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I. Governance and Enterprise Restructuring - the case of Macedonia

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Abstract:

This paper is a case study of the **Republic of Macedonia** (Southeast Europe), which focuses on examining governance and enterprise restructuring.

Governance and enterprise restructuring is already defined indicator in EBRD's studies and transition reports, measuring the effective corporate governance and corporate control exercised through domestic financial institutions and markets, fostering market-driven restructuring. As of the beginning of the transition process, governance and enterprise restructuring remains in the center, as essential pillar, that moves forward the society towards developed market economy.

The data used in this article are analyzed with an econometric regression model, which as employed in this study examines the interrelationships between governance and enterprise restructuring and set of policies that influence the governance patterns.

JEL Classifications: G30, G32, G38; L33; O11; P31

Keywords: governance, corporate governance, management strategy, transition, Southeast Europe, Macedonia

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Introduction

The research in this paper is to be focused on examining governance and enterprise restructuring in **Southeast Europe** economies and in particular a case study of the Republic of Macedonia.

EBRD has governance and enterprise restructuring as basic indicator of economic transition and defines it as effective corporate governance and corporate control exercised through domestic financial institutions and markets, fostering market-driven restructuring. The corporate governance is most often defined in terms of the roles, responsibilities, and interactions of top management and the board of directors.

Using data of South-East Europe i.e. case study of Macedonia, will be examined the interrelationships between governance and enterprise restructuring and set of policies that influence the governance patterns.

Literature Review

There are several contemporary theories that set the foundations of governance and enterprise restructuring within a framework important for this research.

The *institutional setting* is of essence when governance and enterprise restructuring is analyzed in transition economies. Further, the literature on corporate governance is extensive and is linked to important theories, of which the agency theory is fundamentally predominant. The established agency theory highlights the function of corporate governance in the overall enterprise restructuring, ensuring that the firm protects the interests of shareholders in a given institutional context (Fama & Jensen, 1983). Thus, the institutional setting has impact on the outcome of companies' performance through the very nature of country's ownership structure and policies undertaken to shape the governance system. When companies are analyzed, it is important to state the presence of different agency conflicts between shareholders and management in a given ownership structure of each country. Hence, different countries have divergent governance systems leading to variations in the nature of the agency problems, where according to the 'law and economics' viewpoint, legal systems craft institutional specificities (La Porta, Lopez-de-

Silanes, Shleifer, & Vishny, 2000). The literature further proposes that different national governance systems are also influenced by cultural and historical features in addition to their specific legal system (Hall & Gingerich, 2009).

The links between *agency theory and institutional theory* (Aguilera & Jackson, 2003) explain that divergences in national institutions may have significant impact on the effectiveness of governance at the firm level (Aguilera, Filatotchev, Gospel, & Jackson, 2008).

The *law and economics* approach (e.g., (La Porta et al., 2000; La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1998)) puts the focus on the fact that the ability to enforce financial contracts and thus increase the effectiveness of governance depends on institutional characteristics (Djankov, Hart, McLiesh, & Shleifer, 2008; Douma, George, & Kabir, 2006; Hoskisson, Cannella, Tihanyi, & Faraci, 2004). Further, it is stated that in order to complete the frame already set by the agency theory it is necessary to merge it with institutional theory (Douma et al., 2006; Kaplan, Martel, & Stromberg, 2003). There are two principal strings of institutional theory fitted to the analysis: a) the first, origins in political science (North, 1990) and b) the second is derived from organizational theory (Scott, 2002). The political science approach focuses on the setup where political and economic institutions create incentives for managers and the way the outcomes are shaped. On the other hand, the organizational theory approach is concerned with the adjusting function of organizations while creating the institutional environment. In this regard, Aggarwal and Goodell argue that national corporate governance differences between countries used in their study are determined by legal, cultural, and other national characteristics (Aggarwal & Goodell, 2010).

1. Corporate Strategies in transition economy environment

As countries undergo serious system transformations the managers are faced with complex decision-making environment (Sanders & Mason, 1998), and thus it is closely regarded that the performance of large enterprises should be linked to managerial flexibility in making strategic decisions within the context of the firm's governance. Furthermore, there aren't many sources that can point towards emerging corporate governance mechanisms in South-East Europe, although prior research suggests that independent managers and board of directors (corporate governance) may be an important necessity for managerial ability to undertake performance-enhancing strategies (Hoskisson, Eden, Lau, & Wright, 2000). Before restructuring, the revenues were generated by monopolistic structure through a handful of specialized state-owned companies. As the reforms progressed towards free market economy in environment with sluggish internal demand, adopting better strategies may be closely linked to better financial performance of the firm (Luo & Peng, 1999). Moreover, we can see that previous research has linked strategies with performance (Hoskisson et al., 2000; Makhija, 2004), and governance directly with performance (Djankov & Murrell, 2002; Peng, 2004), and consequently in this research we will make an essay to implement the governance and enterprise restructuring EBRD indicator as measure against set of policies.

Economic reforms introduced in Southeast Europe aimed at increasing enterprise efficiency and making their products internationally competitive and thus reforms were tied with structural crisis (Uhlenbruck, Meyer, & Hitt, 2003). The pre-reform environment that was characterized by import protection and export promotion through monopolistic, state-owned foreign trade companies which in many terms crippled the enterprises to meet overseas threats and as a result made the internationalization of their work very difficult. As liberalization of the market forces and privatization progressed they were meant to eliminate the constraints imposed on managers by state ownership and command economy system (Hoskisson et al., 2000; Makhija, 2004). In the case of the Southeast Europe, companies were privatized using range of methods (Claessens, Djankov, & Lang, 2000; Djankov & Murrell, 2002). Thus, the privatization process resulted with diverse range of ownership structures and governance mechanisms (Newman, 2000).

The corporate governance affects enterprises restructuring and financial performance (Hoskisson et al., 2000; Peng, 2004). Indeed, when firms from transition economies are involved in international activities, they are likely to develop their capabilities (Luo & Peng, 1999; Sanders & Mason, 1998). As a consequence of the peculiar characteristics of the capital markets in South-East Europe i.e. lack of well developed capital markets, limited portfolio diversification and liquidity, it is often stated that large shareholders could wish to utilize potential upside of a particular business strategy, but they are frequently restrained and affected adversely by the company's idiosyncratic risk[1] (Maug, 1998). Due to this phenomenon they chose to impose sub-optimal strategies on managers. Moreover, large shareholders in transition countries where the protection of minority investors is low, most often endeavor to take advantage of their power and grasp "private benefits of control". This 'expropriation' can be found in a range of forms, such as 'related party transactions, use of transfer pricing, assets stripping and other forms of "tunnelling" of revenue and assets from firms' (Porta, Lopez-De-Silanes, & Shleifer, 1999; Porta, Lopez-De-Silanes, Shleifer, & Vishny, 1997). Therefore, in such economies high ownership concentration was investors' response to low levels of protection of minority shareholders in emerging markets (Hitt, Keats, & DeMarie, 1998; Porta et al., 1997). Even though we analyze and focus specifically on Macedonia, variations in governance regimes indicate sufficient international analyses of governance and enterprise restructuring in the specific group of economies that undergo serious difficulties in transformation (Apostolov, 2010a; Apostolov, 2011b).

Corporate governance and enterprise restructuring in Macedonia

1. Institutional and legal framework

a) The *institutional framework* is essential in the development of the governance and enterprise restructuring process. There institutions that carry of the process are the Securities Commission and the Macedonian Stock Exchange and are aided by the Central Securities Depository (IFC, 2007).

b) The *legal framework* is comprised of sets of laws and regulations including the first 1996 Company Law its enactment of 2004, as well as, the Securities Law, the Law on Takeovers, the Bankruptcy Law, and the Macedonian Stock Exchange's corporate governance code and listing rules (IFC, 2007).

[1] Another term for unsystematic risk. The variability in the returns of an investment as a result of factors specific to that investment only.

2. Overall assessment of corporate governance characteristics

Macedonia's corporate governance model is consistently built since the beginning of transition to modern market economy. Thus, it complies with the notion that each country shapes its particular way of governance due to its own history, culture, and legal and regulatory framework (Aggarwal & Goodell, 2010; La Porta et al., 2000; La Porta et al., 1998; Porta et al., 1999; Porta et al., 1997). The main characteristics of the Macedonian corporate governance model are (IFC, 2007):

a) *Gradual concentration of ownership* which is reflected through policies leading to dispersed ownership structure of companies to become concentrated over time in a more regular manner. As 2007 IFC Corporate Governance Manual for Macedonian Companies indicates around 300,000 individuals become shareholders in the first phase of the privatization process. Later the process reinforced itself and eventually resulted with 255,000 in 2004 and 105,000 in August 2007 individuals as shareholders. This was result due imposed regulatory reform (Company Law, 1996) and also the development of the capital market urging for voluntary decisions of shareholders to sell their shares on the Macedonian Stock Exchange, characterized with constant default on minority shareholders' and investor protection during this period. However, with creation of the Central Securities Depository (state authority for securities registration), the quality of the process had improved.

b) *Company shareholders as company employees and vice-versa*, describes the phenomenon of the dual role and mutual interaction of these two categories as most of the employees are at the same time shareholders in the company. Thus, there is conflict in the rights and the duties as these two roles, which in essence oppose themselves and exclude each other. Indeed, this characteristic is problem of many transition economies and needs time to be resolved, while is still producing mixed outcomes.

c) As a consequence of the previous two, there is the third main characteristic of the Macedonian economy in light of governance and enterprise restructuring i.e. *lack of* *separation of company's ownership from company's control*. This practice, despite the introduced regulation, is still lagging, hence the unfortunate problem where majority-vote shareholders who most often hold companies' top positions, trigger overwhelming influence over comprehensive daily work of the enterprise. Further, this reduces and prevents the control systems' vigilance and reporting to and from shareholders and investors.

d) The forth important feature derived from the previous, is *the inadequate oversight of management's work*. This is due the fact that members of the supervisory board are individuals with lack of experience directly appointed by the controlling majority shareholders or in submission to the very persons that they are supposed to control.

Research hypotheses

Two basic hypotheses to test governance and enterprise restructuring:

- 1st Hypothesis: Governance and enterprise restructuring depend on set of policies : large-scale privatization, small-scale privatization, price liberalization, competition policy, trade and foreign exchange system, banking reform and interest rate liberalization, securities markets and non-bank financial institutions and overall infrastructure reform; and ,

- 2nd Hypothesis: Governance and enterprise restructuring is significant and improves over time due to imposed policies.

Sample selection and Data

It this paper it is used the same econometric model as in the first article.

The European Bank for Reconstruction and Development (EBRD) Transition Report series have the latest information on the countries that are classified in transition. The data that this prominent organization offers are based on wide network of sources that they obtain from national and international authorities (Apostolov, 2010b; Bennett, 2004a, 2004b; Zinnes, Eilat, & Sachs, 2001). EBRD tracks reforms and assesses the overall process of transition using set of transition indicators, which are formed in comparison to the standards of industrialized market economies.

Further, the data sample is mainly drawn from the extended research and data bases of the European Bank for Reconstruction and Development (EBRD), the Transition Report publication series. Consequently, the data used in this research are taken from their index structure 'economic statistics and forecasts' (Apostolov, 2011b; EBRD, 1994-2009). The scale used in shaping the transition indicators ranges from 1 to 4+, 'where 1 represents little or no change from a rigid centrally planned economy and 4+ represents the standards of an industrialized market economy' (Apostolov, 2011a; EBRD, 1994-2009). There are detailed numbers for the countries in transition analyzing the period of 1989 to 2009 in different areas. These indicators are sorted by sector and country and are analyzing nine arias: large scale privatization, small scale privatization, governance and enterprise restructuring, price liberalization, trade and foreign exchange system, competition policy, banking reform and interest rate liberalization, securities markets and non-bank financial institutions, and overall infrastructure reform (EBRD, 1994-2009; Gouret, 2007).

Model and Econometrics

The econometric model that is used in this study is a regression model where we have estimated the fallowing equation (Freedman, 2005):

$$\gamma i = \beta_o + \beta_1 x_{1i} + \ldots + \beta_p x_{pi} + \varepsilon_i \quad \textbf{(1)}$$

$i = 1,...n$ **(2)**

Thus, applied to our research this model has the fallowing shape:

$$GOV_{i,t} = \beta_o + \beta_1 LSP_{i,t} + \beta_2 SSP_{i,t} + \beta_3 PL_{i,t} + \beta_4 CP_{i,t} + \beta_5 TFS_{i,t} + \beta_6 BRIRL_{\mathrm{i,t}} + \beta_7 SMNBFI_{\mathrm{i,t}} + \beta_8 OIR_{\mathrm{i,t}} + \varepsilon_{i,t}$$
(3)

- where the ***dependent variable***, $GOV_{i,t}$. shows governance and enterprise restructuring;
- the ***independent variables***, are as follows :
  1. $LSP_{i,t}$ large-scale privatization;
  2. $SSP_{i,t}$ small-scale privatization;
  3. $PL_{i,t}$ price liberalization;
  4. $CP_{i,t}$ competition policy;
  5. $TFS_{i,t}$ trade and foreign exchange system;
  6. $BRIRL_{\mathrm{i,t}}$ banking reform and interest rate liberalization;
  7. $SMNBFI_{\mathrm{i,t}}$ securities markets and non-bank financial institutions;
  8. $OIR_{\mathrm{i,t}}$ overall infrastructure reform;
- β is a p-dimensional ***parameter vector*** ;

ε is the ***error term*** or *noise*.

Results and Effects

The *first* hypothesis is that governance and enterprise restructuring depend on set of policies: large-scale privatization, small-scale privatization, price liberalization, competition policy, trade and foreign exchange system, banking reform and interest rate liberalization, securities markets and non-bank financial institutions and overall infrastructure reform. The transition theory explains well the effects of privatization, restructuring, competition, budget constraints, policies of governance and management (Djankov & Murrell, 2002).

The country results of the OLS regression for Macedonia (Figure 2) show that there are good results on correlation and dependence of governance and enterprise restructuring to large-scale privatization. However, the coefficients are negative pointing towards possible lag of governance mostly because of country specific dispersed ownership and agency conflicts as analyzed before (CG Manuel-IFC, 2007). The variable explaining trade and foreign exchange system and its relation to GOV behaves with mixed outcome depending on the model. Further, the price liberalization variable shows good results and there is good evidence and correlation between country's governance, as well as, positive impact on GOV.

The banking reform of the system and the interest rate liberalization demonstrated good results in contribution to the governance and enterprise restructuring. In this analysis the overall infrastructure reform has given important input in improving the overall economic governance, but the negative sign suggests some concern, as the disinvestment in infrastructure is constant lag in transition countries.

On the other hand, governance and enterprise restructuring have strong relation to the small-scale privatization; competition policy and securities markets and non-bank financial institutions. In the case of these variables, the models have shown evidence i.e. $p < 0.001$(and $p < 0.05$).

Figure I.1 Results of OLS on Macedonia

OLS	*Dependent Variable* Governance and enterprise restructuring				
	Macedonia				
Independent Variable	[1]	[2]	[3]	[4]	[5]
lsp	-0.0400841	-0.0718089	-0.0403039	-0.0307779	-0.0546197
	[0.0844591]	[0.1341494]	[0.0802903]	[0.0713962]	[0.0730469]
ssp	0.954126		0.9522068	0.9881459	0.9583012
	[0.2081172]***		[0.1715753]***	[0.1410507]***	[0.2009124]***
pl	0.0632146	-0.0857734	0.0617463	0.0625092	0.0386737
	[0.1236557]	[0.190142]	[0.0891231]	[0.1190298]	[0.1024566]
tfs	-0.0019025	0.2475254		-0.0020039	0.0035742
	[0.1059441]	[0.1448785]		[0.1020113]	[0.1014893]
cp	0.3170152	0.3173858	0.3167068	0.3163479	0.2908476
	[0.0978953]***	[0.1560151]*	[0.0925978]***	[0.0942207]***	[0.0681516]***
brirl	0.0324758	0.4920464	0.0324864		0.031418
	[0.141122]	[0.158304]***	[0.1355862]		[0.1363957]
smnbfi	0.2358248	0.1866295	0.235749	0.2379681	0.2128045
	[0.101816]**	[0.16136]	[0.0977389]**	[0.0976263]**	[0.0796935]**
oir	-0.0878511	-0.1422885	-0.0873017	-0.0868301	
	[0.2280277]	[0.3629135]	[0.2171038]	[0.2195233]	
Constant	-2.513445	-0.0655663	-2.507403	-2.592015	-2.495099
	[0.5982257]***	[0.4299509]	[0.4752273]***	[0.4729974]***	[0.5764654]***
Observations	189				
R-squared	0.9085	0.9182	0.9385	0.8884	0.9283
Adj R-sqrd	0.7808	0.7511	0.7822	0.7822	0.782
Time period	1989-2009				
Standard errors are in parentheses.					
Significance Level:	*** p < 0.01	** p < 0.05	* p < 0.1		

The *second* hypothesis is that the variable governance and enterprise restructuring is significant and improves over time due to imposed policies.

In the analysis (Figure 1) the results confirm this hypothesis with some mixed outcomes i.e. sluggishly improves over time. In fact, the close relation with number of these policies shows the significant impact of these policies to the way the governance and enterprise restructuring was imposed, positively or negatively. Thus, there is significant correlation to SSP, CP, BRIRL and SMNBFI, presenting outcomes to how each of these variables impacts GOV. Nonetheless, over time most of the variables improved and it is clear that there is relationship between them moving upwards.

Further in Figure 2 we can see the movements of governance and enterprise restructuring over time. Also, in this case the analyzed variable moved alongside the increase of the other variables and towards positive upward climb. Figure 3 indicates that even though there is positive movement up, governance and enterprise restructuring is still at the bottom of estimated policies' progress.

Figure I.2 Macedonia's Governance and Enterprise Restructuring

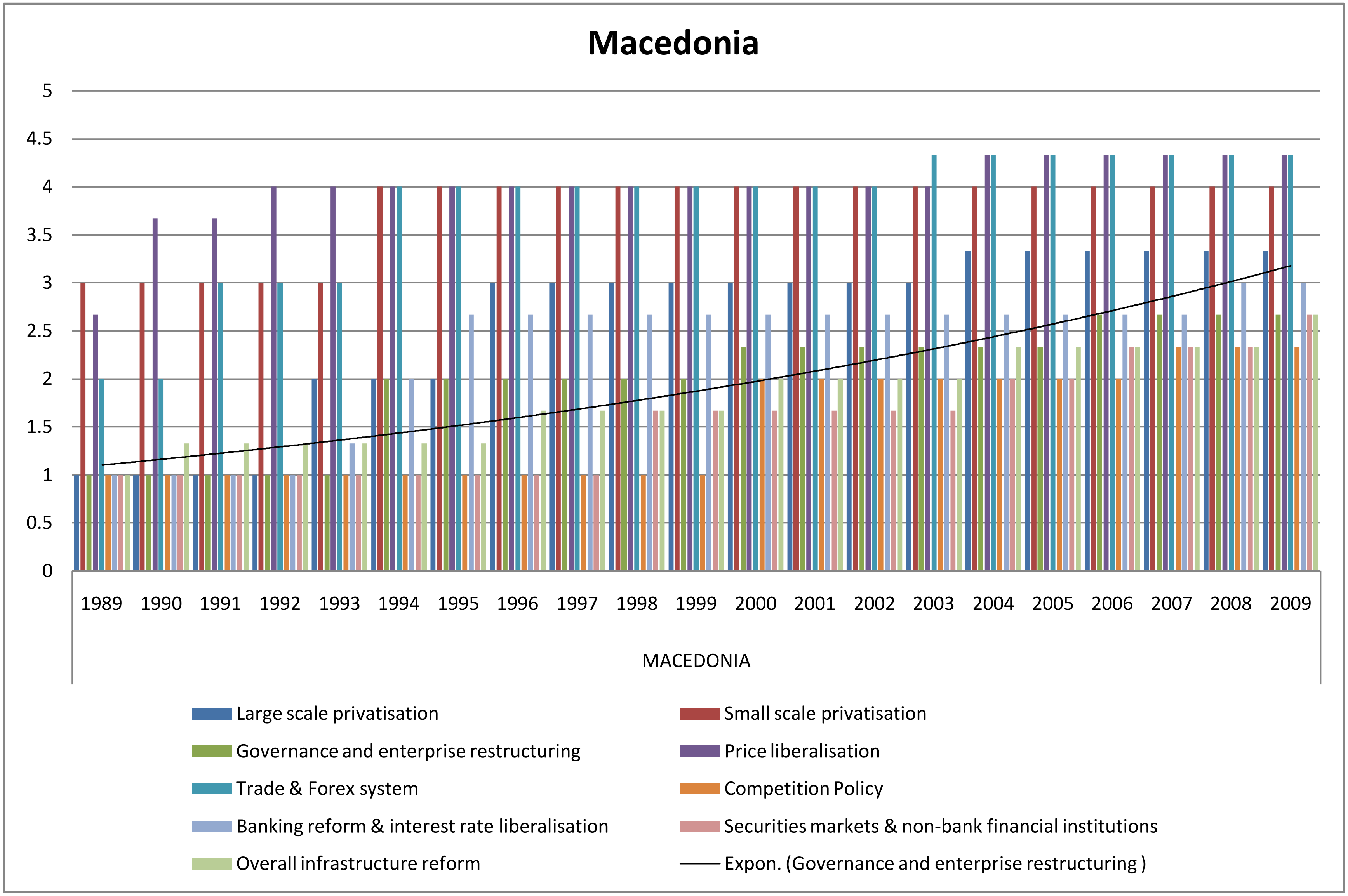
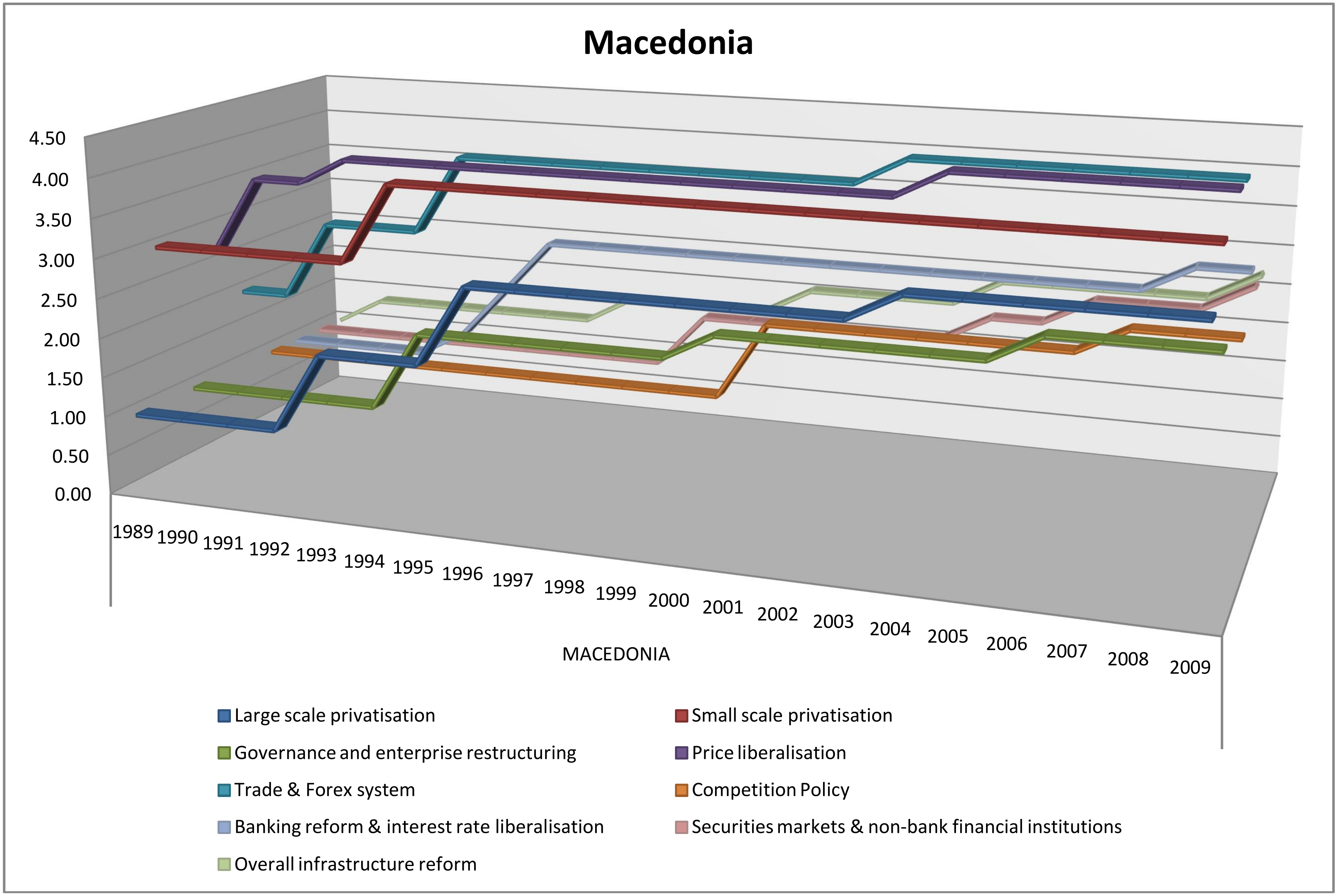


Figure I.3 Indicators' Dynamics



Discussion

On the first assumption that governance and enterprise restructuring depend on imposed set of policies, the analysis showed that there are mixed outcomes. There are positive and negative influences that eventually bring satisfactory picture for the overall governance and enterprise restructuring.

On the other hand, due to analysis of the second assumption it is clear that as the transition process progressed along with the imposed reforms and there is a positive inclination of governance and enterprise restructuring.

However, there is still more to be done in order to bring these economies closer to the standards of developed ones. Indeed, it is needed considerable improvement of corporate governance, institution-building to control agency problems and imposing already adopted regulation, as well as, enforcing new enterprise restructuring policies, within existing policies of overall transition economy restructuring.

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