

PECULIARITIES OF CORPORATE GOVERNANCE IMPROVEMENT IN GEORGIA

Givi Duchidze

Associate Professor, Doctor of Business Administration

East European University

Abstract

The article discusses topical issues of corporate governance formation in Georgia, which were founded in the 1990s. The steps taken towards the implementation of the Anglo-Saxon model of corporate governance in Georgia are assessed. The problems of corporate governance that are characteristic of both Western European countries and Georgia are analyzed, and steps are taken to address these problems. The trends in the formation of corporate legislation in Georgia are discussed. It is suggested that in order to establish a high standard of corporate governance in Georgia, it is necessary to develop and adopt a Corporate Governance Code of Companies, which ensures the establishment of general principles of corporate governance.

Keywords: *Corporation, Management, Business, Shareholders, Property, Legislation*

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Givi Duchidze

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Introduction

The logic of forming the Georgian model of corporate governance in the 90s of the last century was based on the import of experience of the stock market and institutions oriented on the Anglo-Saxon model of corporate management. The following practical steps have been taken to implement indicated model in Georgia:

- "Voucher" privatization, forced transformation of former state-owned enterprises into open stock companies and distribution of their shares among a large number of small shareholders;
- Intensive development of the stock market and its infrastructure (exchanges, brokers, depositors and registrars);
- Establishment of collective investment institutions (check and share investment funds, forming non-state pension fund)

Reform organizers believed that the dispersal of shares among a large number of small shareholders would be a prerequisite for the high liquidity of the stock market, as well as it would provide access to shares of privatized enterprises by external investors (through secondary market operations). In turn, the development of stock market infrastructure would reduce transaction costs and allow minority shareholders to vote while their disagreement with the management policy of the company. Investment institutions would be even allowed to accumulate shares of small shareholders in order to more effectively protect their interests by controlling the management of enterprises.

To implement this assumption in practice became partially available. Within the framework of mass privatization, an intensive imports and dispersal of institutions in the field of corporate law have made it impossible to neutralize the demand for the "insider" model of privatization due to the actions of the managers of former state-owned enterprises. As a result, already in the mid-90s of the last century, two trends in the corporate sector became clear:

- Concentration and control of ownership before purchasing 75% stake;
- Maximum closure of joint stock companies and opacity of activities within the framework of the formation of a complex system of corporate control over large enterprises, through numerous affiliated firms and offshore companies.

The most important specific feature of the Georgian model of corporate management based on these two trends, is the extraction of income not through profit (which is typical of the "Anglo-Saxon" model), but through the control of the dominated owner by public finances. Through the transfer pricing mechanism, profits were always derived from a leading company, a dominant shareholder or a senior manager of a leading company. At that time, the interests of the "junior" shareholders, including the employees, who were not involved in the management of the company, were actually ignored.

Research Methodology. Introduction of the most common trends in the business environment in Georgia today and realizing the prospects of attracting foreign investment and focusing on the IPO (initial public offering). Therefore, the study consisted of the following activities: the experience of Western countries in regulating the main problems of corporate management was studied, the trends of formation corporate law in Georgia and the peculiarities of the establishment of corporate management principles were analyzed.

Conducted research. The most popular trend in the business environment in Georgia today is to attract foreign investment and provide prospects for going to an IPO (initial public offering). Therefore, it is very important for the company to regulate corporate management issues, which are very important for the investor.

Currently the main problems of corporate management in the West are:

- Management control problem due to shareholders' stiffness and inertness;
- Influencing on the decisions and activities from the shareholders;
- Multimillion contracts of managers, difficulty of accountability and misuse of insider information.

Due to the above mentioned corporate management level enhancement is hindered by the lack of interests on finances, qualified specialists and governing bodies. The main problem in the corporate management is:

- Ignorance of shareholders' rights;
- Ignoring the rules established by the legislation and internal regulations;
- Ineffective governing bodies and their formal control;
- Existence of transactions with related parties;
- Non-publicity of information;
- Gaps in legislation.

All corporate governance codes require an annual evaluation of the performance of the Supervisory Board and the Board of Directors. There are three main problems in the functioning of the Supervisory Board of Georgia:

- Formal existence;
- Having relatives and friends in board;
- Incorporating non-qualified members in the board.

The best way to solve these problems is to appoint independent members to the supervisory board, which gives the investor confidence that the investment made by him will not be used by the company's management for its own interests. A common problem is the corporations' non transparent information. The companies do not publish annual reports and the information is not accessible to minority shareholders.

Simultaneously, the formation of progressive corporate legislation began in Georgia in the 1990s. In particular, on October 28, 1994, the Law of Georgia on Entrepreneurs was adopted, which regulated the forms of legal status and activities of entrepreneurial entities operating in the country in the field of entrepreneurship.¹ Since December 24, 1998 the Law of Georgia on the Securities Market was enacted, on the basis of which a stock exchange, a securities register, a central depository and the necessary infrastructure for the circulation of securities were established in the country. In June, 1996 the Law of Georgia on „Bankruptcy Regulations“ was adopted, which was amended in March 2007, and finally the law was titled: „Insolvency Proceedings“ which allowed the judiciary to initiate bankruptcy proceedings.

In February 1995, the Law of Georgia on Auditing was adopted, on the basis of which the rules and conditions for conducting auditing activities, the peculiarities of public and private audit services were determined. In February 1999, the Law of Georgia on Accounting, and Reporting Regulation was adopted, on the basis of which the accounting-reporting production in the enterprises of the country was regulated, and since 2000 it has been actively moving to the international standards of accounting-reporting.

In regulating the securities market, it's crucial Organic law of Georgia on "National Bank", adopted in June, 1995. It was a step forward in corporate management. Though, the legal framework of corporate management in Georgia is too poor, in the law of Georgia „On Entrepreneurs“ the liability of executives is also unclear, as well as important regulations in the law on "Securities Market" is unclear, as for "Criminal Code", it foresees the liability of of managers, though it's difficult to name the case, when where the issue of liability of managers has been raised using these articles.

¹ Law of Georgia „On Entrepreneurs“ 1994.

Since 2009 Corporate Governance Code is in force for the corporate banks. This is a voluntary code that obeys the "Obey or Explain" principle, after its adoption commercial banks have joined the Corporate Governance Code. Aimed at facilitating banks to implement effective corporate governance mechanisms related to separation of responsibilities, effective decision-making, protection of shareholder rights, effective regulation of conflicts of interest, disclosure, control and balancing policies, corporate governance, corporate governance, other corporate issues to ensure the effective protection of shareholders, depositors, creditors, investors and the public interest in general. The Corporate Governance Code of Commercial Banks is based on the principles of corporate governance of ETGO and Basel and covers issues such as:

- Shareholders' rights;
- Governing bodies;
- Corporate Secretary;
- Internal control and risk management;
- Disclosure and information transparency;
- Evaluation and remuneration of members of governing bodies;
- Conflict of interest;
- Corporate Governance for the holding;
- Corporate governance parties.

According to the recommendations of this Code, all banks operating in Georgia take into account the essence of the norms established by the Code and prepare an annual corporate governance report. Such an account of each bank is in full compliance with the requirements of the Code, and in case of difference, the reasons why the bank did not comply with these requirements are explained. The Code recommends that each bank develop internal regulations on governing bodies, supervisory boards and committees. Each statute shall include the structural part of the body, its composition, powers, responsibilities, accountability and any procedural matters relating to its functioning.

Unfortunately, the legal framework of the corporate governance system in Georgia needs to be refined and expanded, the implementation of which is a perspective for the near future. In the perspective, it is possible to highlight the following principal processes characteristic to the formation of the Georgian model of corporate governance:

- The latent status of the ownership and management division process (merger of controlling shareholders and managers) will be maintained in the medium term;
- The probability of external equity financing (as the second principal economic precondition for effective corporate governance) remains too low;
- The current condition of the Georgian financial system does not allow us to estimate the propensity of the Georgian corporate governance system for any of the classical models (above all, with any of them, except self-financing sources and the corresponding type of control);
- Share capital concentration is a visible process in which not only the consolidation of control is carried out, but also the realization of the "self-sufficient" model of corporate governance by economic methods (considered in the legal context of the transitional period of the 90s);
- Legal innovations in the field of corporate law (protection of shareholders' rights) have reached a significant level in terms of the current economic conditions;
- Shareholder's rights protection methods cannot provide further development without adequate joint measures in the field of application of legal acts.
- As a result, given a number of empirical and legal data, it is now possible to speak of stable and fundamental contradictions in the formation of corporate governance in the Georgian model. Its essence lies in the fact that in the established model there are two fundamentally contradictory approaches:
- Concentration of share capital, which provides at least the means of legal protection of shareholders;

- The Anglo-Saxon legal tradition, which is characterized by the maximization of legal remedies for minority shareholders;
- Their combination led to a unique situation of mutual neutralization;
- On the one hand, the concentration of share capital and the gradual disappearance of small shareholders have, in principle, diminished the importance of broad legal instruments to protect minorities in the corporate sector as a whole, while small shareholder protection instruments are being transformed into corporate blackmail;
- On the other hand, the creation of an extensive system of shareholder protection remedies, in turn, inhibits the post-capital concentration process (as a factor influencing economic processes).

The analysis of surveys conducted at different times in corporations (2004-2012) showed that the share of one large shareholder in Georgian companies in this period ranges from 32-36%, and the share of 3 large shareholders is in the range of 41-47%. Studies also have shown that among the three largest shareholders, board members were named in 74.6% of cases and locals (excluding board members) in 56.6% of cases. Among the three largest shareholders in terms of ownership of the controlling stake, the members of the Board of Directors were the ones who were most often named among the largest shareholders (36.1%), the members of the Supervisory Board took the second place (30.6%). From this it can be assumed that under current corporate law (acquisition conditions) the average concentration has reached its formal limit.

With a more optimistic interpretation, it can be said that a kind of "model" balance has been achieved in Georgia today between the level of concentration and certain measures of protection of the interests of small shareholders. The element of optimism lies in the fact that the system has stabilized in some way. But most of the controlling shareholders act in the same way as the company's CEO and are represented on the supervisory board. Even in companies that separate ownership and control, it is often only on paper. In such companies we face weak structures of accountability and control (most controlling shareholders supervise themselves in the role of director and manager), weak mechanisms of disclosure of information. Major business groups in the country in the form of holding companies control companies in most industries. While holding structures can serve legal purposes, complex business structures, cross-shareholding, pyramid schemes, and other mechanisms can create a vague system of ownership, making companies difficult for shareholders and investors to understand. In Georgia, we have inexperienced and inadequate corporate bodies in the corporate governance system. In particular, the law established the institutions of the Supervisory Board and the Executive Board in 1994, but in March 2008 a significant amendment was made to the law. In particular, the existence of a supervisory board has become mandatory in only a few cases, in other cases the company has to decide whether to set up a supervisory board. Unfortunately, strong, viable and independent corporate bodies are rarely found in the Georgian economy.

Conclusion

In order to establish corporate governance principles in Georgia, it is necessary to develop and adopt a corporate governance code for companies, which is an application for corporate governance of companies. It should be aimed at making the management structure more transparent, reaffirming the company's commitment to exemplary corporate governance and ensuring:

- Existence of responsible, accountable and value-oriented management;
- Establishment an effective supervisory and executive board based on the interests of the company and its shareholders;
- Proper disclosure and transparency of information, as well as the formation of an effective risk management and internal control system.

Through adoption of the code of corporate governance and its regular update country expresses its desire demonstratively manage and implement corporate governance exemplary practice. The company corporate governance code should go beyond the established legal and regulatory system and include national and internationally recognized corporate governance practice standards.

Due to the existing business relations in Georgia, when there are not even corporate governance guidelines, it is difficult to talk about the validity of „soft law“, at the initial stage, we consider it justified to develop recommendatory documents, which, as a result of practical application, will allow us to refine and improve the relevant legal framework. The specifics of the Georgian model of corporate governance discussed above should be taken into account while assessing the level of corporate governance in local companies.

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