IMPORTANCE OF CORPORATE GOVERNANCE

Zoran Vukčević
Directorate for Development of Small and Medium Size Enterprise, Podgorica, Montenegro,
zoran.vukcevic@t-com.me

Summary:*The state creates a systemic environment to guarantee the rights of the company owners to get registered and to invest. Companies engage in business activity and earn profit, thus affecting the environment around them. However, through the institute of corporate management the society demands from the companies to act in a collective manner that will serve its interests in the best way. This is achieved by creating an environment conducive to investments and competition, encourages development, productivity and motivates managers and employees, while the use of formal and informal rules limits the abuse of authority.*

Key words: *corporate governance, systemic environment*

1. INTRODUCTION

Corporate governance creates the structure, in which the company objectives are defined, tools for their achievement and supervision by the owner over the operations of the company. If the corporate governance system is sound, it will give effective incentives to achieve the objectives in the best interest of the company and the shareholders. This will contribute to the more efficient supervision over operations, with direct impact on the effective use of resources in the company.

Dynamic business environment requires from business companies to be flexible and to react quickly to the market demands.[1] In a market economy, corporate governance encourages economic development, ensures economic growth and allows companies to get involved in long-term projects.

Corporate governance can be defined in a usual manner, "corporate governance is a system through which companies are managed and supervised"[2]. In this way, corporate governance is defined as a set of mechanisms through which the company operates when ownership is separated from management.

The commonly seen issues with corporate governance do not arise in all types of companies, but can arise only in the ones where there are several owners and where ownership and management are two separate areas.

There are two central issues regarding corporate management, and their existence and solution depend on the ownership structure in the company. On one hand, in the shareholding companies with dispersed ownership, the basic difficulty is how the external shareholders can control performance of the managers if they do not have enough power to influence them. On the other hand, in the companies with a small number of owners, managers are usually controlled by the

[1] Milenović, B. and Ratković, M.: Marketing, Cekom books, Sremski Karlovci, 2012. str. 35.
[2] *Report of the Committee on the Financial Aspects of Corporate Governance* (Cadbury Report), 1992

biggest owner/s, so the main issue when it comes to good corporate governance is how the minority shareholders can prevent the controlling owner/s from achieving excessive benefits through actions that are harmful for minority owners.

2. FUNDAMENTS OF CORPORATE GOVERNANCE

Corporate governance deals with relations between various stakeholders in the limited liability company; it is the manner in which the shareholders, directors, managers and suppliers, employees, main clients and communities mutually interact. Formal and informal rules of corporate governance can be found in the legal, institutional and regulatory framework of every country.

Corporate governance represents a key element in improving economic efficiency and growth, as well as increased trust of the investors. Corporate governance also ensures structure, through which company goals are set, as well as ways to achieve those goals and monitoring of results. Good corporate governance should ensure adequate incentives to the Board of Directors and the management in the achievement of goals that are in the interest of the company and its shareholders, as well as ensure easier and more efficient monitoring. Companies must build mutual trust with the byers bz guarantying satisfaction, safety and privacy.[3]

Corporate governance depends on a reliable and functional legal system and institutional environment that enable establishment of corporations and their proper operations. However, such an environment can be created through positive development that will prevent abuse of authority, and investments will not be made until the companies feel certain that the risk of the project and the risk of the “state” are bearable.

3. IMPORTANCE OF CORPORATE GOVERNANCE

Corporate governance contributes to growth and development of the corporation itself, the related activities and the state in general. For a long time now the role of the company is not only to produce or provide services and make profits in this way. Companies take responsibility for development of the social environment. It is not possible to ensure development of the company relying only upon the interest of the company, while neglecting the overall development of the community.

Corporate governance contributes to improved efficiency and effectiveness of the economic system. The existence of an efficient system of corporate governance within a company or the economy as a whole helps to reach the level of trust necessary for proper operations of a market economy. As a result, we have lower cost of capital; companies are encouraged to efficiently use resources, thus supporting growth.

4. PRINCIPLES OF CORPORATE GOVERNANCE (OECD)

Existence of a good system of corporate governance ensures transparency, fairness and accountability to the shareholders and other stakeholders in the company. Key role of corporate governance is to introduce the instruments for supervision of managers’

[3] Milenović, B. and Ratković, M.: Marketing, Cekom books, Sremski Karlovci, 2012. str. 33.

behavior, to ensure corporate responsibility and cost-effective protection of interests of investors and the society with regard to the insiders.

Recognizing the importance of corporate governance, OECD requested (1998) definition of corporate governance standards and guidelines for the national governments of the member states, other relevant international organizations, including the World Bank and the private sector. The principles represent a general basis that the countries find important for development of good governance practice. They are supposed to be concise, understandable and accessible to the international community and they focus on the following[4]:

- ***I. Creating basis for efficient corporate governance framework***
- ***II. Rights of shareholders and key ownership functions***
- ***III. Equal treatment of shareholders***
- ***IV. Role of stakeholders in corporate governance***
- ***V. Data disclosure and transparency***
- ***VI. Responsibility of the Board***

By observing these principles corporate governance can ensure strategic management of the company, efficient supervision of the management and responsibility to the company and the shareholders.

5. ROLE OF THE STATE IN CORPORATE GOVERNANCE

Role of the state in corporate governance consists of improving and encouraging development of companies and ensuring responsibility in the exercise of power, as well as protection. Local entrepreneurs in the markets of the developing countries need political initiative to convince local and foreign sources of finance to enter the market. The state is obliged to give guidelines and to:

- Ensure incentives and sanctions for companies
- Balance gap between wages in the public sector and private companies
- Protect the interests of persons who have an interest in the company.

Lessons to be learned from successful market economies are that the state policy should strive to create an environment that leads to the following:

- Easing the initiation of business activity
- Reducing the obstacles for business arrangements
- Friendly and fair tax environment
- Service oriented state administration
- Provision of export incentives
- Incentives for job creation and regional objectives
- Protection of persons having an interest in the company (suppliers, clients and employees)

[4]OECD Principles of Corporate Governance - 2004 Edition, OECD Mission to Serbia and Montenegro

- Protection of rights of shareholders

The state should support the stock market as one of the important sources of capital investments, but also the capital providers, such as the market of bonds and other securities and the commercial banking sector.

6. CORPORATE GOVERNANCE INSTITUTIONS

Corporate governance institutions consist of the key actors and formal and informal rules that the system is comprised of. Key actors in corporate governance are: government, corporations, business managers, stock exchange and securities commission, market agents, business associations, judicial system and other actors, including the pension funds, the media that report on financial issues and institutional investors.

Formal rules that apply to the aforementioned institutions are as follows: regulations based on which the corporation is granted the status of a legal entity, regulations that define the business regulatory framework, regulations regarding the stock exchange, stock exchange listing requirements.

Informal rules involve the following: licensing of professional associations, provision of information and exerting pressure on members that contribute to the observance of professional standards, business associations affect the behavior of actors regarding the generally accepted practice.

7. CORPORATE GOVERNANCE AND DEVELOPMENT

Corporate governance is important for economic development and its important role is to encourage local and foreign investments in the economy. However, there will be no inflow of investments until the investors are convinced that the risk is reduced and until they get tangible evidence that the government activities do not involve mere rhetoric. It is possible to present huge investment possibilities to the investors, but they will not come if the government and the local businessmen do not observe the rule of law.

In the developing countries, the role of the government is to pave the way. Consistency, transparency, and honest government will be necessary for support to corporate governance reform. Business community would like to be given the opportunity to participate in planning the stages of reform, thus contributing to the reduced resistance to change and encouraging adoption of principles of good governance. In other countries, the stakeholders, such as business community leaders and professional bodies have accepted the opportunity to contribute to debate. Having in mind the investment opportunities in Montenegro, foreign and local investment communities with long-term interests in the country, should prove their readiness to cooperate in improving the good corporate governance.

To summarize, there is no standard package of measures that can be applied. Good corporate governance requires good political governance.

8. CONCLUSION

Corporate governance contributes to growth and development of the corporation itself, the community around it and the state in general. For long now the role of the company is not only to produce or provide services, thus acquiring profit. Companies now take the responsibility for development of the social surroundings.

Corporate governance represents a key element in improving economic efficiency and growth and increasing the trust of investors.

Corporate governance is important for economic development and its important role is to encourage local and foreign investments in the economy. However, there will be no inflow of investments until the investors are convinced that the risk is reduced and until they get tangible evidence that the government activities do not involve mere rhetoric.

Existence of a good corporate governance system ensures transparency, fairness and responsibility to shareholders and other stakeholders in the company.

It is not sufficient to adopt the laws with the aim to improve corporate governance. Global financial and economic crisis demonstrated that even in the developed countries, there are weaknesses in the overall corporate governance system, especially in the corporations dealing with financial affairs. The US example shows that this is not so simple, not even in the countries with big experience in implementation of market principles, thus, it is necessary to continuously upgrade the overall system.

In the modern times of business operations, the strategic path of the top management should focus on how to implement socially responsible activities in the company operations. Top management must find the ways in which corporate responsibility can be effectively incorporated into the company strategy, as a necessary and sufficient prerequisite for achievement and maintenance of competitive advantages in a turbulent environment.

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