CHANGES IN MANAGEMENT ROLE IN THE CORPORATE GOVERNANCE SYSTEM – EXAMPLE OF MONTENEGRO

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The breakdown of the management system on a global scale, after the major financial scandals, first in the US and then in Europe, has launched a debate on reviewing the position of management in the corporate governance system. Since then, a number of studies, professional papers, policy initiatives and legislative solutions have attempted to change the place and role of management in the corporate governance system. The need to improve corporate governance is not a global necessity belonging to the developed countries; it is also inherent in developing countries. During the global crisis, the role of management and the quality of the regulatory mechanism were re-examined at the level of the European Union. The initial hypothesis of the present paper is contained in the claim that management is one of the most important elements in the corporate governance system. Therefore, the research focus of the authors is placed on empirical, practical and regulatory analysis of the position and role of management in the corporate governance system. Analyzing the changes in the position of management on the global, European and Montenegrin transition experience, the authors strive to prove the hypothesis that the lack of understanding of the position of management and its inadequate regulation have significantly influenced the current situation in the Montenegrin economy.

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1. INTRODUCTION

If we consider one of the most cited definitions of the notion of corporate governance, which is contained in the Cadbury Report, according to which corporate governance is a system by which companies are managed and controlled, it logically follows that the role of management is crucial for the formation of quality corporate governance systems in companies. The Cadbury Report (Cadbury, 1992) has laid the foundations for a review of the role and position of management in the corporate governance systems, first in 1992 in the UK and then on the global scene. The key messages of this document were that the board was a unique body with the specific role of independent directors, that the board had to be structured through special committees and that in order to have high-quality corporate governance system it was essential to provide independence of the members of the board of directors from the rest of the management. The basic premises of the document are still valid given that there is a debate at the global, regional and national level in which the role of management in the corporate governance system is reviewed. For the purposes of this paper, management in the corporate governance system is viewed through the role of the board of directors and the chief executive (CEO). Starting from a theoretical position that the board of directors is an important link in the corporate governance system (Baysinger, 1985), the authors argue for the need to change this concept in Montenegro.

In the assessment of the role of management in the corporate governance system, one question needs to be addressed. Will the people who manage other people's capital always work exclusively in the interest of achieving the goals of the company and its shareholders or will they work towards achieveing their own interests in the process? The question is even more relevant in the case of transition countries, where management has the possibility to abuse its powers. In explaining the issue of corporate governance, it is difficult to give an affirmative answer to the above question. Relations between owners and managers are not established on a friendly, but rather on a professional basis (Jocović, 2007). In explaining the essence of the agency problem between owners and the management, Jensen and Meckling, point out that if both sides want to achieve greater benefits for themselves, there is good reason to believe that the manager will not work in the interests of the owner (Michael C. Jensen, 1976). Cox indicates that managers do not differ from other individuals facing economic choices, because in the process of maximizing their own benefit they cannot be expected to act in the way in which other individuals act when making discretionary decisions (Cox, 1997). Due to this fact, it is difficult to speak of establishing trust between owners and managers in theory and in practice. Regardless of the various means of motivating managers as well as legal provisions that prescribe their responsibilities, there will always be a risk of managers abusing shareholders' rights. In Montenegro, this question has not been much in the focus of the experts and the response of the legislator was therefore limited and unsubstantiated.

If we add many other outstanding issues to the foregoing, there is no doubt that management in the corporate governance systems has become a serious global challenge that managers and board members have to face. Examples of Enron, WorldCom, Tyco and the collapse of large financial companies such as Lehman Brothers, Bear Stearns, Merrill Lynch and Wachovia show that, in a number of cases, management functions were not carried out exactly as it was prescribed and expected. In his book "The Future of Management", Hamell (2007) notes that management has become obsolete. Therefore, it is an irrefutable fact that the basic principles of functioning in the so-called intangible economy and knowledge economy are dramatically different from the traditional concept of value creation and business operation of companies. This understanding of management is additionally supported by explanations of a range of authors, suggesting that new success factors have become increasingly important: knowledge, information, intelligence, etc. This places a demanding task before managers and board members to review and renew their new roles in the corporate governance system. The above changes have also been identified in the corporate practice, while regulators around the world are trying to address the issue by searching for the final formula of corporate governance in the sphere of management.

As the developed countries are searching for a model that could define the role of management in the corporate governance system in a long-term, sustainable manner, it is alarming that transition countries have spent two decades wandering through attempts to position management in the system. A long transitional experience shows that the concept of corporate governance is still not clear enough, especially when it comes to the various modalities of management and control in economies in transition. The issue becomes increasingly important if we adopt an acceptable statement that the causes of insufficiently fast recovery of individual companies in transition countries are largely linked to the very fact that management is conducting its job poorly (Lojpur, 2013). In this regard, the management, as well as the overall corporate governance system, is increasingly being viewed as one of the elements contributing significantly to improving the competitiveness of the national economy (Jocovic & Milovic, 2013). Thus, in addition to its micro dimension, corporate governance plays an important macro dimension (Milović, 2012). The economic crisis has led to a situation where countries that were initially more resistant to such crisis are facing more problems now. After all, the crisis has begun with the collapse of individual companies that have caused losses on the large regional market. Conditions in the global market are increasingly stringent and higher standards have been established. In these circumstances, it is difficult to talk about good management in the corporate governance system, which could, in a shorter period of time, significantly reduce transition losses. Taking into account the above, the aim of the present paper is to identify the extent to which the position of management in the corporate governance system in Montenegro, as a transitional country and a candidate for European Union membership, is currently undergoing changes and improvements.

2. REVIEWING THE POSITION OF MANAGEMENT AT THE EU LEVEL

Reviewing the role of management and seeking a long-term, sustainable regulatory solution has been a basic topic of initiatives for reforming corporate governance at the EU level since 2002. The joint aim of all the initiatives is the search for a model that will improve the control and management function in the corporate governance system (Hopt & Leyens, 2005). Board of directors, as a crucial body that simultaneously provides managerial and supervisory function is particularly in the focus of attention. The first document at the EU level that opened the field for discussion, reviewing and promoting the role of management in the Member States was the Action Plan of the European Commission (2003) *“Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward”*. Realizing that company law and corporate governance in the EU do not follow the changes on a global scale caused by financial scandals, the European Commission has launched a debate in which it tasked a group of experts with analyzing the basic gaps in the European corporate governance system, as well as with proposing guidelines for fixing those gaps. This effort resulted in a report entitled “Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe”. In this document, the reform of the board of directors has been identified as one of the key preconditions for promoting corporate governance at the EU level (European Commision, 2003).

Through non-binding recommendations, the European Commission has quickly attempted to improve and modernize the position of board of directors in the Member States and thus, relevant recommendations have been adopted-

Recommendation on the role of (independent) non-executive or supervisory directors and Recommendation on establishing an appropriate regime for the remuneration of directors of listed companies (European Commission, 2004). The above recommendations represent a basis for reforming the position of management in the corporate governance systems in the Member States. Following their adoption, the EU Member States have transformed their company law and have introduced the institutes of independent directors and have strengthened the system of transparency in disclosing the remuneration paid to management members. During the crisis, in addition to reviewing the role of management in the financial sector, a broader initiative was launched once again, confirming serious flaws in practice and in the regulatory mechanisms. The final result of activities which, given the complexity of decision-making procedures and importance of the problem involved a number of subjects, was the adoption of the document entitled 'Action Plan: European company law and corporate governance – a modern legal framework for more engaged shareholders and sustainable companies'. The issue of management has been analyzed indirectly through the implementation of one of the key goals of the document – encouraging greater familiarization of shareholders with the topic of corporate governance.

Analysis of the above initiatives shows that special attention has been paid to the following issues – the improvement of the control functions of the board of directors, remuneration policy and encouraging diversity in management structures.

The control function of the board of directors within the EU has been significantly improved in the previous period, through the institute of independent directors. Corporate practice has not yet given a clear answer to the question of how much would independent members of the board of directors improve its work – especially its supervisory function (Davies, 2000). In this regard, the recommendations of the European Commission do not provide strict criteria but give instructions as to who is considered an independent member. Primarily, it comes down to the lack of employment-legal, creditor, ownership or functional relationship with the company in which the board member carries out the activity. Remuneration regime within the EU is regulated through non-binding recommendations. Therefore, the Member States are free to regulate this area in a way that best suits the achieved level of development of corporate governance. With regard to the remuneration to the management, the prevailing view in theory is that, by disclosing it, a positive impact is exerted on the overall system of corporate governance (European Commission, 2012).

The last initiative in relation to the management position concerns the diversity in the management composition. Namely, it is believed that greater diversity contributes to the quality of discussion, improves control and work efficiency (Carter, 2003). In the document published by the European Commission – *"Green Paper: The EU corporate governance framework from 2011"*, it is particularly emphasized that the composition and qualifications of the board of directors may contribute to improved control and increased efficiency of operations (European Commission, 2011). The ultimate goal is to make the structure of the management suit the specific needs of the society (Radović, 2013). The view is also imposed that diversity in the board of directors should be driven in the direction of professional, international and gender representation. Professional diversity is considered a key element for enhancing both the role of the board and of the management in the corporate governance system. The surveys conducted on this issue within the EU reveal disturbing data that 48% of the boards in the EU do not have a board member who is an expert in marketing. Relevant recommendations of the European Commission which are not binding, as well as the last Action Plan from 2012 show the importance of having diverse knowledge and views in the board in order to improve the quality of decision making (European Commission, 2012). Vasiljević (2007) stresses that factors such as globalization of the world capital market and fierce competition impose the need to enhance the competencies of members of the boards of directors.

Moreover, there is an increasing emphasis in comparative business practice and theoretical research on the importance of international diversity in management structures, whereas the knowledge of the regional market by some members of the board tends to be a crucial argument for appointing a board member (European Commission, 2011). Particularly important is the international diversity in multinational companies, which are expected to have higher presence of foreign board members. However, a survey by Heidrick & Struggles, which was carried out on a sample of 371 large companies in 13 European countries, shows that about 25% of listed companies in the European Union had no board members from other countries. Still, there are obvious differences between individual countries.

For example, in the Netherlands, the percentage of foreign members is 54%, while in Germany it amounts to 8% (Heidrick & Struggles, 2009). The issue of the structure of the management boards and their contribution to performance of companies is also very debated in the US, that have significantly reviewed the system of corporate governance after the financial scandals from 2000 onwards. Surveys on structures of boards show that corporate boards in the US have a small number of members who are not US citizens – for example in 2007, only 6% of the largest 200 in the framework of the Standard & Poor's 500 companies had directors who were not US citizens, while more than half of US companies in general had no directors who were not US citizens. Therefore, the debate on the role of management and the need for greater diversity is very current on the other side of the Atlantic as well (Butler, 2012). Finally, in favour of encouraging diversity in the management structures, we should also mention the initiative of the European Commission towards promoting greater representation of women in the management of large corporations. Adams and Ferreira emphasize that gender diversity significantly contributes to the enhancement of the control function in the corporate governance systems (Adams & Ferreira, 2009).

Another ongoing debate is currently led in the attempt to answer the question whether accumulation of functions between the executive director and the chairman of the board of directors should be made in the corporate governance system. This issue should not be the sole expression of the will of the legislator but should reflect the actual needs of the company to accumulate or not to accumulate this function. While there are different solutions in comparative practice, we believe that countries in transition have not reached the level of development of management to allow one person to be the holder of both important functions at the same time. In a document entitled Response to the European Commission's Green Paper "*The EU Corporate Governance Framework*", a group of experts advocates a unique normative separation of competencies between the executive director and chairman of the board, while it is recommended that Member States allow companies to make their own decisions on merging or separating these functions taking into account the size of the company, the ownership structure, market circumstances, etc. (Davies, 2011).

3. MANAGEMENT AS THE WEAKEST LINK IN THE CORPORATE GOVERNANCE SYSTEM IN MONTENEGRO

Aware that privatization by itself does not solve the problem of corporate governance, with a lack of shareholder culture and practices, deprived of a stable legal and institutional environment as a necessary preconditions for development, transition countries have, with more or less success, developed the managerial structures at the national level. Due to the objective burden of transition, the search for the right model of privatization, with permanently threatened macroeconomic stability, policy makers in Montenegro have not managed to sufficiently perceive the importance of management in the corporate governance system. However, in this period, a generation of managers has emerged that misunderstood and misapplied the basic postulates of corporate governance, making a long-term negative impact on the position of management in the corporate governance system. With the adoption of the new Law on Companies in 2002, which created a discontinuity in relation to the previous legislation in the field of governing joint stock companies, the situation in corporate practice did not change significantly. The Law fully accepted the Anglo-Saxon (one-tier) model of corporate governance with a board elected by the shareholders' assembly whereas the control over management work is performed by an independent auditor appointed by the assembly. Unfortunately, in practice, the Law did not accomplish its mission and one of the key causes for this was the inadequate regulatory framework for the position of management (Jocović, 2011).

Regardless of the fact that the corporate governance problems are addressed through legislative and self-regulatory mechanisms, the position of management should not be viewed solely through the prism of a regulatory mechanism. This issue requires constant attention and demands giving practical responses that are eventually incorporated into normative solutions. In this regard, after analyzing the practices in which management structure in the corporate governance system in Montenegro have developed, we present the following observations and conclusions:

- slow changes in the belief that skills and knowledge in management and entrepreneurship in general are considerably scarcer resource than capital;
- misperception of management as an extension of *self-management governance* (the so-called "managerial revolution" did not occur); understanding management as an honorary function instead of a serious profession (Čolaković, 2008);
- the very term *management* was taken from other areas and obtained a vulgarized character;
- the *stakeholder concept* slowly takes root in practice; there has been no complete separation of ownership, control and executive functions;
- the attitude that management can be set up or introduced by law is still present;
- board members in corporate practice have very poor knowledge of their company (value chain);
- there is no sense of introducing individual accountability among board members;
- the management is most often "turned" away from the market and the consumers towards the government and the state instead;

- adequate compensation strategies in the corporate governance system are not sufficiently developed (Lojpur, 2013).

At the same time, we emphasize that the issue of corporate governance reform and the review of the role of management in its framework is the subject of constant attention of the legislator and policy makers. In the theoretical analysis of the role of the board of directors in the one-tier model of corporate governance, Cadbury stresses that the improvements in the functions of the board of directors is crucial for the corporate governance reform (Cadbury, 1999). Barbić (2008) points out that in the one-tier model of corporate governance the board of directors includes two important functions – the management of the company operations and control. After exploring the changes in the system of management in the European Union and its Member States, we suggest that the lack of regulation and slow changes in the perception of the system of management had significantly contributed to the negative image of the overall system of corporate governance in Montenegro. If the changes and initiatives at the EU level and the changes that have followed in the neighbouring countries are compared to the situation in Montenegro, the conclusion is that policy makers in this field are not responsive to changes in the system of management which were initiated in 2002 and are still continuing.

Due to the above, and after analyzing the real causes of the crisis of management and review of initiatives within the EU, the necessary directions for future changes must be focused on modernization of solutions in relation to the role of management in the corporate governance system. Primarily, the institute of independent directors should be introduced, clear criteria should be set for selection of members of the board of directors and the chief executive, and there should be more detailed and precise regulation of the issue of remuneration, competencies and accountability of the management.

4. CONCLUSION

Fast and uniform actions under the new principles of functioning of management in the corporate governance system need to be completely different from the current ones. The current management models, tools, skills and principles are mainly based on an outdated way of thinking and cannot be objectively and efficiently applied to the new factors of development of Montenegrin society.

Reforms of the role of management in the corporate governance system need to improve the economic position of the companies and the overall competitiveness of the Montenegrin economy. Given the strategic commitment of Montenegro to join the European Union, it is important for the country to harmonize its development policies with common strategies of the European Union in the field of corporate governance systems. In its legislation, Montenegro adopted a one-tier model of corporate governance. However, the regulatory framework has failed to address a key issue in the management systems in the developed world – creating mechanisms for improving managerial and supervisory functions of management.

Following the overall analysis, we conclude that since 2002, there have been improvements and changes in the position of management in the corporate governance system in the EU. From the need to strengthen accountability to the modernization of the board of directors, a path was crossed that, although failing to result in a single legislative regulation at the EU level, significantly strengthened the role of management in the corporate governance system. On the other hand, a question is posed regarding the developments in this field over the last 15 years in Montenegro? Did the traditional understanding of management change and did the new generation of managers get an opportunity to use modern tools in managing corporations? Did the tectonic changes in the management system, created in the aftermath of the financial scandals from the beginning of this millennium and the current financial crisis, lead to the questioning of management position in Montenegro? Did soft law take foot in the form of a corporate governance code which imposes additional obligations on management? Did the state improve, in companies in which it is a majority shareholder, the traditional understanding of management position as an opportunity for mostly incompetent members of the state administration to prosper? Are professional, international and gender representations in management structures in line with current global trends? Answers to these questions are not positive and are largely reflected in the current state of the Montenegrin economy.

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PROMJENA ULOGE MENADŽMENTA U SUSTAVU KORPORATIVNOG UPRAVLJANJA: PRIMJER CRNE GORE

Sažetak

Krupni nedostaci sustava menadžmenta na globalnoj razini, nakon velikih financijskih skandala, prvo u SAD, a zatim u Europi, pokrenuli su debatu o redizajniranju pozicije menadžmenta u sustavu korporativnog upravljanja. Od tada do danas, brojne studije, stručni radovi, političke inicijative i zakonska rješenja pokušavala su promijeniti mjesto i ulogu menadžmenta u sustavu korporativnog upravljanja. Potreba za unapređenjem korporativnog upravljanja nije samo globalna potreba, koja pripada razvijenim zemljama, već se odnosi i na zemlje u razvoju. Tijekom globalne krize, ponovo se na razini Europske unije preispituje uloga menadžmenta i kvaliteta regulatornog mehanizma. Polazna hipoteza ovog rada odnosi se na stav o menadžmentu, kao jednom od najvažnijih elemenata u sustavu korporativnog upravljanja. Zbog toga je istraživački fokus autora usmjeren na empirijsku, praktičnu i regulatornu analizu pozicije i uloge menadžmenta u sustavu korporativnog upravljanja. Analizirajući promjene u poziciji menadžmenta na globalnom, europskom i crnogorskom tranzicijskom iskustvu, autori pokušavaju dokazati hipotezu da su nerazumijevanje pozicije menadžmenta i njegova neadekvatna regulacija u značajnoj mjeri uticali na trenutno stanje u crnogorskom gospodarstvu.