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CORPORATE BOARDS: PRACTICES AND TENDENCIES FOR BULGARIA*

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***Resume:** Practices of corporate boards are the focus of researchers in the last decade. The dynamics of external environment determined necessity of reforms in corporate governance. Institutional pressure and new requirements of stakeholders to practices of boards have changed traditions and evolution to convergence and revolution.*

***Keywords:** corporate governance, corporate boards*

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The last decade has outlined corporate governance as a key factor for the development of economy and society. Mistakes made of the companies identified a number of measures to improve practices in corporate governance. Originated as an internal matter, corporate governance has become a leading item on the agenda of external analysts.

The relationships "principal-agent" has led to overlapping of interests between them to reporting short-term profit. Despite the existence of external players in corporate governance, internal problems infiltrated and took over from the external environment. Actions taken to improve corporate governance practices affect all participants: shareholders, managers, auditors and regulators.

The modern Corporate Governance projects mark the biggest changes in the practices of boards. The institutional pressure and updated requirements of stakeholders led to the evolution in practices to revolution [10, 1]. The national traditions account for the greater dynamism to the convergence of the practices of boards: composition of the board, fold level of stakeholder engagement and risk management. External factors have combined effect by requiring for increased transparency to the management practices and active regulatory environment.

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The board is one of the most important mechanisms in modern companies. Setting practices on board is of particular importance for the development of the company due to the deployment of rights for decision making and the responsibility for decisions.

In corporate governance the boards perform a dual role. On the one hand, to protect the interests of company, the boards carry out a control on executive management. On the other hand, they carry out a representative function between the company and its external environment [7, 55].

The importance of corporate boards reflected in a wide academic literature and in the focus of supervisors. Due to data availability and comparability, the majority of the literature on the boards is focused on research for US companies. The diversity of practices on board in the EU is particularly important because many of the regulatory proposals emerged at the beginning of the crisis to change the practices of European boards. The most ambitious proposals are aimed at reforming the boards of financial intermediaries because of their importance to the development of economy and society.

The corporate governance practices are varied at macro level as well as individual countries differ in territorial organisation, standard of living, political and economic history. In economic development boards become participants in corporate governance due to the transfer of control rights from the state of shareholders. The change in shareholder liability from unlimited to limited gives them a reason to participate in the selection of the composition and practices of boards. The first boards are necessarily included only shareholders of the company – the composition is reflected by the ratio between majority shareholders. The historical dynamics of corporate governance professionalise the activities of the boards, which is outsourced for a limited period - one year for the Anglo-Saxon countries and five years for continental countries.

In the late Middle Ages in Europe have imposed practices for collective management. It included a representative body for public institutions - city councils, parliaments, professional guilds, church [6, 32]. For members of the representative body were chosen socially significant persons with large public authority.

The first corporate structures of the sixteenth century (shipping guilds, commercial banks and some forms of monopoly for carrying out of foreign trade) did not include boards and managed by managers called governors. They have rights beyond current notions of managers, incl. diplomatic immunity and some tax powers. Their appointment has been made by decree of overlord (octroi de licence). Their functions were limited to determining the commercial networks for sailing and supplies.

The Industrial Revolution (XVIII c.) changes the practices on board due to expansion of activities of the companies. The family property provides the management outside from the family parties, most have been elected officials with the greatest experience in the company. The control over the managers is carried out by the family board or by professional guilds, which can be considered as the forerunner of two-tier system.

At the end of the nineteenth century, in the railway companies established one-tier system. For effective management of the property were appointed proven industrialists and traders. The control was exercised over the board by person, authorized by the State, to comply with the fiscal discipline. The history notes a conflict between the interests of an individual company and the interests of society. Began appointment of a supervisory body, often called the "Committee", for advising the board in making the decision and review the documentation and real property.

Since 1861 the state policy of Germany competition with France and England approved a two-tier system. It includes a management board, composed of industrialists, and supervisory board, which includes representatives of state bodies, controlling shareholders and lending banks. The function of the state as a monitor over the companies is transferred to the supervisory board, which in 1937 began to recruit board members instead of the general meeting of shareholders.

In Bulgarian history corporate boards marked his start of the first Commercial Law (1897 г.). The only system of two-tier management was: general meeting of shareholders, the examiner board and management board. The participation of the majority shareholders in management boards are made on a proportional basis on the grounds of greater engagement in

managing. In rare cases, minority shareholders appeared as board members, mainly because of their expert skills.

In the recent history of Bulgaria, the Commercial Law (1991) allows the French system: a choice between one-tier and two-tier system. Currently thirteen Member States have adopted the French system: Bulgaria, Croatia, Denmark, Finland, France, Hungary, Italy, Lithuania, Luxembourg, Netherlands, Portugal, Romania and Slovenia. The preference for a one-tier or two-tier system does not increase the composition of the board - EU companies with two-tier structure have an average of 9 members (the Netherlands) to 14 members (Germany), which is not higher than the one-tier system in the US [4, 199].

Corporate boards play a key role in corporate governance and are therefore regulated by company law and corporate governance codes [3]. Notwithstanding the general basis for the rules of the board, remain significant differences. They arise from the structure of shareholder composition; the historical, political and social development; the presentation of staff in the board. With the emergence of the movement toward corporate governance codes, there is a clear trend towards convergence of minimum requirements for boards.

In Bulgaria, as in most countries in Eastern Europe are used different practices of corporate boards. The diversity is determined by historical and legal heritage, and the choice made during the transitional period [7, 55]. The main factors in determining the type of board practices are:

- Nationality of the capital. In companies with foreign capital is applied two-tier system, with a view to protecting the interests of shareholders to solve the agent conflict. In practice this case refers to subsidiaries of financial intermediaries Companies with Bulgarian capital apply one-tier system.

- Mode of occurrence. For holding groups and privatized companies in which dependence on the historical development (path dependence) is large, apply two-tier system. Practices in start-ups indicate a one-tier system.

- Status of the company. Modern preferences are for switching to one-tier system for companies coming out of the stock exchange. The listing leads to replacement of the

supervisory board by the stock exchange and related financial analysts in the exercise of control functions. 75% of public companies in Bulgaria have adopted a one-tier system because the better option for the appointment and dismissal of the CEO [13].

- Size and scope of activity. Companies with diversified products and wide geographical coverage implement two-tier system. On the other hand, companies with limited scope and activities apply one-tier system. It should be referred and sector of activity: in financial intermediation system is two-tier system, while companies in the real sector – one-tier system.

The modern practice at international level respects two processes - convergence and divergence. Convergence of practices conducted in respect of the board, while shareholders retain practices according to the shareholder structure. Convergence in practices of boards in the EU is due to the pressure of competition, the support of governments and institutional investors. The convergence is evident in the national codes on corporate governance than in the statutes of companies.

The practices of boards in the EU have made some harmonization, but there are still gaps in terms of [1, 5]:

- ratio of the number of outside directors in the board;
- independence of the chairman of the committees with supervision functions;
- requirements for education and experience of the chairman of the board;
- rights for the nomination of managers [5, vii];
- participation of employee in decision making.

Prospects for the practices of boards in Bulgaria are consistent with those in the EU:

- Strengthen on the obligation for reporting by the boards. After Bulgaria's full membership in the EU, the practices of the boards are reported in Global Competitiveness Report. The World Economic Forum examined the effectiveness of corporate boards as reporting of managers to the board and shareholders. For the past six years the indicator for Bulgaria has dropped from 96th position (2008) [9, 119] to 127th position (2013) [11, 139]. The European

Commission recommendations are to encourage the shareholders to attend general meetings and exercise their voting rights wisely for control over managers [2].

- Control over executive remuneration. Should be paid more attention to the role of institutional investors for giving statements on issues related to salaries. The aim is to reduce the "risk appetite" for short-term results and managers to be materially interested in the future of the company.

In many countries, the ability of the board to monitor effectively the remuneration of executive directors, recommended by the Corporate Governance Principles of the OECD, is a key change in practice and remains one of the central elements of the debate on corporate governance [8, 7]. The nature of this challenge goes beyond the level of remuneration of the executive members and directors, because that is the focus of more political discourse, to orient how the remuneration commitments and motives they harmonize with the long-term interests of the company.

- Number of non-executive members to the supervisory board/board of directors. The independence of the board (the ratio of directors designated as independent non-executive directors) has increased in both the EU and the US, but levels of independence are higher in the US (74%) than in the EU (34 %) [4, 192]. Variations in the size of the board are dictated by company size and industry classification. Small companies reduce both board size and independence of board. Such changes are related to companies with weak results that change their board to increase the focus and improve its expertise.

For Bulgaria the number of executive members is provided in the requirements of the law to public companies only. They at least 1/3 of the members of the supervisory board/board of directors must be independent members.

- Establishment of committees with control functions. The European Commission recommendations are to complement national codes with three key committees: nomination committee, remuneration committee and audit committee. Audit committees are required by law for companies that operate in the public interest. In Bulgaria, through legislation, only commercial banks and insurance companies are required presence of audit committee and remuneration committee.

- Participation of employees in the company's management. For example, in Germany through the legislative requirement is provided one of the members of the supervisory

board must be elected by the employees. In Bulgaria, according to the Commerce Act, is provided a situation in which an employee has the opportunity to participate in the general meeting of shareholders in an advisory capacity.

- Participation of minority shareholders on the board. It is achieved by nominating a member of the supervisory board/board of directors of minority shareholders. Thus enabling to protect the rights and interests of minority shareholders.

- Diversification of the composition of the boards by profession, nationality and gender. While markets become transnational, their management structures remain national. A greater diversity of board members will improve the quality of debates and processes of decision-making.

- Separation of the functions of chairman and CEO. In Bulgaria, the regulatory requirements for separating the functions of chairman of the board and CEO have been introduced for insurance and pension companies only [12, 6].

- Active participation of institutional investors. It includes large shareholders to publish their voting policy. This means controlling shareholders to clearly indicate whether profit oriented or social interests.

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The practices of corporate boards determine the level of development of market principles and the level of convergence. The modern trends mark a convergence of practices in terms of accountability of the board to shareholders and to stakeholders.

Bulgarian law trends in the EU, taking into account the degree of implementation of best practices. The biggest changes and convergence towards the European practices is at the boards of financial intermediaries - companies with cross-border operations and foreign ownership.

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