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Measuring the quality of corporate governance in the banking sector of Bosnia and Herzegovina

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A good system of corporate governance is a key prerequisite for sustainable economic growth and increased efficiency of an economic system and it guarantees easier access to foreign sources of capital. The financial system of Bosnia and Herzegovina is dominated by the banking system. The banking system is mostly owned by foreign enterprises. It is characterised by a very high level of ownership concentration and a closed system of corporate governance. A successful corporation requires efficient and successful management, as development of good practice in corporate governance is a *sine qua non* for corporations aiming to prosper on the market. Measuring corporate governance provides a clear overview of strengths and weaknesses of the system of corporate governance, not only for banks, but also for other enterprises. It is a foundation for a long-term sustainable and socially responsible growth and development, both of the banking system and the entire economic system of Bosnia and Herzegovina.

Keywords: corporate governance; Bosnia and Herzegovina; banking sector; system of corporate governance; measuring corporate governance; Bosnia and Herzegovina Corporate Governance index (BHCoG)

JEL classification: G28, G34, K20

1. Introduction

A modern corporation can be described as an open social and economic system that is firmly and inseparably tied into complex networks of social relationships in which values that drive all segments of modern societies are created. The current phase of corporate development has created several ways in which corporations influence the society, both directly and indirectly.

A successful corporation requires efficient and successful management, as development of good practice in corporate governance is a *sine qua non* for corporations aiming to prosper on the market. Corporate governance is actually a set of mechanisms that connects these relationships and subjects within corporations.

The aim of this research is to define a set of criteria by which the quality level of corporate governance in Bosnia and Herzegovina can be evaluated and to apply these instruments when analysing the system of corporate governance in banks of Bosnia and Herzegovina. In addition, the basic criteria for evaluation of corporate governance will be determined and associated into particular groups, ranking each criterion at the same

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time within the total evaluation. The results will be interpreted with the aim of applying these findings in business practice.

The development of corporate governance in banks of Bosnia and Herzegovina as well as in other corporations is the foundation for creation of mutual trust and development of overall business practice and trust of market participants.

2. Definition of corporate governance

The term corporate governance is very broad and it can be defined in many ways according to different approaches. It refers to the analysis of governing structures and processes in corporations and business systems (Monks, 2003, p. 8).

According to the definition by the OECD:

> … corporate governance involves … a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide adequate incentive for the board and the management to achieve goals that are of interest to the company and its shareholders …' (2004, p. 8)

Corporate governance includes the way of defining strategic objectives of an enterprise, the means of attaining those objectives and methods for monitoring performance, as well as defining relationships between the key interest groups and the enterprise itself (Cengic, 2001, p. 11). The objectives of corporate governance are transparency of operation of a joint stock company, efficient and effective use of its resources and establishing relationships among interest groups that will facilitate the realisation of strategic objectives of a joint stock company (Clarke, 2007, p. 11). With its impact on increased trust and responsibility, good governance provides credibility to a company in front of its business partners, employees and others. Good corporate governance is also a significant factor in attracting investments to the company and protection of investors (Veršic-Marušic, 2004, pp. 238–354).

3. Corporate governance in Bosnia and Herzegovina

Corporate governance within a country is regulated by a set of laws, regulations and other rules. Bosnia and Herzegovina is divided in two entities, the Federation of Bosnia and Herzegovina and Republika Srpska, with the third region, the Brčko District. For this reason in Bosnia and Herzegovina there are two separate, partially harmonised, but still different systems of corporate governance, which are based on entity laws.[1]

In the Federation of Bosnia and Herzegovina, this field is regulated by a set of laws, starting with the Company Act ('Official Gazette of the Federation of Bosnia and Herzegovina', No. 23/99, 45/00, 2/02, 6/02, 29/03, 68/05, 91/07 and 84/08), the Banking Act ('Official Gazette of the Federation of Bosnia and Herzegovina', No. 39/98, 32/00, 48/01, 41/02, 58/02, 13/03, 19/03 and 28/03) and the Takeover Code ('Official Gazette of the Federation of Bosnia and Herzegovina', No. 7/06). In addition, of significance in the Federation of Bosnia and Herzegovina is the Code of Corporate Governance ('Official Gazette of the Federation of Bosnia and Herzegovina', No. 24/06, 30/07).

Corporate governance in Republika Srpska is regulated by the Company Act of Republika Srpska ('Official Gazette' No.24/98, 62/02, 66/02, 38/03, 97/04), the Public

Company Act of Republika Srpska ('Official Gazette' No. 75/04) and the Banking Act of Republika Srpska ('Official Gazette' No. 44/03).

Considering the given circumstances, the systems of corporate governance have to be analysed separately at entity levels. This is supported by the fact that in Bosnia and Herzegovina there are two independent corporate governance codes, one by the Federation of Bosnia and Herzegovina for companies whose shares are traded on the Sarajevo Stock Exchange and the other for companies whose shares are traded on the Banja Luka Stock Exchange. Moreover, privatisation acts are also separated at the entity level, which additionally creates arguments for separate analysis of the system of corporate governance in Bosnia and Herzegovina.

4. Mechanisms of corporate governance and control

Corporate governance is reflected in several different mechanisms that make it possible for the management to run a corporation for the benefit of one or more stakeholders (Morck, 2002, pp. 10–12). There are many different mechanisms ensuring the efficiency of corporate governance, such as large shareholders, creditors, systems of internal control and monitoring, external and independent auditors, including the legal framework within which a corporation operates.

Mechanisms of corporate governance can be divided in two basic groups: internal and external. External mechanisms include: legal framework, influence of the market and competition and protection of minority ownership rights. Internal mechanisms most often include: boards of directors, management motivation policy, ownership concentration, relationship with stakeholders and transparency in the current financial operations and reporting.

Each of these mechanisms is, in a different way, significant for the control of the management's work and good implementation and application of corporate governance principles. Internal and external mechanisms are foundations for determining the index for measuring the quality of corporate governance.

4.1. External mechanisms of corporate governance

According to some authors, the mechanisms are divided by the place of origin and the way of implementing corrective measures for corporate governance. With external mechanisms, outside aspects that have an impact on setting the objectives of a corporation and their implementation are observed. External mechanisms that will be studied in the research and that will later be used as the starting point for development of an index for measuring the quality of corporate governance include legal framework, influence of the market (labour, capital and other markets) and competition as well as protection of minority ownership rights (Barbir, 2006, p. 17).

4.2. Internal mechanisms of corporate governance

Internal mechanisms include all those instruments of management control and supervising that are implemented by stakeholders who are directly associated with corporations, which primarily refers to shareholders. These mechanisms are processes of supervision and implementation of discipline in the work of the management carried out by the owner, by means of methods used within the company.

Internal mechanisms that are most frequently and successfully applied and that will be elaborated in the article, particularly in the development of an index for measuring the quality of corporate governance, include boards of directors, management motivation policy, ownership concentration, relationship with stakeholders and transparency in the current financial operations and reporting.

5. Characteristics of the system of corporate governance in the banks of Bosnia and Herzegovina

Good corporate governance depends on balanced relationships among various internal and external mechanisms by means of which management efficiency is ensured and problems and conflicts in corporate structures are solved. Characteristics of the system of corporate governance in the banks of Bosnia and Herzegovina was analysed through a research of ownership concentration and transparency of business operations. Observation of ownership concentration makes it possible to determine the system of corporate governance of the banking sector of Bosnia and Herzegovina.

Ownership concentration in the banking system of Bosnia and Herzegovina by majority ownership (Table 1)

On average, the first owner has an approximately equal share in the capital, both in the banks with majority state ownership and majority foreign ownership. It exceeds 74%, which is typical of a closed system of corporate governance. Banks in foreign ownership participate with 89.4% in total assets of the banking system in Bosnia and Herzegovina.

Table 1. Ownership concentration in banks of Bosnia and Herzegovina.

	Average ownership concentration of banks with majority state ownership in Bosnia and Herzegovina	Average ownership concentration of banks with majority domestic private ownership	Average ownership concentration of banks with majority foreign ownership	Average ownership concentration of the six biggest banks in terms of assets in Bosnia and Herzegovina (consolidated)
1 Owner	74.74	33.49	75.44	93.20
2 Owner	2.20	13.73	9.71	3.98
3 Owner	1.59	7.80	4.26	1.07
4 Owner	1.37	5.24	1.81	0.61
5 Owner	1.36	4.97	0.91	0.21
6 Owner	1.23	4.72	0.67	0.14
7 Owner	1.07	4.46	0.48	0.10
8 Owner	1.07	3.64	0.44	0.08
9 Owner	0.98	3.04	0.35	0.05
10 Owner	0.78	1.83	0.31	0.04
Total concentration of the 10 largest owners	86.39	82.92	94.38	99.48

Source: Calculation by the authors according to available data from official web sites of banks in Bosnia and Herzegovina.

The concentration in banks with majority private domestic capital is below 50%, and the second owner has a higher average share than in all other groups. It could be concluded that these banks belong to an open system of corporate governance, which is entirely opposite to all other studied groups of banks. These differences can be explained with high costs of starting a bank and gathering a large number of owners for the purpose of easier foundation and realisation of market goals. There are only few of such banks and their market share is minor, which is confirmed by the fact that the share in assets of domestic private and state-owned banks in 2011 amounted to 10.6%. However, putting the state-owned banks with centralised ownership aside, significance of domestic private banks with an open system of corporate governance is very low (Matic and Papac, 2010a, pp. 80–94).

Adequate and transparent reporting is of great importance for both existing and future investors in the capital market, as it provides an account of behaviour and work of a corporation's management (in accordance with the V. OECD principle of corporate governance). The OECD principles of corporate governance can be defined as the key document for development of the system of corporate governance at a global level. The level of transparency of the banking business in Bosnia and Herzegovina is shown in Table 2.

The key requests of the transparency directive are (European Parliament and Council: Directive 2004/109/EC, 2004, pp. 40–49): uniform publication periods – four months following the end of the reporting period – annual financial report and two months for interim financial reports; annual reports should include revised financial

Table 2. Transparency of the banking business as of December 31, 2012.

	The number of banks meeting the set criterion in Bosnia and Herzegovina	The percentage share in the total number of banks in Bosnia and Herzegovina
Website	28	100%
General documents of a company	10	35.71%
Report on the overall bank's performance in 2011	23	82.14%
Names and responsibilities of the members of management board	27	96.43%
Names and responsibilities of the members of supervisory board	27	96.43%
The amount of fees paid to the members of management and supervisory boards	0	0%
Publication of shareholders with more than 5% share	24	85.71%
Publication of shareholders with less than 5% share	23	82.14%
Published reports for five years and more	20	71.43%
None of the annual reports were published	1	3.57%

Source: Calculation by authors according to available data from official web site of banks in Bosnia and Herzegovina.

reports and management report; publications have to be available to the public for at least five years; semi-annual financial reports according to IAS 34 have to include additional management report; interim management reports (overview of development and company performance and position as well as description of key risks and uncertainties faced by management) for issuers of shares in the first and third quarters, and mandatory publication on the Internet.

According to these key guidelines and recommendations, a general conclusion can be made that the banking system does not entirely meet the set transparency criteria, although banks, as a whole, have higher transparency level than other institutions and corporations in Bosnia and Herzegovina. It can be further concluded that mechanisms of control and overall transparency enhancement is not sufficiently developed. This can be also explained with the highly closed system of corporate governance with high ownership concentration, firm control by the management, poorer protection of small shareholders and low importance of financial market (Matic and Papac, 2010b, pp. 135–157).

6. Measuring the level of corporate governance

It was determined by the research that there is a relation between the quality of corporate governance and the value of shares, improvement and development of a corporation and, finally, satisfaction of stakeholder groups. Indicators of the quality of corporate governance are in theory called indices of quality of corporate governance, and they are based on the degree to which they are meeting the set criteria prescribed by supranational recommendations and in a framework of law and national standards of corporate governance. In addition to the term quality of corporate governance, another term that is often used in practice is the level of corporate governance.

Indices are most often adjusted to national framework of law of the country in which they have been developed or applied, and they also depend on the form of the system of corporate governance. Indices of corporate governance are used to measure the quality through measuring the degree to which the set criteria have been met. The criteria are actually standards set by the OECD principles of corporate governance that are often included in the national framework of law.

Different indices are used in practice to indicate the quality of corporate governance.

Each of the measuring instruments of indices of the level of corporate governance has some common segments, primarily the fact that corporate governance is measured by analysing a certain number of categories, i.e. set criteria (Table 3).

Each index has a certain number of criteria that are divided in several groups or categories. Evaluation of the level of corporate governance is actually a degree to which the set criteria have been met. The final ranking is therefore expressed as a percentage of meeting the set criteria, which can be further distributed in certain classes and groups. Development of the instruments for measuring the level of corporate governance and its application in Bosnia and Herzegovina is based on international standards and recommendations of corporate governance, national legal framework and regulations pertaining to this area.

7. Measuring the level of corporate governance in Bosnia and Herzegovina

The quality of corporate governance is defined by international standards and the national institutional framework and codices of corporate governance. Deviations from the set standards are assessed by means of an index of the quality of corporate governance, where the final rating is the degree to which the set criteria have been met

Table 3. Comparison of indices for measuring the level/quality of corporate governance.

Index	Application Area	Number of Criteria	Number of Categories	Grading Scale
ISS Index - Corporate Governance Quotient or CGQ	S&P 500, S&P 400, S&P 600, Russell 3,000	61 (American corporations) and 55 (non-American corporations)	8	from 1 to 100%
Index S&P - S&P Corporate governance score	USA and UK (only at the invitation of a corporation)	80 to 100	5	from 1 to 100% (from 1 to 10)
GMI rating	Russell 1,000, S&P 500, S&P 400, TSX 60, Nikkei	450	14	from 1 to 100% (from 1 to 10)
DR rating – Deminor Rating	USA and UK	20 complex criteria	4	from DR-1 (lowest) to DR-10 (highest) => scale goes by 1/2 value
Index DVFA – Scorecard for German Corporate Governance	Germany and other countries of continental Europe	47	7	from 1 to 100% (from 1 to 8)
Index PFCG – Polish Forum for Corporate Governance	Poland – highest rating of OECD for development of corporate governance	60	9	from 1 to 100% (from A to E – for example A, A-, B+, B, B-,…)
Index TRIS – Thai Rating and Information Services	East-Asian stock markets	45	4	from 1 to 100% (from 1 to 10)
Brunswick UBS Warbuk	Moscow stock market	20 complex criteria	8	from 1 for the best ranking companies to 72 for the worst

Source: Analysis by authors.

(compliance). The overall ranking expressed by this index makes it possible to determine the level of deviation from the ideal level of the quality of corporate governance, assess the existing level and make recommendations for future. Accordingly, if deviation is lower, the rating of the level of corporate governance is higher and closer to 100% (which is ideal) and vice versa. The rating for each particular category as well as each criterion is determined in the same way as the final rating of the quality of corporate governance.

An index developed for the purpose of analysing the banking sector of Bosnia and Herzegovina is known as the Bosnia and Herzegovina Corporate Governance index (BHCoG). The BHCoG index was developed and tested based on a Scorecard for German Corporate Governance index, intended for German corporations whose shares are traded with in the German capital markets, where the system of corporate governance has the same properties as in Bosnia and Herzegovina. The main reason for this choice lies in the fact that there are several similarities between the systems of corporate governance in Germany and Bosnia and Herzegovina. This refers to the fact that both systems have characteristics of a closed system of corporate governance, that governing bodies are organised according to a dualistic model, corporations are funded through bank loans and less through financial markets, and finally, legal framework of Bosnia and Herzegovina is related to the legal framework of the countries of Continental Europe, and also, there is a clear traditional orientation toward German business practice.

When creating an index for evaluation of the quality of corporate governance, the properties of the system itself should be taken into account as well as a set of the most important mechanisms. Corporations in Bosnia and Herzegovina have characteristics of a closed system, and potential instruments can be formed according to a pattern that is typical for the European continental system, which has very similar basic characteristics.

7.1. The structure of the index for assessing the quality of corporate governance in Bosnia and Herzegovina

Through seven categories and 47 criteria distributed within these categories, the BHCoG index provides a possibility to determine a unique rating of the quality of corporate governance, as it is adjusted to the institutional framework and conditions in Bosnia and Herzegovina. Categories and criteria for the BHCoG index is taken and adjusted to index Scorecard for German Corporate Governance (Drobetz et al., 2004).[2]
Categories used for rating the quality of corporate governance are as follows:[3]

(1) Corporate governance – general part (weighted to the total rating 10%)
(2) Shareholders and shareholders' assembly (weighted to the total rating 12%)
(3) Supervisory board (weighted to the total rating 15%)
(4) Management board (weighted to the total rating 10%)
(5) Cooperation between the supervisory and management boards (weighted to the total rating 15%)
(6) Business transparency (weighted to the total rating 20%)
(7) Financial reporting and auditing of annual financial reports (weighted to the total rating 18%).

Evaluation by means of this index would be carried out on an annual basis and it would refer to a period of one business year (12 months), i.e. for the period between two shareholders' assemblies. Possible rating classes indicating the quality of corporate governance would include:

0–15%: the enterprise has extremely weak corporate governance (F)
16–25%: the enterprise has very weak corporate governance (E)
26–35%: the enterprise has weak corporate governance (D)
36–45%; the enterprise has poor corporate governance (+D)
46–55%: the enterprise has poor to average corporate governance (C)
56–65%: the enterprise has average corporate governance (+C)
66–75%: the enterprise has average to good corporate governance (B),
76–85%: the enterprise has good corporate governance (+B)
86–93%: the enterprise has very good corporate governance (A)
94–100%: the enterprise has extremely good corporate governance (+A).

The process of assessing the quality of corporate governance according to this index would include several phases, as follows:

(1) Gathering data on the enterprise which will then be used as the foundation for determining the quality of corporate governance (annual reports, general documentation of the enterprise, books of rules, rules of procedure, business policy, websites, reports from shareholders' meetings, boards, etc.)
(2) Determining the rating for each criterion
(3) Determining the rating for each individual category and total rating
(4) Development of a draft report and delivering the report to the enterprise for the purpose of making comments and additional information
(5) Final rating and public disclosure of the rating and overall report.

Structure of such a report could include:

(1) Report title (for example, Report on the quality of corporate governance for the enterprise "XY' measured according to the BHCoG index)
(2) General information on the enterprise (legal form, field of activity, responsible persons, ownership)
(3) Explanation of ratings for particular categories and particular criteria that categories consist of
(4) Explanation of the final rating of the quality of corporate governance of enterprise
(5) Recommendations for future measures for improvement of the quality of corporate governance
(6) Date, signature and seal of the enterprise that carried out the evaluation.

Such an evaluation should be carried out after the annual shareholders' meeting. Users of this report would include all stakeholders (owners, management, the employees, creditors, regulators, stock market, buyers, suppliers, financial mediators, counsellors, academic community and the entire society) (FRC- Financial Reporting Council, 2003).

Reasons for implementation of this type of evaluation arise from the very essence of corporate governance. Risks and obstacles for implementation of the BHCoG index can be found in several facts, including the fear of a negative reaction of the society to those with low ratings, media pressure and 'lynch', negative reaction of owner to the management board of enterprises with poor rating, poor cooperation of the enterprise conducting the evaluation and the enterprise being evaluated, but also of market regulators.

7.2. Analysis of the ranking of corporate governance according to the BHCoG index for the largest four banks in Bosnia and Herzegovina

The BHCoG index is used to analyse the quality of corporate governance in four banks with greatest assets in Bosnia and Herzegovina, through analysis of particular categories and criteria within them. The aim of the index is to determine the degree to which particular criteria and categories have been met and to determine improvement areas.[4] Table 4 provides an overview of the BHCoG rankings for the studied banks (four banks with greatest assets in Bosnia and Herzegovina) separately and analyses the degree to which particular categories have been met (CBBiH Annual Report 2009–2013).[5]

Table 4. Overview of the final ratings according to the BHCoG index for particular banks and the degree to which the criteria have been met.

	Cat I	Cat II	Cat III	Cat IV	Cat V	Cat VI	Cat VII	Final rating of the level of corporate governance according to the BHCoG index
B1	37.50%	90%	100%	55%	50%	82.5%	95%	76.15%
B2	75%	85%	80%	70%	50%	67.5%	100%	75.7%
B3	65%	87.5%	87.5%	85%	80%	62.5%	95%	80.23%
B4	57.5%	70%	92.5%	62.5%	50%	67.5%	92.5%	71.93%
Average ranking	58.75%	83.13%	90%	68.13%	57.5%	70%	95.63%	76%

Source: Calculations by authors according to the BHCoG index.

All banks achieving less than 55% in particular categories indicate the critical situation in corporate governance in this field and require necessary improvements, whereas those with rating from 56% to 65% are in a less alarming situation, but still require improvements. Everything above this result requires small improvements and has average to good corporate governance.

Legal framework of banks, although divided according to the entity they belong to, has created prerequisites for good practice of corporate governance in Bosnia and Herzegovina. This can be seen in the final rating of the BHCoG index for the studied banks, where B2 banks with a rating of 75.70% and B4 with a rating of 71.93% have average corporate governance (rating B), whereas B1 with rating 76.15% and B3 80.23% have good corporate governance (rating B+). Ratings are shown in the last row and calculated by means of the index methodology.

Ratings of particular categories reflect the situation in the entire system in Bosnia and Herzegovina and they represent the average rating of a particular category for each of the studied banks. Categories with the lowest ratings include Category V – Cooperation of the management and supervisory boards: 57.50%; then Category I – General part and recommendations: 58.75%; and the reason for this is lack of a unique legal framework and inadequacy of the existing one in defining the relationship between the management and the supervisory board and insufficient exploration of this problem for banks. Category IV – Work of the management board: 68.13%; and Category VI – Business transparency: 70%, thus belonging to the average level. Category II – Assembly and shareholders, Category III – Supervisory board and Category VII – Financial reporting have very good ratings of corporate governance.

The total rating of corporate governance of the studied banks is + B (76% of compliance), which means that their corporate governance is good. This actually points to the fact that the banking sector is on a turning point in terms of corporate governance, requiring improvements in particular categories in order to make a step forward toward a higher level of trust and improved business practice in Bosnia and Herzegovina.

8. The perspective of corporate governance in the banking sector of Bosnia and Herzegovina

The issue of corporate governance can be approached only through analysis of particular categories and criteria within these categories. Improvement of corporate governance starts from the fact that each category should be improved first, which will result in the need for a more systematic improvement of the quality of corporate governance. Ratings of particular categories are here used as the starting point, as shown in Figure 1.

It can be noted that the main directions for improvement of institutional framework include increased control of work of the management board, standardisation of cooperation of governing bodies that would be based on social responsibility and increased business transparency.

Areas of improved institutional framework lead to raising awareness about the importance of corporate governance. Therefore the Securities Commission should be given the authority to impose sanctions and undertake immediate actions against issuers of shares, define unique regulations of this area at the level of Bosnia and Herzegovina, improve and adjust the existing laws according to supranational recommendations (OECD Principles and recommendations of the EU).

Control of the work by governing bodies should be defined by a unique code of corporate governance. It is necessary to improve education of the members of the

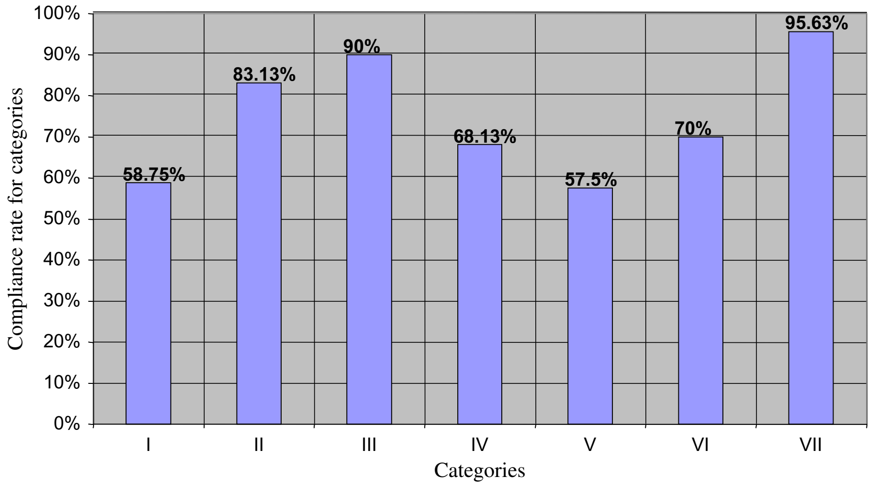

Figure 1. Compliance rate for categories of the BHCoG index.
Source: Calculation by authors according to the BHCoG index.

management and supervisory boards, encourage the importance of independent members in the boards, and introduce responsibilities of the members of boards and control their work (especially of transparency and costs of board activities).

In terms of transparency, standard forms of corporate reports should be introduced, along with disclosure of information through central registers. Information on indirect ownership should be improved; the Internet should be used as the main reporting channel. Also one or a unique 'window' of information on corporations should be introduced (Fathi, 2013).

In terms of shareholders' protection, common and improved procedures for important transactions and transactions with associated persons should be adopted, and shareholders should be entitled to take legal action and ask for damages. Equality of the change in shareholders' equity should be enabled, common provisions for tenders and transaction controls adopted, participation of shareholders in shareholders' assembly facilitated. Also, the rights associated with 'mandatory tender offer' and 'squeeze-out'[6] rights should be considered. Here requests by investment funds to develop and publish ownership policy and the policy of conflict of interest should be mentioned (Gompers, 2003).

For the purpose of determining the level of corporate governance, an analysis of ratings determined according to the BHCoG index will be carried out. According to this index, good corporate governance is the one with compliance being 86% or more, that is, ranking A, or the degree to which the criteria are met is higher than 94%, which is + A ranking. This actually means that the compliance rate of each of the observed categories amounts to more than two thirds of the set criteria.

The level of quality of corporate governance for enterprises ranking from 56% to 85% is characterised by medium level with serious problems in particular segments of corporate governance and by this also with demands for serious changes and improvements in this field. This category also includes the level of corporate governance in banks in Bosnia and Herzegovina.

Every rating below 55% requires a high level of improvement of the quality of corporate governance, and the systems with such ratings are characterised by instability and a high level of internal problems, lack of transparency and full domination of the management.

9. Final considerations

Modern day is the time of many great turning points for the world economy. Crisis and recession, failure of large and, until recently, powerful corporations, discoveries of large management frauds, crises and insolvency of financial markets and many other problems have created new demands on the overall economic theory and practice. All the complexities of the moment have created some new principles, theories and approaches for modern science of economics. One of these new theoretical views and concepts in this context is corporate governance. It is not possible to give an unambiguous definition of the concept of corporate governance and there are several problems with its definition, some of which even of semantic nature. It is defined as the way of responsible management and control of a company.

The aim of this research was to analyse the possibilities to develop measuring of the quality of corporate governance and to define an index which is now known as BHCoG. The index was used to analyse the level of compliance of corporate governance with OECD standards in four banks with their greatest assets in Bosnia and Herzegovina.

Overall evaluation of corporate governance of the studied banks is + B (76% compliance), meaning that corporate governance is good. These facts show that the banking sector, when corporate governance is concerned, is at the turning point where some categories need to be improved in order to make a step forward toward higher level of trust and improved business practice in Bosnia and Herzegovina.

Problems of categories with lower ratings originate in the fact that management has overall control over business, policy, business costs and management compensations as well as information on company performance. Based on this it can be concluded that by controlling these segments the management protects its position and this reflects in lower ratings for cooperation with supervisory board that should control the work of the management and provide corrective actions. The very essence of the problem with the concept of corporate governance arises from this, and that is separation of owner from the management or governing functions. This also reflects on the business transparency which is determined and controlled by the management and reduced to the level of mandatory and legally prescribed information.

The main goal of this research was to define a set of criteria to evaluate corporate governance and to associate them into certain categories through which the level of corporate governance not only in banks, but also in other enterprises in Bosnia and Herzegovina, will be analysed. Analysis of corporate governance in selected banks was carried out in this research and the level of good corporate governance was determined. A set of guidelines was defined to improve the system of corporate governance in the banks of Bosnia and Herzegovina, but also in other enterprises in this country. As a result of this research, conclusions were made about adjustment of institutional framework, increased business transparency, improved cooperation among governing bodies, reduced business costs. This will contribute to the system of corporate governance in Bosnia and Herzegovina, both in banks and other enterprises.

The development of such measuring instruments that can provide a clear image of strengths and weaknesses of the system of corporate governance both in banks and other enterprises has become a foundation of a long-term sustainable and socially responsible growth and development, not only of the banking system, but of the entire economic system of Bosnia and Herzegovina.

Notes

1. However, the banking system of the Brčko District will not be taken into account in this research, as the banks operating in the area are in the jurisdiction of the Banking Agency of Republika Srpska.
2. Adapted from: Scorecard For German Corporate Governance – Deutsche Vereinigung für Finanzanalyse und Asset Management, Frankfurt, 2003. Available from: http://www.ecgi.org/codes/documents/scorecard_d.pdf (accessed February 2014).
3. The number and types of categories as well as their weights in overall ranking are adjusted to original index and harmonised with the existing institutional framework in both entities in Bosnia and Herzegovina. The value of the weight was determined based on the existing experience and results of research of the significance of particular segments of the ranking for social and interest groups and their impact on overall quality of corporate governance. The types of criteria originate from the ranking criteria that were determined in various national codes of corporate governance, such as Sarbanes – Oxley law in the USA, Combined Code – Great Britain, OECD's Principles of corporate governance. The BHCoG is adjusted to the conditions of institutional and market framework of Bosnia and Herzegovina.
4. Research conducted for the development of instruments for measuring the corporate governance in Bosnia and Herzegovina in order to defend a Master's thesis.
5. Bosnia and Herzegovina is financially a bank-based system. Banks control more than 85% of the financial assets in 2012. Majority foreign-owned banks continued to dominate the domestic banking system as they accounted for 87.3% of the total equity and 91.9% of average assets at the end of 2012. The share of the assets of the three largest banks exceeds 50%. These data were the main reason why the analysis of the quality of corporate governance in the four largest banks in Bosnia and Herzegovina (Source: Annual Report 2012, Central Bank of Bosnia and Herzegovina, Sarajevo. Available at: http://www.cbbh.ba/files/godisnji_izvjestaji/2012/GI_2012_en.pdf).
6. Small shareholders are 'squeezed out' in the situation when large shareholders buy a company and start business activities or reregister it in a different form.

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