

THE CORPORATE GOVERNANCE SYSTEMS TRANSFORMATION DURING THE FINANCIAL CRISIS

Beyond doubt the institutionalization of interests of different strata and groups of participants has an impact on the corporate governance system development, as well as business and social partnerships that develop between the state and corporations. Therefore, in a certain way companies implement public authority in the pursuit of maximizing shareholders' interest.

They emerge as representative structures to protect their economic, political, social and ideological interests. Businesses, community organizations, and government agencies cooperate to achieve common goals such as stable profits, sustainable social and political climate, and maintaining their own positive image. Though there are some organizations that have a particular focus on profit maximization, others on charity, and still others on property rights and individual freedoms, as well as environmental protection, health and sports, according to basic corporatism principles they all share the ideals of cooperation and solidarity.

Having analyzed the history of corporate governance we outline the main stages of theoretical and practical aspects of corporate governance development (Table 1).

Therefore, we broadly view corporate governance as a system of directing and controlling company's activities. Corporate governance systems define tasks and responsibilities of shareholders to control managers' actions as well managers' accountability to shareholders for company's performance. Proper corporate governance should always enhance share capital growth.

Global financial crisis of 2008 – 2009 revealed the major flaws of business institution forms that have been dominating the scene in recent decades. Corporate governance systems have also proven inadequate in current economic environment. First of all, this inadequacy was made obvious through flawed incentive systems throughout the development of corporations. Specifically, there has been an exacerbation of the principal-agent problem – a traditional conflict between the mostly short-term interests of hired managers and long-term interests of shareholders. Intensification of this problem was demonstrated through a relative drop in efficiency and accumulation of risks in large multinational corporations. Moreover, this loss of efficiency and risk accumulation was not obvious to outside investors, thus creating an illusion of stability and overall risk reduction in the

economic development process. There were different mechanisms of exacerbation of this conflict of interests: management incentive systems, methods for calculating capital adequacy and / or debt burden ratios, risk management systems, board of directors' organization, execution of shareholders' rights, and, probably, derivatives accounting [2]. According to common opinion, the major reason lay in management incentive systems developed in recent years, which focused exclusively on short-term interests and excluded other benchmarks apart from short-term (mainly one-year) goals of maximizing firm capitalization.

There were objective reasons for a shift in the corporate governance towards the above mentioned mechanisms of distorted incentives. In our view, this shift was driven by the Asian crisis of 1997, when it became obvious that financing of the corporate sector predominantly through banks was ineffective. As a result of having close interactions and personal connections with large borrowers banks turned out incapable of objectively assessing their financial conditions, leading to bad debts accumulation which was one of the causes of the crisis in South Korea and some other countries. In response to this market failure in corporate governance the emphasis was shifted to an alternative model, historically pertaining to the UK and the U.S. and based on assessing company's value through stock market mechanisms. The theoretical foundation for this shift was laid out in numerous works on stock market describing it as an objective mechanism, independent of insiders' manipulation and thus capable of better protecting the rights and interests of external investors (outsiders).

Recent string of corporate scandals and bankruptcies in the developed markets have clearly demonstrated that full exit from the financial crisis is impossible without solving the identified problems in corporate governance. To achieve this it is necessary to solve two key issues in a global context of corporate governance:

- the shift from short-term incentives and goal setting to long-term ones, comparable to the business cycle length;
- extending the scope of corporate relations to include the interests of all key stakeholders, not limited to traditional players such as shareholders and managers.

International community recognizes the “failure” of the corporate governance tools which are currently in

Table 1.

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Period	Fundamentals
End XIX – beg XX century, “dominance” in shareholder management decisions	The emergence of large corporations. Domination of scientific management school, which focuses primarily on the principles and methods of work organization. The start of separation process between stock ownership rights and stock management. A. Marshall systematically described the problem of different interests pursued by managers and company owners. T. Veblen proposed the transfer of control from owners to managers-engineers.
Beg. 30s – 50s XX century, “Management control over decision-making process”	Beg. 30s – 50s XX century, “management control over decision-making process” Corporations expand the field of their activities. Transfer of the executive, control, and then strategic management functions to hired managers. Emergence of conflicts of interest. Requirements on disclosures about the functioning of corporations and circulation of securities are introduced through government regulations. Role enhancement of Securities and Stock Market Commission. American economists A. Berle and G. Means in “The Modern Corporation and Private Property” (1931) raised the question of agency relationship, and the collective and social nature of corporations. R. Coase’s theory of transaction costs (“Nature of the Firm”).
50s – end of the 80s of XX century, “introduction of general rules and principles of corporate governance”	Increase in investments. Export of capital in the form of portfolio investments (stocks). Substantial increase in the proportion of institutional (pension funds, insurance companies) and collective (mutual and new investment funds) investors in equity. EEC issues a directive that unifies corporate governance in public companies. J. K. Galbraith in his work “The New Industrial State” (1961) came to a conclusion that the real power in the corporations is held up within technocratic structure rather than being exercised by its owners. Development of theories: information asymmetry (M. Spence, G. Akerlof) risk (J. Stiglitz) of new institutional economics (O. Williamson) in capital structure (F. Modigliani. and M. Miller). The works of M. Jensen and W. Meckling have special influence on the development of corporate governance by justifying contractual relationship between shareholders and other stakeholders in corporate governance system.
Beg. 90s – present, “resolution of a problem of systematic approach to corporate governance”	The bankruptcy of a number of joint stock companies. Strengthening of globalization processes and state regulation of corporate governance. Cadbury Report (UK, 1992). Implementation of “comply or explain” principle. Development of internal controls and incentives applied to members of supervisory boards. Adoption of the OECD Principles of Corporate governance (1999). Sarbanes-Oakley Act (USA 2002). Restructuring of corporate governance system in most countries. Spread of global multinationals. Evolution of strategies and models of corporate governance. Exacerbation of corporate relations issues during the global crisis and search for new tools and mechanisms of corporate governance.

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practice. Thus, the OECD report “Corporate Governance and The Financial Crisis: Reform and Exit Strategies” outlines concrete approaches to solving problems in a number of critical areas, such as compensation systems, risk management, and shareholders rights execution. [2]

In its turn “Principles of sound compensation practices. Standards implementation” prepared by Pittsburgh G20 Summit on Financial Stability, provide an example of the practical implementation of these approaches” [3].

However, for the moment the following position dominates in assessing failures in corporate governance: the principles of corporate governance formed and codified by the OECD in the past decades do not need to be changed, as they already contain the approaches to solving the identified problems. The main issue remains the proper implementation of corporate governance principles.

Thus, the above mentioned OECD report on the impact of financial crisis on corporate governance and the analysis of the causes of inefficiencies in the leading corporate governance subsystems (specifically, compensation and risk management) and their role in the financial crisis, published in June 2009, states: “There is no need to revise the OECD principles (of corporate governance). These principles provide a good foundation ... to achieve the objectives (of corporate governance). The most urgent challenge is to support the effective implementation of the already agreed upon standards” [2, p. 7].

In other words, the problem lies not in theoretical concepts of corporate governance, but in the practical implementation of the recommendations of best practices in corporate governance.

Although some international experts support the adjustment of some of these standards, in general the currently established “ideal model” of corporate governance and its theoretical foundations are considered to be correct [4]. According to this logic in terms of fundamental corporate relations “principal-agent problem” overall thrust of measures to improve corporate governance is now focused on the regulation and the tighter control of managers (“agents”) by regulators acting in the interests of shareholders (“principals”). It should be emphasized that such measures are not new – the response to the crisis triggered by Enron’s bankruptcy in 2001 at the political level was formulated and implemented in the same vein.

Given the background of global trends Ukrainian companies stand out with certain unique characteristics. On the one hand, in most cases, they have preserved the concentrated structure of ownership and control. And their current controlling shareholders “have something

to share” with the management when it comes to incentives and stimuli for initiative, etc.

However, compared to their global competitors Ukrainian companies exist in a qualitatively different institutional setting. Ukraine’s poor investment climate dramatically reduces the time horizon in which an owner can make informed decisions, and thus shuns away long-term direct and portfolio investors. Moreover, contrary to established notions, problem lies in the instability of institutions rather than the poor quality of Ukrainian laws as such. No Ukrainian company can guarantee the feasibility of its long-term goals because of the state constantly changing the “rules of the game”.

Constant instability of the “rules of the game” in Ukraine is demonstrated in two dimensions. At the political level, we increasingly observe that some things are claimed (“We want innovation and modernization”, “We create the rule of law”), but different things are actually implemented (social support is granted to important, but inefficient authorities-friendly companies; the law is applied selectively and does not affect the representatives of the state). At the bureaucratic level, abundant new changes of law are constantly implemented which are justified by good intentions, but in fact lead to a permanent change in rules. As a result of these two trends companies cannot build a long-term strategy and a suitable system of long-term incentives, unless a specific corporation is able to create a favorable regime for itself (taking individual or collective action). Problem of unstable “rules of the game” cannot be solved solely by the business. This is a problem of interest groups operating on the side of the state that should finally understand the difference between their short-term opportunistic and political objectives and the long-term goals (priorities) of the country, and put themselves in the framework of law.

In the absence of such changes the only way for Ukrainian companies to ensure stable “rules of the game” is to develop further approaches to formal and informal integration with the state on behalf of its individual members. Moreover, since Ukraine is already a part of the global markets, Ukrainian companies along with their foreign competitors will participate in the search of new forms of organization of large business.

But given the current uncertainty of “rules of the game” the movement at the level of individual companies will be slower in Ukraine than in other countries, and as a result we will continue to lag behind our competitors.

The crisis of 2008 – 2009 showed that the model of corporate governance, codified by the OECD standards and considered in the 2000s as a target benchmark for companies and regulators from countries with developing and transition economies, is not ideal. Serious distortions in the incentive system, which predetermined orientation

of large firms – public companies – to achieve short-term results without the risks arising in the long run, have become one of the inner causes of the global financial crisis. Therefore, the search for new and more effective forms of organization appears inevitable. This search will be based on already existing non-standard practices, go through experimentation combining elements of different models, and with a high probability will lead to more complex mechanisms of corporate governance. From the point of view of companies that process will require greater flexibility and willingness to test new tools and mechanisms of corporate governance.

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Баюра Д. О., Романюк В. М. Трансформація корпоративних систем управління в умовах фінансової кризи

У статті проаналізовано етапи становлення та розвитку системи корпоративного управління. Вивчено проблеми та нові виклики в період реформування, трансформацій і конвергенцій сучасних систем (моделей) корпоративного управління, які проявилися в контексті глобальної економічної кризи 2008 – 2009 рр.

Ключові слова: системи корпоративного управління, глобальна фінансова криза, багатонаціональні кор-

порації, спотворені стимули менеджменту та акціонерів.

Баюра Д. А., Романюк В. Н. Трансформация корпоративных систем управления в условиях финансового кризиса

В статье проанализированы этапы становления и развития системы корпоративного управления. Изучены проблемы и новые вызовы в период реформирования, трансформаций и конвергенций современных систем (моделей) корпоративного управления, выявившиеся в контексте глобального экономического кризиса 2008 – 2009 гг.

Ключевые слова: системы корпоративного управления, глобальный финансовый кризис, многонациональные корпорации, искаженные стимулы менеджмента и акционеров

Bayura D. O., Romanyuk V. M. The Corporate Governance Systems Transformation During the Financial Crisis

This paper analyzes the stages of corporate governance development. It studies the issues and new challenges in the period of reform, transformation and convergence of modern corporate governance systems (models) that emerged in the context of the global economic crisis of 2008 – 2009. It demonstrates the causes of gradual accumulation of inefficiencies in large corporations operating in the global markets. The paper raises the need to find new forms of management for large businesses. In this context, we describe the strengths and weaknesses of corporate management in Ukrainian companies.

Key words: corporate governance systems, global financial crisis, multinational corporations, distorted incentives of management and shareholders.

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