

Managing the Czech Joint-Stock Companies – Failure of Economic Transformation¹

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Abstract: The aim of this paper is to analyse whether legal rules, set up during the first years of the economic transition, could stimulate behaviour of economic subjects so that it would lead to desired results in macroeconomic benchmarks. This problem is solved using a case of joint-stock companies management (i.e. both ways and possibilities of their administration) in the Czech Republic during the 1990s.

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Introduction

Economic transformation is often seen as a process, where changes of macroeconomic aggregates are reached by means of changes of formal rules (norms). On this basis normative decisions on fulfilling or not fulfilling quantitative economic criteria are designed. Significantly less attention was paid to finding if—in the given structure of formal and informal institutions—set legal rules could stimulate behaviour of economic agents so that it would lead to desired results in employment and macroeconomic output.

The aim of this paper is to define and analyse this problem using an example of joint-stock companies administration. In the first part, we analyze the process of transformation from the microeconomic and macroeconomic point of view and we explain the significance of formal and informal institutions in transformation. In the second part, we consider some economic aspects of the transformation, which

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resulted in the voucher privatization. In the third part, we deal with the process of creating of joint-stock companies as a new form of enterprise during the voucher privatization. In key fourth and fifth parts, we analyze the process of joint-stock companies administration in the context of transformation. In the sixth part, we summarize the results of the previous analysis and we put them into the context of the economic transformation and its results.

Economic Transformation and Transformation of Institutions

The aim of the economic transformation was not only change of economic system but primarily increase of allocation efficiency to reach both higher economic growth and welfare, which are necessary prerequisites for approaching more developed countries (Spevacek 2002). The main evaluating criterion for transformation success is impact of systemic changes on long-term economic growth. Economic development, however, takes place in a concrete institutional framework, which is for it defining and restricting; economic transformation is possible only within the bounds of transformation of economic, political and social structures of a given country (compare Mlcoch 1996, Chlumsky 1997). From this point of view, start of the transformation as well as following economic and social processes can not be considered only in the context of the transformation itself, but also in the context of its previous state.

This principle, so called path dependency (Mlcoch 1997: 27), can help to explain some problems of the economic transformation for which it would be difficult to find another explanation than simply stating they exist. In particular, it relates to creation and application of formal institutions (i.e. legal rules) and their incompatibility with informal institutions, i.e. behaviour of individual economic subjects and their qualitative attributes (compare Mlcoch – Machonin – Sojka 2000). In the course of the transformation, we find direct links between the quality of business environment, capital market and company administration and the rate and efficiency of restructuring as a whole. While it is possible to change immediately and to some extent in a directive manner formal institutions, i.e. legal framework and political structure, informal institutions, i.e. manners and stereotypes of behaviour, change spontaneously and continuously with higher or lower inertia (Mlcoch, 1997).

If we proceed from fundamental principles of economic theory, we must consider a firm as a basic unit of economy structure. From the point of economic transformation process, then the firm, its structure and its position in institutional arrangement is decisive for final macroeconomic outputs of a country. From this perspective, the role of the state within the bounds of redistribution processes, which are linked to the state budget, is marginal: on the contrary, the state has its essential

influence as a provider of economic policy that defines rules, limits and restrictions for an organisational structure of both markets and firms (see Chlumsky 1997: 15). The result is formal transformation, which is centrally supported and managed by the state, and simultaneously accompanied by transformations at the firm level. Although these firm transformations have primarily microeconomic character, they very soon reflect themselves in macroeconomic aggregates; because all firms are exposed to the same conditions, the transformation gets on in one way and thus changes of institutional structures occur spontaneously.

It is clear from the above that one of the decisive characteristics of each economy is the structure of firm proprietary rights and from this the system of its management. Proprietary rights as the institutional system of power and control, where individual participant's motive is to get better access to resources and information, are thus decisive for individual firm's efficiency (and its profitability) and international competitiveness of the national economy. The transformation was established on the grounds of radical systemic changes heading towards institutional anchoring of market economy mechanisms. The change of entire legislative economy framework, i.e. formal institutions, reflected itself in several fundamental processes: the price liberalization process, privatization process, restructuring process and international liberalization process (compare Spevacek 2002: 106). These processes then, together with general reintroduction of civil liberties, effected changes of informal institutions.

During the nineties, social dimension of the transformation gradually gained greater significance (compare Lasek 1997: 58). In connection with the decline of manufacturing, increase of unemployment and decrease of living standards, the burden of citizens and social tension grew to the extent that the process of formal institutional changes in fundamental macroeconomic areas was intentionally slowed down to keep political viability of the transformation. Simultaneously, the motive was of course the effort of governing political representation to maintain its election position; in this connection the question of using political capital, particularly in the first years of transformation, arises (for details see e.g. Kaderabkova - Zak 2002). The process of informal institutional changes, the inertia of path dependency and transformation at the firm level, however, at least from the middle of the nineties, continued (quicker or slower) with its own inertia and to the great extent independently of the formal transformation. In a number of firms, managerial structures were formed from people closely connected with the management of former socialist enterprises with links to the communist party and similar structures of state officers recruited again from officers of former socialist ministries. The model of managers' behaviour and decision-making based on maximization of their own profit and impunity, in the case of adequate political and bureaucratic connections, was inconsistent with the intention with which the formal institutions

were established. These institutions, however, were not able to defend against this model. Let's have a closer look at the institutional structure of the Czech economy in the middle of the nineties.

The Structure of Institutions and Success of the Economic Transformation

To form institutions which constitute market environment and to ensure its functioning is a long-term process; formal rules can be transferred in a relatively short time but establishing of consequent informal institutions is a long-term process. Development and efficiency of informal institutions, i.e. models of behaviour, is a long-term test of efficiency and sustainability of formal rules – norms and laws. In the course of the transformation, the foundations of market economy, which are based on private property and entrepreneurial freedom, were laid. In a relatively short time, stability of institutions ensuring democracy, law and civil rights (political criteria for the European Union entry) was guaranteed. At the beginning of the transformation, these relatively successfully implemented institutions reflected themselves in favourable development of macroeconomic aggregates: low inflation rate (in comparison with majority of transitive countries), relatively stable exchange rate, low rate of unemployment, external economic equilibrium kept within acceptable limits and inflow of foreign investments.

However, long-term, stable and positive achieving of these aggregates involved a longer time period and fulfilling of further fundamentals. The radical economic reform, based on ad hoc passing of new laws, did not lead to automatic, spontaneous establishing of an adequate institutional framework, the significance of process regulation of some key subjects and sectors of economy, such as investment funds, banking and the capital market, was underestimated (Spevacek 2002). We can also agree with L. Mlcoch (2000) that at the expense of purposive transformation of institutions, creation of well functioning legal framework and necessary emphasis on moral aspects, an excessive stress was put on rate and mass course of privatization processes. The result of such procedure, which we can now after more than ten years of the transformation observe, is the evidence of failure of promoted economic strategy just because of underestimating the role of institutions.

The structure of the economic system, which was developed in the Czech Republic in the middle of the nineties, is to a certain extent kind of state or mixed capitalism, having most of the elements of real socialism that did not function. The state does not formally manage economic processes, however, its role has been so far bigger than one could have assumed and boundaries between public and private sectors have been unclear and not obvious. The state has remained the strategic owner

of the country biggest financial institutions that founded the most important privatization funds.

The structure of the Czech economy started to be formed, apart from other things, also on the grounds of paternalistic, friendly or lobbying behaviour of the half-state oligarchy. In that way, market pressures were deformed or entirely eliminated right from the beginning. The pressures would in other situations have led to creation of a different economy structure. What is crucial is the fact that because the structure of informal institutions was stronger due to its evolutionary foundations, formal institutions could not have asserted themselves (wholly or partly) in the course of structural changes. In connection with this, there appears consideration about moral dimension of the transformation. This consideration gets through the rational economic core to irrational requirements which are then presented by e.g. trade unions and which led to restoration of formal institutions.

Distortion between formal and informal institutions retrieves other anchored institutions of thinking: Marxist 'class hatred', which was for decades the basic idea of socialistic economy. It is not thus surprising that 75% of citizens believed in the middle of the nineties that property differences between people are very big, more than 50% believed that majority of 'rich' people gained their property corruptly and 12% inferred that all of them got it corruptly. At the same time, however, the Czech economy demonstrates one of the lowest values of Gini coefficient from European countries (Spevacek 2002: 38); the Czech Republic is thus one of the most egalitarian countries. Here, the dichotomy of institutional transformation manifests itself completely. The concrete impact of this phenomenon can be seen also in the administration of joint-stock companies: fully flagrant overlooking of small shareholders rights from the side of majority owners, company administration by managers who follow solely their own, firstly planned profit without regard to final impact of this on company owners, resignation of small shareholders to their own rights performance and in consequence also to administration of their own property, etc.

The failure of the legal basis, in confrontation with the reality of the Czech economy transformation, gives evidence of the long-term nature of institutional transformation. Common element of the above mentioned failure is automatic assumption of existence of institutions that were in the Czech Republic in the nineties partly or entirely missing. From this point of view, the choice of privatisation method leading to intermediated dispersed control over privatized joint-stock companies in institutionally very weak environment and with absence of efficient regulation of financial mediators is problematic. Using the legal form of public joint-stock company also led to the failure of the voucher privatisation as a transformational programme. Reasons are associated with problems of delegation, which naturally arise, if the administration is not accompanied by developed institutional

background. The important but not the only part of this background is corporation law and the system of its enforcing (compare Richter 2002). In the next part we analyse problems of the voucher privatisation, in particular in connection with key business form: joint-stock companies.

Creating Joint-Stock Companies During the Privatisation

There were two reasons for the failure of the voucher privatisation: (i) purely economic one and (ii) blank-sale one. From the economic point of view, the voucher privatisation was based on denying of economic theory principles. By means of vouchers, the owner of corporations, who would either guarantee development of perspective firms or let the less perspective fall, should have been changed. Any positive movement in firms' development, with exceptions, had to be connected with considerable investment, at the same time however, transfer of proprietary right on the grounds of vouchers was accompanied by no capital movement and owners of these vouchers had no capital whatsoever. Only a strategic capital-strong investor with a clear business plan was able to guarantee the necessary investment.

The blank-sale problem is closely connected with this question: who could have had, even with the lack of capital, interest of property- and/or management-of privatised corporations? Apart from extraordinarily risking or above-standard informed agents, first of all those who intended to solve the lack of capital by doing transactions with the property of privatised corporations, selling their parts, selling out their property including capital substance, and finally by speculation with capital share. In this enumeration, we follow the line from the standard business plan to solve the lack of operation capital and necessary investment for sustentation of the firm economic nature to fully unconcealed speculation which leads to assessment of their property and simultaneously to closing-down of the privatised firm. It was assumed, by setting of formal rules for the voucher privatisation, that all economic agents would understand their sense and subordinate their pursuance to their declarative goal and at the same time they would change their behaviour stereotypes in a way that mass denial, violation, no observance, snub and negation of these norms would not occur. It was very naive to expect that.

The real owners of a privatized enterprise, hidden in privatization investment funds, acted according to rooted informal rule about relationship to state (collective) property and they considered property rights of new assignees only as transmission mechanism of transfer of state property into their own private ownership. This behaviour then often survived and demonstrated itself in open violation of rights of minority owners of joint-stock companies. Right at this moment, as it is shown further, the fundamental collapse of property-legal relationship with principal impact

also on macroeconomic aggregates and thus the whole economic transformation occurred.

What was then the sense to build the privatisation process on the basis of joint-stock companies? If we take into consideration that the aim of the privatisation was to establish enterprise subjects that are able to guarantee more rational and efficient economy functioning, then we must evaluate the choice of joint-stock companies as correct. Joint-stock companies are in developed market economies considered as a modern functional form of intermediated private ownership (compare Lasek 1998). In the context of this experience, hundreds of joint-stock companies were founded by a political decision for the purpose of the voucher privatisation in the Czech Republic in the beginning of the nineties. If we have a look at the choice of joint-stock companies from the broader point of view, i.e. concrete goals of the transformation, then the choice of the stock form of enterprise can be seen as more problematic. From the beginning, two main goals emerged from the conception of the transformation: (i) to change the property structure of economy and (ii) to change the organisational structure. If we suppose that these goals and their fulfilling were, to a prevailing extent, connected with the stock form of companies, then it is possible to consider the defined function of newly formed joint-stock companies as enormously difficult. The problems came mainly from the task to participate significantly in changes of proprietary relationship within the bounds of privatisation and at the same time to play its effective function at the economy's restructuring.

Generally speaking, several basic conditions—under which a joint-stock company is able to develop successfully—must be fulfilled:

- limited responsibility of associates, i.e. providers of capital, for company liabilities – it is a condition sine qua non capital concentration for assuring of investment needs of the modern enterprise. Theories of institutional evolution are based on the assumption that the social profit that comes from limited responsibility exceeds, with the greatest probability, social expenses that limited responsibility of associates brings (compare Carney 1999).
- free convertibility of membership shares. It is the condition that enables to transfer company shares without limits, contributing investment liquidity in the company. By means of this, the investor gets the possibility to manage investment risk with share portfolio diversification. Apart from the liquidity, the investment strategy also requires company monitoring and active investors' participation in the company's management. Free share convertibility requires existence of a reliable and organized market, on which it is possible to trade with shares at acceptable transaction costs. The market reliability is required, depending on information coherence, which investors have at their disposal regarding traded shares.

- role of the specialization inside the company, particularly management specialization – it means separation of claims to property and cash flows from the company enterprise management (compare Jensen – Meckling 1976, Bohata – Pechova 1999).

The further prerequisite of joint-stock companies functioning is adequate institutional background. It is difficult to determine unambiguously and completely its defining features. Therefore, we restrict only to definition of facts which at the beginning of the Czech transformation negatively influenced further institutional framework development. Joint-stock companies were set in environment which showed many specific moments:

- internal relationships of joint-stock companies were legally regulated only very briefly and unsystematically,
- financial market participants did not have experience with organisational form of joint-stock companies,
- capital markets lacked adequate legal rules for their functioning and did not have at their disposal effective administrative supervision over observance of these rules,
- courts of law were not able to operate because of their insufficient capacity,
- capital markets did not have a possibility to rely on informal institutions, above all on ethic rules guaranteeing respect for private property or on awareness that contracts should be fulfilled.

To evaluate legal aspects of Czech joint-stock companies institutional background one can use a number of approaches which the theory of corporation law provides. Contractual theories of corporate law are based on the fact that, if left on their own, capital providers will negotiate with managers which they hire to manage the company an economically efficient structure of the joint-stock company and allocation of mutual rights and duties (Richter 2002).

Formulating further conclusions will be based on these prerequisites:

- It is possible to divide all acceptable approaches into two basic groups:
 - approaches that rely on market, in other words, contractual instruments,
 - approaches that rather rely on legal regulation.
- We consider both approaches, the theoretical approach relying on market instruments and the approach rather relying on legal regulation, as complementary and in principal not mutually excluding. The differences between them are seen in importance which is assigned by supporters of one or latter approach to market or, on the contrary, to regulatory instruments.

- Both theoretical approaches take legal norm of joint-stock companies as a result of long evolutionary institutional selection. Joint-stock company is the dominant legal form creating a decisive part of gross domestic product of developed economies.
- It is necessary to link the efficiency of administration of joint-stock company to institutions which are able to keep the problems of delegation under supervision and cut delegation costs at an acceptable level.

In the following two sections we analyse the evaluative mechanisms of joint-stock companies administration in the context of the economic transformation. Then we formulate basic problems which in this connection accompanied the real performance of the Czech economy. We based our ideas on the assumption that if it is not possible to efficiently control and evaluate some subject's activities then this subject can not and will not function effectively – and this should influence macroeconomic outputs.

Evaluation of Czech Joint-Stock Companies Administration from the Market Instruments Point of View

Product and capital markets, labour market and structuring of management rewards are rated as market instruments of joint-stock companies administration. This structure of market instruments can be considered as the basic precondition for successful transformation and for fulfilment of expected aims of privatisation. On the contrary if any of these instruments do not function, it is reflected in the result of transformation and also in macroeconomic aggregates. In the next part we focus on legal analysis of individual instruments in the context of the Czech transformation and we identify the problems.

Product Market

Product markets, on which the joint-stock company sells its outputs, are important for stock markets because they integrate both the interests: of management and shareholders. If the joint-stock company is managed ineffectively, then this fact reflects itself in its low competitiveness on the market and the consequence of this should be a change of management or even the ownership. The product market is able to fulfil this role only if it works out the problems connected with:

- the existence of natural or administrative monopoly or oligopoly,

- considerable delay of information about company administration efficiency – this fact usually results in high costs, which are spent because the real state of company administration can be identified in the same time when there is no other solution than bankruptcy.

The main goal of the privatisation was set in this way and it naturally should solve restructuring of the Czech economy. Fulfilment of this goal was however complicated mainly by key norm imperfection: the law of bankruptcy and compensation.² Bankruptcy proceedings were very lengthy and complicated, the level of legal security of participants was low, proceeding costs were high and scope for activities of bankruptcy creditors insufficient. These law defects were multiplied by considerable clumsiness with which the legal rules of due settlement with liabilities in the case of bankruptcy and company financial insolvency were formulated. Insufficient institutional bankruptcy background together with difficult enforceability led to a serious failure of its functions.

In the Czech economy of the nineties there were not achieved fundamental standards on product markets. There still prevailed a monopoly (oligopoly) market structure linked to till-that-time still state owned or state managed companies, administrative regulations both in price and structural areas which led to administrative monopolisation and finally opaque and corruptive environment of contracting out of public orders and interconnection of corporate management with political establishment and state executive. Together with delayed and imperfect information, for analyses of which there was a lack of experience and historical context, product markets could have not been considered as the instrument of joint-stock companies administration.

Capital Market

An effectively functioning capital market is able to reflect general opinion about company administration quicker than a product market. It is able to provide information for both management and shareholders by means of stock price setting. The price of stock can give evidence of how well the management, charged with joint-stock company managing, operates. Anyway, there is a threat of hostile takeover if a significant fall of stock prices occurs. Generally, the capital market must, equally as the product markets, comply with certain preconditions: price integrity, liquidity, sufficient number of registered stocks with voting rights and enough financial capital to gain control over the joint-stock company. A whole number of further preconditions following from the undeveloped institutional and legal framework of the capital market was missing for efficient administration of

Czech joint-stock companies. As a starting point of the destruction of the Czech capital market institutional framework we however consider the voucher privatisation and by-state-administratively enforced share issue of almost two thousand companies with their public marketability.

Another destructive step was a support of a simplified notion about quick establishment of a liquid and functioning market with all stocks and investment certificates for all even small investors. All stocks could not have met these expectations also for the reason that the state resigned from development of rigid institutional adjustment of the capital market which could not have been compared to international standards. We can critically see especially the following characteristics of the Czech legal framework:

- Not only efficient banks were missing but also corresponding legal rules of their behaviour.
- Suitable regulation and supervision over both bank and not-bank financial institutions were missing. The principal question discussed was the range of regulation and choice of their forms, the capital market however remained practically without efficient regulation at the crucial period.
- there were no legal obstacles for company takeovers.
- finally the already mentioned absence of relevant information.

The Czech capital market developed itself mainly as the market with majorities. There prevailed destructive opinion that gaining majority in the company (i.e. at least 50.1% share in voting rights) entitled to dispose of those parts of the profit which should belong to minority shareholders. The not favourable position of minority shareholders would be multiplied if abolition of public tradability of company shares occurred. By 1996 the stated processes had proceeded without any principal legal protection of minority shareholders which led to their position weakening. They could not have relied on sufficient information flow and on protection of profit sharing to which they had their claim. Their stocks were devaluated and they could not have been publicly negotiable. The legislation did not amend rigidly the duty of majority shareholders to submit a public takeover bid. It all led to considerable difficulties of minority shareholders because their stocks became tradable with difficulty and not profitably (Mejstrik 1998). Such destructed investment environment did not motivate both foreign and domestic portfolio investors to invest in the Czech Republic. This reality is demonstrated by a considerable decline of the number of publicly negotiable (respectively registered) issues of shares on the Czech capital market since 1998.

One of the serious imperfections of the capital market was also continuing low issue activity and absence of primal issues. As a consequence of this described trend,

a considerable movement from bank credits to security issues did not occur. The capital market did not act as a more important financial resource for joint-stock companies.

The trend of buying in joint-stock shares by one shareholder was accompanied by a spontaneous tendency to cancel public marketability and leave the market. It became more and more serious because not only small and middle-sized companies left the market but also a number of the biggest joint-stock companies. On one hand, the transparency of these companies was reduced for business partners; the way to maximization of selling price of minority capital shares was closed to external investors. On the other hand, at the same time, external monitoring of the company and its managers became harder. Only monitoring institutions were thus banks which provided credits to the companies.

The situation on the capital market was complicated also by a whole number of further non-standard elements. We even witnessed the absence of such legal institutions which are taken for granted on developed securities market, e.g. not exercising sanctions for not fulfilment of minimal information duty, when the company did not publish its financial statement in the Commercial Gazette, eventually not fulfilment of information duty towards the Securities Commission.

The most profitable strategy of many companies in the nineties was cheating, which was based on using incompleteness of contracts and the legal framework. It enabled to take away the needed capital from companies and simultaneously to weaken their restructuring and deepen their indebtedness. The tendency to cheat appeared even in many companies established for the purpose of assets management and investment consultancy. They redistributed, to their advantage, entrusted foreign assets invested in shares and investment certificates.

Problems of the Czech capital market functioning were also based on its complicated and inefficient structure: low performance, high transactional costs, big fragmentation of infrastructure for registration, accounting and settlement of trade in stocks. Unlike majority of European countries, in the Czech Republic there was not a single one institution which would carry out the function of a securities register and also the function of settlement. Inappropriateness of legal amendment was within the restricted compass of the Securities Centre, which could register only entered securities while records of other investment instruments were neglected. The market transparency was reduced particularly at the time when transformations from entered to listed shares, which were not registered in the Securities Centre, took place in large scale. There often appeared situations when it was not possible to discover who the company owners were and thus sanctioned them efficiently for insufficient cooperation with regulatory authorities.

The poor joint-stock companies administration led in the nineties to rigid behaviour of the companies and to freezing of the restructuring process instead of

their creative destruction. The capital market either did not carry out its role as an instrument of joint-stock-companies administration control.

The Labour Market and Management Remuneration

The labour market is generally able to positively influence behaviour of joint-stock companies managements and stimulate them to a responsible approach to joint-stock companies administration. The principle is based on labour price decline of those managers who repeatedly inefficiently manage joint-stock companies or if the market is not interested in their work.

A serious problem in joint-stock companies administration appears as a result of the contrast between economic motivation of shareholders and of management. This contrast can be eliminated by using of a certain system of management remuneration. Experience shows that this system operates according to expectations if management is involved in economic results of the joint-stock company as much as possible and simultaneously if it is enough transparent. Often used elements of this system are direct profit sharing or option for company's share purchase. Generally, salaries of managing and advisory board members and executive directors could be made public – this mechanism, however, did not function and with regard to zero history and experience it was nearly impossible. The labour market thus also did not carry out the role of an instrument of joint-stock-companies administration control in the important period of the transformation.

Evaluation of Joint-Stock Companies Administration with Regard to Fulfilment of Legal Instruments

Legal instruments of joint-stock companies administration were in the Czech Republic based—according to the general theory—on fulfilment of several legal principles:

- protection of shareholders rights,
- equal approach to all shareholders,
- rights protection of people with influence,
- publicity and transparency of the company
- responsibility of company authority members.

Principle of Protection of Shareholders' Rights

Czech legal amendment followed the definition of shareholders rights done by OECD countries. Its effort is to fulfil standard protection principles which are:

- guaranteeing of basic shareholders rights,
- sufficient information for shareholders - the possibility to participate on decision-making about important changes in strategy,
- efficient shareholders participation at general meeting,
- keeping shareholders well informed about meetings, guaranteeing shareholder's possibility to vote either in person or also by proxy,
- publishing of the ownership structure, which enables certain shareholders to gain bigger control over the company by means of their share,
- functioning of company's authorities based on transparency and efficiency,
- considering of costs and profits of fulfilment of shareholders' rights.

Introduction of the stated principles into the Czech legal system went gradually through the whole nineties and it went together with the rules of enforcement of legitimate shareholders' claims. The economic transformation proceeded mainly in the first half of the nineties and without anchoring of majority of the stated principles into the legal system. Therefore, insufficient protection of shareholders, in particular minority ones, was characteristic through the whole nineties for joint-stock companies. Similarly, we can evaluate the situation when observing fulfilment of other principles of joint-stock company administration.

The Principle of Equal Approach to All Shareholders

In the nineties, the legal framework of joint-stock company administration was not too attractive for foreign investors. It was mainly caused by not fulfilling of the principle of equal approach to all shareholders, including foreign and small ones. Incomplete development of this principle negatively demonstrated itself in non-compliance with standard requirement for adequate compensation for all shareholders if violation of their right occurred. The stated moment significantly influenced investors' assurance because they were not provided with sufficient guarantee for their capital invested in the company. The Czech legislation did not provide, in comparison with foreign countries, efficient legal instruments for invested capital protection against misusing or ineffective treatment by managers, managing board and majority shareholders. These groups were often involved in

activities that were in their own interest and considerably harmed other groups of shareholders.

Forming of required legal rules proceeded within the bounds of amendments very slowly. Crucial changes in favour of shareholders protection came step by step as late as in the second half of the nineties concerned rules³ according to which:

- shareholders have equal rights for shares of one type,
- insider trading is strictly forbidden, as well as trades at their own expense,
- members of advisory board and board of directors are expected to show regularly their own interest in company trades, respectively in other trades influencing company management.

The principles of equal approach to all shareholders were not fulfilled during the very important period of transformation.

The Principle of Rights Protection of People with Influence

Fulfilment of the principle of rights protection of people with influence should be guaranteed primarily by means of the Civil Code⁴, Labour Code⁵, Law of bankruptcy and compensation⁶, Commercial Code⁷ etc. It was assumed that problems which these laws would not solve would be adapted contractually by a mutual agreement. It is possible to say that until the year 2000, the cited legal norms did not sufficiently define active cooperation between companies and people with influence. There was not even fulfilled the assumption of defining of compensation rules for the cases when law violation of rights protection of people with influence occurred. We have not found in laws permission for mechanisms which increase company performance by means of interference of people with influence. Their possibilities to enter the process of companies' administration were limited particularly by an insufficient approach to relevant information.

The Principle of Publicity and Transparency of the Company

The process of publishing certain information is the key moment in company monitoring and it serves as the main base for shareholders and potential investors to decide correctly. Insufficient or ambiguous information can lead the capital market to inefficiency – capital would be overcharged and company resources would be faulty allocated.

The first decade of the economy transformation was accompanied by low joint-stock companies' transparency and different approaches to shareholders when information was published. Publishing of information did not fulfil required quality and it had very destructive impact on economic decision-making of its users. Information duty of the company was not anchored in laws globally and apart from this it was not enforced in any way. Companies which had reasons to be fog certain facts were not motivated by formal institutions to fulfil, by law stated, information duty. Particularly these facts were available with difficulties or were ambiguous: financial and operational company's results, company's goals, majority shareholders and voting rights, specified future risk factors, information about employees and other people with influence, the structure of company's administration and its internal form. For many years, there was not even the condition that published information must be prepared and audited according to very quality standards of accounting⁸ and audit. Enforcement of the principle that audit must be worked out by an independent auditor (who could give an independent report on company management) was also very problematic.

Czech joint-stock companies did not manage to cope successfully with the next requirement for information which is an early and cost efficient approach to relevant information. Rules for publishing information about the company were set up formally but the way of its publishing is done by internal (informal) rules of companies themselves. This fact enables us to understand why information was often published with delay or incomplete or why an access to them was difficult and expensive.

The Principle of Responsibility of Company Authority Members

Only amendment of the Commercial Code from 2001⁹ resulted in more significant strengthening of responsibility for damage and of sanction guarantee by company authority members. The new legal amendment reacted on continuing unwillingness of some company representatives to bear responsibility for consequences of their activities which relate to company managing. These tight measures should have contributed to elimination of a possibility to misuse the considerable power of which statutory authority members disposed. New duty of managing and advisory board members to perform their tasks with the care of proper thrifty person was anchored.

At the same time, there appeared the transfer of burden of proof, that proceeding was in harmony with the care of proper thrifty person, to managing and advisory board members themselves. Each shareholder thus gained the right to accuse any member of the managing or advisory board of breaking the duty to perform their tasks

with the care of proper thrifty person. Shareholders were not obliged to submit evidence confirming that they were right.

All above mentioned institutions were missed in the nineties. As the instruments of control didn't work efficiently and the markets were still deformed, the privatised joint-stock companies performed absolutely differently of developed financial markets' standards. In that way, these companies performed differently of privatisation's aims and of the aims of the entire transition process.

Structural Changes and Macroeconomic Aggregates

The theory of joint-stock companies administration deals, in the broader sense of the word, with this issue: how one can guarantee that joint-stock companies are governed in the interest of their owners.¹⁰ In the period of the transformation, joint-stock companies should have also carried out an important function within the bounds of privatisation process and thus hopes for fulfilling of social interests were associated with them. From the logic of the chosen privatisation strategy based on the voucher method, it was obvious that there would appear winners but also losers. The process of economy restructuring, based on the development of winners and the decline of losers, was brought out of primary structural governmental policy and restructuring was, to a considerable extent, 'privatised' ex ante. Splitting up of new owners (shareholders) into groups of winners and losers was thus left to market forces and out of a direct state influence. The market, where these forces could operate, did not function perfectly because it was not sufficiently and correctly treated with formal institutions and informal institutions did not (and could not) function towards efficient and market-fair¹¹ distribution of profits and losses either. To form groups of winners and losers was thus not seen as fair and natural (and it was not in this sense); prevailing absence of adequate formal institutions when owners behaviour was shaped strengthened the importance of informal institutions and led to a higher number of deformations in administrating and functioning of new joint-stock companies.

In connection with the previous restriction of the institutional structure, we can follow the restructuring process at all levels of economy: organisational, financial and productive restructuring (compare Lasek 1997, Spevacek 2002). Basic trends of the Czech economy restructuring can be summarised into three areas: (i) privatisation, (ii) forming of new management and (iii) integration into international economy. In view of economy restructuring, its last form–production restructuring–was fundamental. To manage structural changes in production assumes the choice of suitable production programmes, stoppage of inefficient production, approach to modern technologies, free capital and retraining of labour

force. Firms that were not able to achieve this on their own (or by a merger with a stronger foreign partner) did not manage to put up with stronger and stronger competitive pressures and ended in liquidation. This influenced macroeconomic aggregates and gave picture about the success of the whole transformation.

It is obvious that two main principles of transformation meet in the sphere of production restructuring: (i) macroeconomic managed by the state and (ii) microeconomic at the level of firms. It is further obvious that total success or failure of production restructuring significantly influence the result of economic transformation as a whole. Nevertheless, the state has very small possibility to influence its own production restructuring directly. This itself conflicts with the institutional principle of economy transformation and in a purely economic view, it is a source of inefficiency. The main role of the state in this area is then to establish such institutional framework in which structural changes in production area can take place efficiently and with the lowest losses of the national economy as possible. These losses, which directly relate to production restructuring, inhibit economy performance and particularly, unemployment acceleration. As the great portion of that process laid down on the joint-stock companies, their effective management was essential.

Conclusion

The main goal of the Czech economy transformation in the nineties was to establish such institutional structure of the economy that enables to reach the EU countries' economic level. This goal is mainly seen—in general awareness and also in analytical studies—as reaching a certain level of macroeconomic benchmarks, but less as reaching a certain level of an institutional structure. The decisive moment of the transformation was the change of ownership structure in the shape of the voucher privatisation, where the key part was played by newly created joint-stock companies. In this paper we have identified main problems connected with functioning of joint-stock companies in the process of denationalization and restructuring of the Czech economy:

- formal institutions, i.e. a new legal code, amending functioning of joint-stock companies, were not implemented completely, the rule of repeated evolution was adopted and inertia of informal institutions was underestimated;
- failure of the institutional framework for joint-stock companies functioning reflected itself in failure of joint-stock companies' management and thus it made it impossible—in macroeconomic criteria—to reach the target level of main aggregates, particularly the rate of GDP growth and labour productivity;

- not functioning mechanisms of evaluation and control of joint-stock companies' management resulted in shift of management strategy of these companies towards maximization of managers' income at the profit expense of real owners;
- as a method of this strategy of maximisation of profits there occurred—in this imperfect and from the evaluation and management control point of view not functional institutional environment—financial transactions which were almost illegal or illegal completely instead of labour productivity increase and real economic performance.

Consequences of these defects were not only on the microeconomic level but also in relatively low dynamism of transformed economy, distrust of market economy, in feeling of injustice and stolen social values and finally in protracting of the economic transformation into a long-lasting process.

NOTES

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² Act N. 328/1991 Coll., of bankruptcy and compensation

³ Act N. 513/1991 Coll., Commercial Code, in valid version

⁴ Act N. 40/1964 Coll., Civil Code, in valid version

⁵ Act N. 65/1965 Coll., Labour Code, in valid version

⁶ Act N. 328/1991 Coll., of bankruptcy and compensation, in valid version

⁷ Act N. 513/1991 Coll., Commercial Code, in valid version

⁸ Act N. 563/1991 Coll., of accounting

⁹ Act N° 513/1991 Coll., Commercial Code

¹⁰ The term corporate governance is used also in the narrower sense for description of structures and process rules use data the level of company managing board (compare Marks 1999).

¹¹ As market-fair we understand such distribution of profits and losses (respectively property) which is neither result of arbitrary decisions of central authority, nor impact of market forces deformed by intentional and deliberate asymmetry of information, corruptions, deceptions, etc.

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