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I. Attributes to corporate governance and enterprise restructuring in the Macedonian economy

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Abstract:

Corporate governance is most often defined in terms of the roles, responsibilities, and interactions of top management and the board of directors. Using information on Macedonia, obtained through various sources, this study is an attempt on determining some of the factors that influence the development of governance and enterprise restructuring in this economy.

This study is founded on *governance-conduct-performance* paradigm in strategic management. We will examine the possibilities that lead to the following outcomes: A) The degree to which governance and enterprise restructuring is positively related to foreign direct investments, exports and value added (industry and services) in Macedonian economy; B) The degree to which governance and enterprise restructuring is related to: listed domestic companies, market capitalization of listed companies and stocks traded, and presumably that relation is somewhat ambiguous, nonetheless important.

Keywords: corporate governance, enterprise restructuring, transition, SEE, Macedonia

JEL Classifications: G30; G3; G34; G38; L33; O11; P31

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Introduction

Corporate governance is most often defined ‘in terms of the roles, responsibilities, and interactions of top management and the board of directors’ ([Thomas L. Wheelen & Hunger, 2008](#)). Using information on Macedonia, obtained through various sources, this study is an attempt on determining some of the factors that influence the development of governance and enterprise restructuring in this transition economy.

In transition economies the processes of transformation are grave, much turbulent and thus our analysis will observe some of the factors that influence the development of governance and enterprise restructuring in Macedonia. Consecutively, we will be interested to see weather corporate governance and enterprise restructuring, as defined by European Bank of Reconstruction and Development (EBRD) through the indicator ‘governance and enterprise restructuring’([EBRD, 1994-2009](#)), has certain relations to some of the country’s performances and what these supposed relationships are in particular.

This project is founded on *governance-conduct-performance* paradigm in strategic management ([Hitt, Hoskisson, Johnson, & Moesel, 1996](#); [Hitt, Keats, & DeMarie, 1998](#); [Iii & Waring, 1999](#)).

It examines the possibilities that lead to the following outcomes:

- I. The degree to which governance and enterprise restructuring is positively related to foreign direct investments;*
- II. The degree to which governance and enterprise restructuring is positively related to exports ;*
- III. The degree to which governance and enterprise restructuring is ambiguously related to: listed domestic companies, market capitalization of listed companies and stocks traded;*
- IV. The degree to which governance and enterprise restructuring is positively related to value added (industry and services).*

Theoretical and literature framework

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](#)), governance directly with performance ([Djankov & Murrell, 2002](#); [Peng, 2004](#)), and consequently in this research we will make an essay to implement the *governance-strategy-performance paradigm* ([Hitt et al., 1996](#); [Iii & Waring, 1999](#)).

The introduced economic reforms in Southeast Europe (and also Macedonia) aimed at increasing enterprise efficiency and making the products internationally competitive, therefore reforms were tied to structural crisis ([Uhlenbruck, Meyer, & Hitt, 2003](#)). The pre-reform environment 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 ([Djankov & Murrell, 2002](#)). Thus, the privatization process resulted with diverse range of ownership structures and corporate governance mechanisms ([Newman, 2000](#)). Through recent research has been found that performance and internationalization strategies depend and can be enhanced by bigger managerial independence, however it is clear that the second depends of firm's corporate governance, and in particular of the ownership structure and board composition ([Hoskisson et al., 2000](#); [Uhlenbruck et al., 2003](#)).

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 ([Sanders & Mason, 1998](#)), which implies a positive relationship between governance exports and financial performance ([Luo & Peng, 1999](#)).

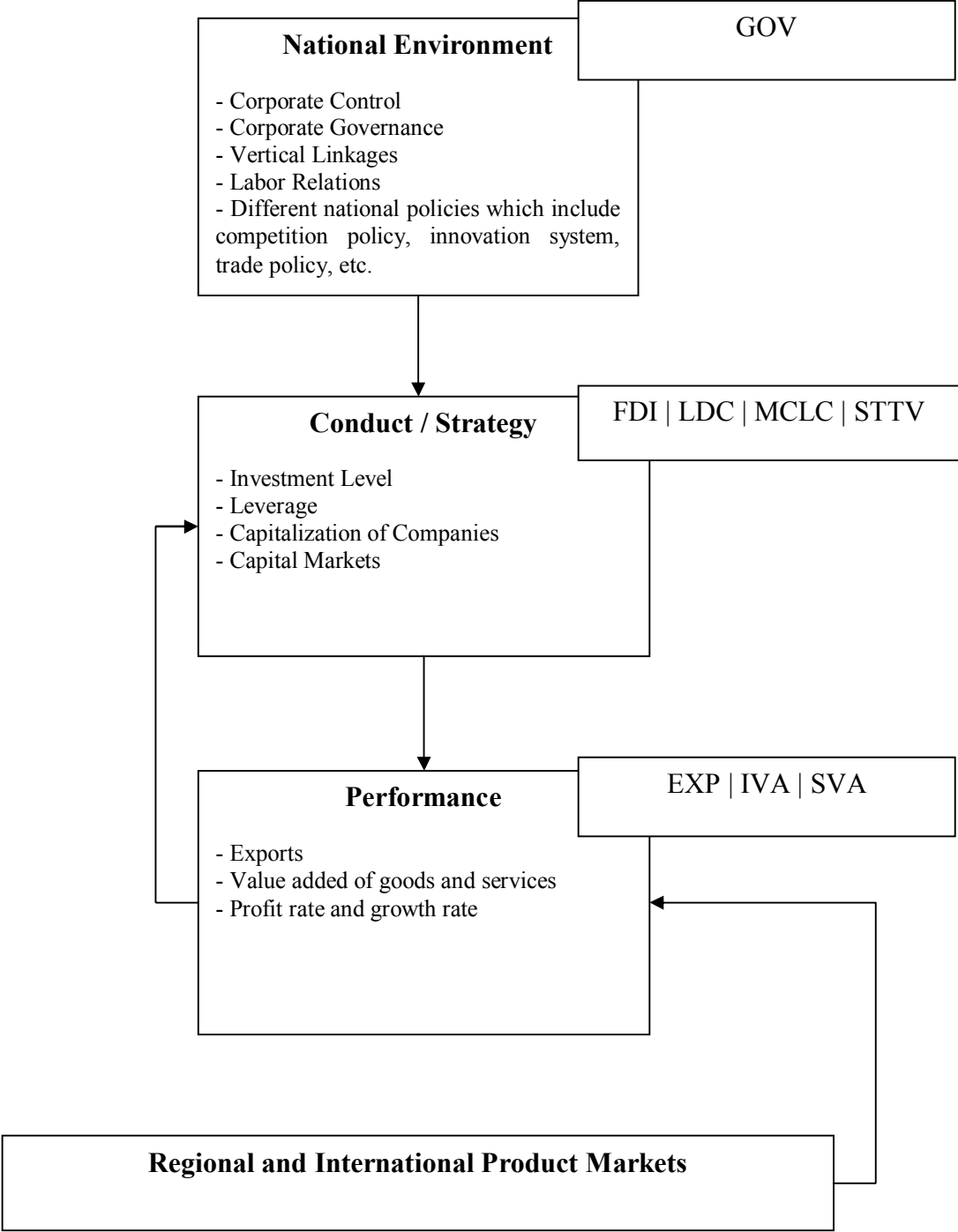
As a consequence of the peculiar characteristics of the capital market in Macedonia i.e. lack of developed capital markets, limited portfolio diversification and liquidity, it is often stated that large shareholders could wish to utilize potential upside of a particular business strategy, but they are frequently restrained and affected adversely by the company's idiosyncratic risk¹ ([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 "tunneling" of revenue and assets from firms' ([La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 2000](#); [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 ([Shleifer & Vishny, 1997](#)).

Even though we analyze and focus specifically on Macedonia, variations in governance regimes indicate sufficient international analyses of the links between governance and enterprise

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

restructuring and other parameters of the national economy ([La Porta et al., 2000](#); [La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1998](#); [Porta, Lopez-De-Silanes, & Shleifer, 1999](#); [Porta et al., 1997](#); [Shleifer & Vishny, 1997](#)).

Figure I.1 Governance-Conduct-Performance paradigm



Analytical Framework

1. Sample selection and Data

This study is based on sources provided by the data bases of the European Bank for Reconstruction and Development (EBRD) ([EBRD, 1994-2009](#)), the World Bank Database², the National Bank of the Republic of Macedonia³ and the Macedonian Stock Exchange⁴, for the period of 1996-2008.

Further, the World Bank Database is comprised of many sources gathered from: Standard & Poor's and supplemental S&P data, World Bank national accounts data, International Monetary Fund, International Financial Statistics and Balance of Payments databases, Global Development Finance, Emerging Stock Markets Factbook, OECD GDP estimates, OECD National Accounts data files.

The data sample of the European Bank for Reconstruction and Development (EBRD) i.e. Transition Report publication series used in this research are taken from their index structure 'economic statistics and forecasts' ([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' ([EBRD, 1994-2009](#)).

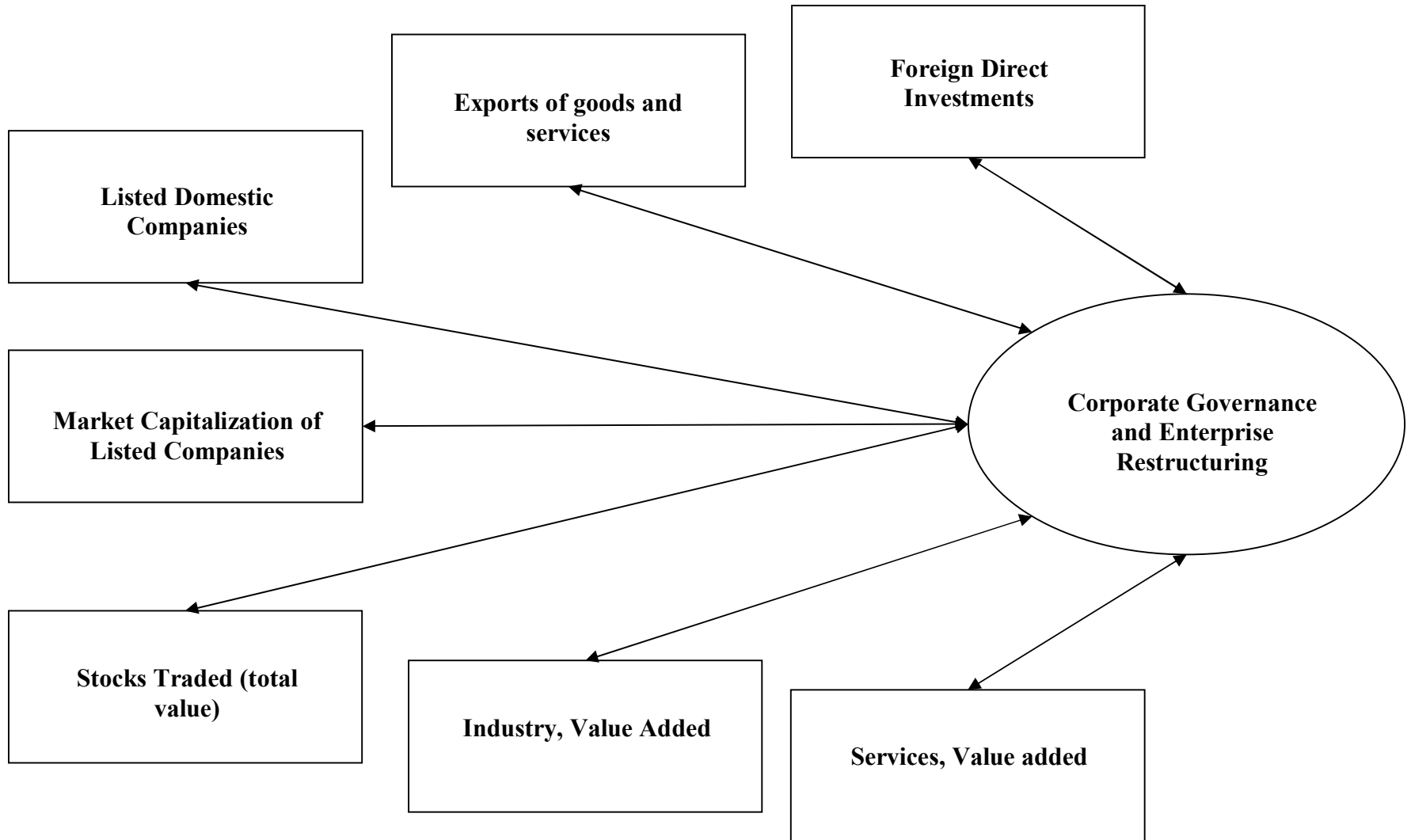
The data taken from the Macedonian Stock Exchanges and the National Bank of the Republic of Macedonia is relatively good and viable for research, as the institutional requirements are close to those in developed countries, as the European integration processes and the implementation of European Directives keep the standards constantly up to date.

² World Bank Database, Available at: <http://data.worldbank.org/>

³ National Bank of the Republic of Macedonia: <http://www.nbrm.gov.mk/>

⁴ Macedonian Stock Exchange: <http://www.mse.org.mk/>

Figure I.2 Analytical Framework



2. Model and Econometrics

The econometric model that is used in this study is a regression model where we have estimated the following equation ([Freedman, 2005](#); [Gelman, 1996](#); [Gilks, Richardson, & Spiegelhalter, 1996](#)):

$$y_i = \beta_0 + \beta_1 x_{1i} + \dots + \beta_p x_{pi} + \varepsilon_i \quad (1)$$

$$i = 1, \dots, n \quad (2)$$

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

$$GOV_{i,t} = \beta_0 + \beta_1 FDI_{i,t} + \beta_2 EXP_{i,t} + \beta_3 LDC_{i,t} + \beta_4 MCLC_{i,t} + \beta_5 STTV_{i,t} + \beta_6 IVA_{i,t} + \beta_7 SVA_{i,t} + \varepsilon_{i,t} \quad (3)$$

- where the **dependent variable**, $GOV_{i,t}$, shows governance and enterprise restructuring;
- the **independent variables**, are as follows :
 1. $FDI_{i,t}$ foreign direct investments;
 2. $EXP_{i,t}$ exports of goods and services
 3. $LDC_{i,t}$ listed domestic companies, total
 4. $MCLC_{i,t}$ market capitalization of listed companies
 5. $STTV_{i,t}$ stocks traded, total value
 6. $IVA_{i,t}$ industry, value added
 7. $SVA_{i,t}$ services, value added
- β is a p -dimensional **parameter vector** ;
- ε is the **error term** or *noise*.

Figure I.3 Definition of variables

Definition of variables		
<i>dependent variable</i>		
0.	GOV - Governance and Enterprise restructuring	<p><i>Governance and Enterprise restructuring</i></p> <p>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.</p> <p>Source: EBRD</p>
<i>independent variables</i>		
1.	FDI - Foreign direct investment, net inflows (BoP, current US\$)	<p><i>FDI are Foreign direct investment, net inflows (BoP, current US\$)</i></p> <p>Foreign direct investment are the net inflows of investment to acquire a lasting management interest (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor. It is the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital as shown in the balance of payments. This series shows net inflows (new investment inflows less disinvestment) in the reporting economy from foreign investors. Data are in current U.S. dollars.</p> <p>Source: International Monetary Fund, International Financial Statistics and Balance of Payments databases, and World Bank, Global Development Finance.</p>
3.	EXP - Exports of goods and services (% of GDP)	<p><i>Exports of goods and services represent the value of all goods and other market services provided to the rest of the world.</i></p> <p>They include the value of merchandise, freight, insurance, transport, travel, royalties, license fees, and other services, such as communication, construction, financial, information, business, personal, and government services. They exclude compensation of employees and investment income (formerly called factor services) and transfer payments.</p> <p>Source: World Bank national accounts data, and OECD National Accounts data files.</p>
4.	LDC - Listed domestic companies, total	<p><i>Listed domestic companies, total</i></p> <p>Listed domestic companies are the domestically incorporated companies listed on the country's stock exchanges at the end of the year. This indicator does not include investment companies, mutual funds, or other collective investment vehicles.</p> <p>Source: Standard & Poor's, Emerging Stock Markets Factbook and supplemental S&P data.</p>

Continuation

<i>independent variables</i>		
5.	MCLC - Market capitalization of listed companies (% of GDP)	<p><i>Market capitalization (also known as market value) is the share price times the number of shares outstanding.</i></p> <p>Listed domestic companies are the domestically incorporated companies listed on the country's stock exchanges at the end of the year. Listed companies does not include investment companies, mutual funds, or other collective investment vehicles.</p> <p>Source: Standard & Poor's, Emerging Stock Markets Factbook and supplemental S&P data, and World Bank and OECD GDP estimates.</p>
6.	STTV - Stocks traded, total value (% of GDP)	<p><i>Stocks traded refers to the total value of shares traded during the period.</i></p> <p>This indicator complements the market capitalization ratio by showing whether market size is matched by trading.</p> <p>Source: Standard & Poor's, Emerging Stock Markets Factbook and supplemental S&P data, and World Bank and OECD GDP estimates.</p>
7.	IVA – Industry, value added (% of GDP)	<p><i>Industry corresponds to ISIC divisions 10-45 and includes manufacturing (ISIC divisions 15-37).</i></p> <p>It comprises value added in mining, manufacturing (also reported as a separate subgroup), construction, electricity, water, and gas. Value added is the net output of a sector after adding up all outputs and subtracting intermediate inputs. It is calculated without making deductions for depreciation of fabricated assets or depletion and degradation of natural resources. The origin of value added is determined by the International Standard Industrial Classification (ISIC), revision 3.</p> <p>Source: World Bank national accounts data, and OECD National Accounts data files.</p>
8.	SVA - Services, etc., value added (% of GDP)	<p><i>Services correspond to ISIC divisions 50-99 and they include value added in wholesale and retail trade (including hotels and restaurants), transport, and government, financial, professional, and personal services such as education, health care, and real estate services.</i></p> <p>Also included are imputed bank service charges, import duties, and any statistical discrepancies noted by national compilers as well as discrepancies arising from rescaling. Value added is the net output of a sector after adding up all outputs and subtracting intermediate inputs. It is calculated without making deductions for depreciation of fabricated assets or depletion and degradation of natural resources. The industrial origin of value added is determined by the International Standard Industrial Classification (ISIC), revision 3.</p> <p>Source: World Bank national accounts data, and OECD National Accounts data files.</p>

Results and Effects

The study adopts variables that are compatible to *governance-conduct-performance* paradigm in strategic management ([Hitt et al., 1996](#); [Hitt et al., 1998](#); [Iii & Waring, 1999](#)), and using OLS regression gives answers to the posed hypotheses:

1. The degree to which governance and enterprise restructuring is positively related to foreign direct investments

The results of the OLS regression, depending on the model, show different significance ($p < 0.01$, $p < 0.05$ and $p < 0.1$). This points out that there is evidence that governance and enterprise restructuring is positively related to foreign direct investments (FDI).

The ownership structure of the companies that produce most of Macedonia's domestic product is moving towards dominant participation of foreign direct investments, hence members of board that are foreigners which is important impact on the way corporate governance is conducted and its future prospects ([IFC, 2008](#)).

2. The degree to which governance and enterprise restructuring is positively related to exports

Exports (EXP) are very important component of country's economy, as they represent the value of outputs that are compatible on international markets, thus exports stand for the core value of the economy. The models in this study show significance of $p < 0.05$ and $p < 0.1$, which can be taken as evidence in support to this hypothesis.

This variable shows good and stable results in different models always giving results that go in favor of the posed hypothesis. Hence, it is evident that governance and enterprise restructuring is positively related to exports, which is at length explained in the literature through many case studies and empirical examinations ([Aulakh, Kotabe, & Teegen, 2000](#); [Bernard & Bradford Jensen, 1999](#); [Clerides, Lach, & Tybout, 1998](#)).

Figure I.4 OLS on Macedonia

OLS	Dependent Variable										
	Governance and enterprise restructuring										
Independent Variable	Macedonia										
	[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]	[9]	[10]	[11]
FDI	0.0004198 [0.0003011]*	0.0003968 [0.0002313]*	0.0006149 [0.000185]***	0.0006066 [0.0002495]**							
EXP	0.0128715 [0.0096059]*	0.0138421 [0.0065788]*	0.0120253 [0.0061497]*	0.0026239 [0.001181]*	0.0221788 [0.007264]**	0.0187067 [0.0066181]**					
LDC	0.0023395 [0.0015107]*	0.0021274 [0.0010159]*	0.0028694 [0.000819]***			0.0021813 [0.0011321]*	0.0032371 [0.0016764]*	0.0030523 [0.0022172]	0.0030526 [0.0014519]*		
MCLC	-0.0019121 [0.0085776]						-0.0003502 [0.0095783]	0.0070824 [0.0115265]		0.0030523 [0.0083757]*	
STTV	0.0102849 [0.047734]						0.0442949 [0.0492703]	0.0631784 [0.0598984]		0.0080859 [0.0465195]	
IVA	0.0452572 [0.0714842]*	0.0458168 [0.0603836]		0.0875782 [0.0681573]	0.0725762 [0.0602511]	0.1047018 [0.0553845]*	0.1716308 [0.0583034]**		0.2256834 [0.046851]***		0.2110666 [0.053674]***
SVA	0.0792699 [0.0753913]*	0.0781704 [0.0638924]		0.1057383 [0.074738]	0.1426811 [0.0621923]**	0.148559 [0.0546022]**	0.2023326 [0.065463]**		0.2560758 [0.052214]***		0.277355 [0.059340]***
Constant	-4.288757 [6.265517]	-4.270065 [5.319115]	1.544574 [0.235429]***	-6.609103 [6.216735]	-8.906548 [5.09977]	-10.17887 [4.518894]*	-14.61289 [5.330305]**	2.041323 [0.11047]***	-19.24564 [4.242581]***	2.15636 [0.075419]***	-19.86619 [4.902935]***
Observations	104	78	52	65	52	91	78	52	52	39	39
R-squared	0.9276	0.9268	0.8947	0.8805	0.8478	0.896	0.8445	0.6274	0.7922	0.549	0.6902
Adj R-sqrd	0.8262	0.8745	0.8596	0.8208	0.7971	0.8441	0.7334	0.5032	0.723	0.4588	0.6282
Time period	1996-2008										
Standard errors are in parentheses.											
Significance Level:	*** p < 0.01	** p < 0.05	* p < 0.1								

3. The degree to which governance and enterprise restructuring is ambiguously related to: listed domestic companies, market capitalization of listed companies and stocks traded

The relation of governance and enterprise restructuring to the variables representing listed domestic companies, market capitalization of listed companies and stocks traded was tested and gave rather mixed results.

The variable showing listed domestic companies (LDC) in almost all models showed significance ($p < 0.01$ or $p < 0.1$). Hence, it could be claimed that the increase and presence of domestic companies that are capable to fulfill the criteria to be listed on the Macedonian Stock Exchange is important attribute to governance and enterprise restructuring.

As for the other two variables, market capitalization of listed companies (MCLC) and stocks traded (STTV) there aren't significant outcomes.

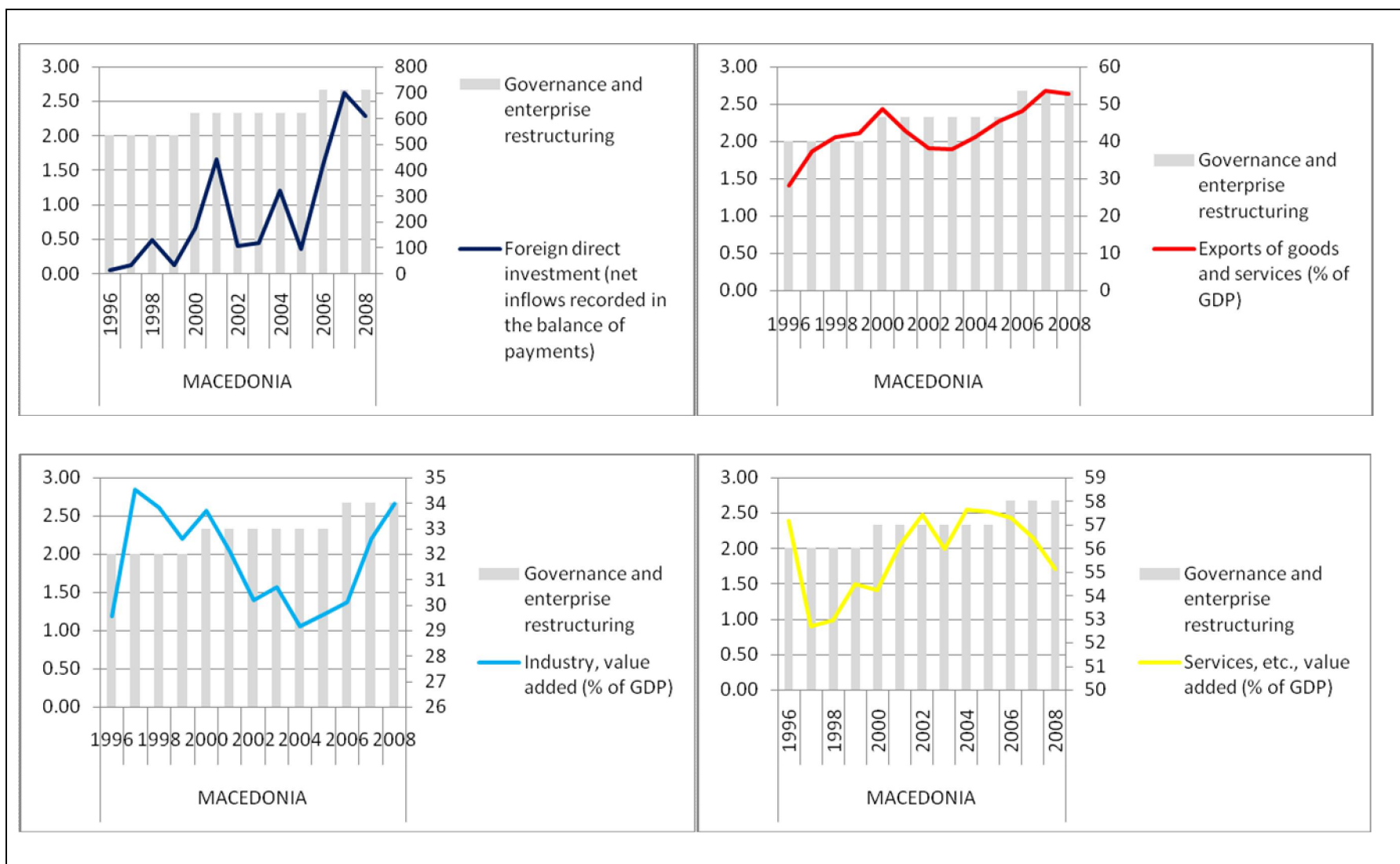
4. The degree to which governance and enterprise restructuring is positively related to value added (industry and services)

The variables explaining value added in industry (IVA) and value added in services (SVA) were tested for a relationship with governance and enterprise restructuring.

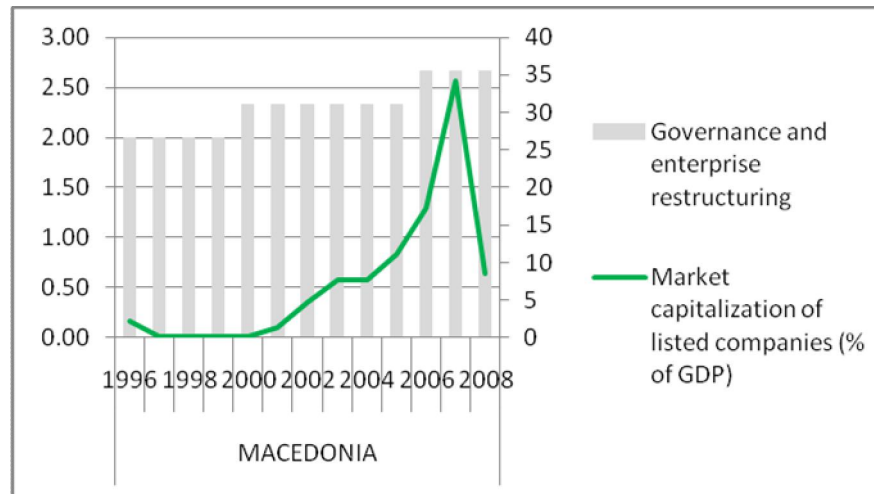
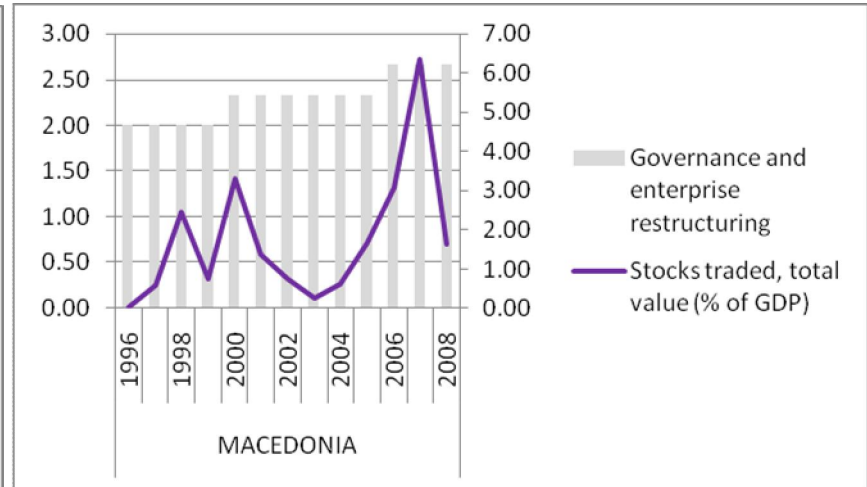
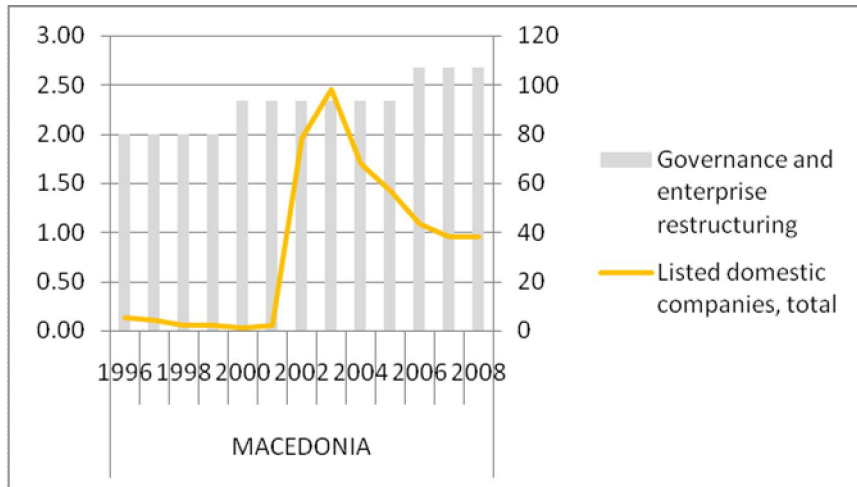
Further, the results on value added in industry (IVA) in most of the OLS regression models comport with decent significance ($p < 0.01$ or $p < 0.5$). Thus, this demonstrates a relation of value added in industry to overall governance and enterprise restructuring.

As far as the variable explaining value added in services (SVA) is concerned, the outcomes and conduct is almost the same as IVA, even though the curve it gives is quite different from that of value added in industry.

Figure I.5 Variables' movements in governance and enterprise restructuring



Continuation



Discussion

The purpose of this analysis was to test four hypotheses, that is, the extent to which governance and enterprise restructuring is positively related to foreign direct investments, exports and value added (industry and services), as well as, the extent to which governance and enterprise restructuring is related to listed domestic companies, market capitalization of listed companies and stocks traded. Further, as a conceptual framework the study used governance-conduct-performance paradigm in strategic management.

Hence, the findings of the regression analysis point out that there is evidence to tie positive developments in governance and enterprise restructuring to foreign direct investments, exports and listed domestic companies. On the other hand, there is inconclusive evidence on market capitalization of listed companies and stocks traded to the extent of their impact on corporate governance and enterprise restructuring. Finally, there are significant results on value added in industry and services.

This paper is a contribution to the research developing the business aspects of the Macedonian economy, as there is constant lack of scientific papers that deal with the specific issues of corporate governance and enterprise restructuring.

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