues when it comes to corporate governance. However, transition economies face additional hurdles because their corporate boards lack the institutional memory and experience that boards in developed market economies have. They also have particular challenges that the more developed economies do not face to the same extent. Some of these extra challenges include:

• Establishing a rule-based (as opposed to a relationship-based) system of governance.
• Combating vested interests.
• Dismantling pyramid ownership structures that allow insiders to control and, at times, siphon off assets from publicly owned firms based on very little direct equity ownership and thus few consequences.
• Severing links such as cross shareholdings between banks and corporations.
• Establishing property rights systems that clearly and easily identify true owners even if the state is the owner. (When the state is an owner, it is important to indicate which state branch or department enjoys ownership and the accompanying rights and responsibilities.)
• De-politicizing decision-making and establishing firewalls between the government and management in corporatized companies where the state is a dominant or majority shareholder.
• Protecting and enforcing minority shareholders’ rights.
• Preventing asset stripping after mass privatization.
• Finding active owners and skilled managers amid diffuse ownership structures.
• Cultivating technical and professional know-how (CIPE 2002).

Review of the Literature

Actually, the literature on the topic of corporate governance is too large to review in any detail. A full review of just the Russian literature in the English language would require a book. Then there is the Russian language literature and the English and national language literature for each of the other former Soviet republics, plus each country in Central and Eastern Europe, the Balkans and China.

Hundreds of articles and dozens of books have been written about corporate governance in the last few years alone. One book that should be mentioned is Corporate Governance by Monks and Minow (2004). This book was a required reading for the ACCA Diploma in Corporate Governance program before that program was discontinued. Davis Global Advisors publishes an annual Leading Corporate Governance Indicators, which measures corporate governance compliance using a variety of indicators.