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INTRODUCING SINGLE BOARD SYSTEM AT JOINT STOCK COMPANIES MERGER - JUSTIFICATION OF ITS INTRODUCTION AND DEVELOPMENT OF ECONOMIC PRACTICE IN THE REPUBLIC OF CROATIA

ABSTRACT

The purpose of this study is to show the possibility of transition to a single board system at the merger of joint stock companies. The study aims at analyzing the business situation of merging Puljanka d.d. (Puljanka Joint Stock Company), Brionka d.d. (Brionka Joint Stock Company) and Istra d.d. (Istra Joint Stock Company) as well as the organization of the new company according to single board system. The indirect aim is the contribution to the development of economic practice in the Republic of Croatia as well as further scientific research in this field.

This research is built upon the assumptions that the Management and Supervisory Boards find it justified for the merger of public joint stock companies to take place as well as that the Management and Supervisory Boards consider it appropriate for the new common company to be organized according to a single board system.

The merger and the single board system implementation are based on theoretical assumptions, legislative regulations of the Republic of Croatia as well as the global business practice so far.

JEL: G34, M10, L20, K22

Key words: *merger, dual board system, single board system, joint stock companies*

1. Introduction

Since the Act on Amendments to the Companies Act came into effect (1 April 2008) the following joint stock companies have introduced single board system: Arenaturist, Pula and Dina-Petrokemija from Omišalj, member of the DIOKI group; some companies have announced to do so, such as Nexe Grupa from Našice; while some predict the same for Pliva d.d., Istra cement, INA d.d. daughter companies, Adris Group and Uljanik plovidba.

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The scientific studies published in 2007 and 2008 in the Republic of Croatia in the field of corporate governance, management and corporate law, which mostly dealt with the features of dual board and single board system, possibility of choosing between the two models as possible models of corporate governance of joint stock companies (hereinafter: the companies) in the Republic of Croatia, interpretation of the Companies Act, interpretation of the EU regulations and comparisons etc., made an attempt to forecast to what extent and in what situations the owners would choose to introduce a single board system. There was a widespread opinion that the possibility of choosing a single board system would be mostly used by those companies which had that same corporate governance system in the country where the corporation head office is (headquarters), then the offered possibility would be considered by the newly founded companies as well as companies with concentrated ownership. Therefore, the experts do not expect many of the owners of joint stock companies in Croatia to choose to leave the dual board system. This is supported by the Slovenian example, where single board system was introduced two years ago and some 20 companies have implemented it since then (11).

The purpose of this study is to show the possibility of introducing single board system at **merger**. The aim is the analysis of business situation of merging Puljanka d.d., Brionka d.d. and Istra d.d. and the introduction of a single board system in the new company. Indirectly, it aims at contributing to the development of the business practice in the Republic of Croatia as well as to further scientific research in this field.

This study is built upon the following assumptions:

(1) Management Boards and Supervisory Boards find it justified for the merger of public joint stock companies to take place

(2) Management Boards and Supervisory Boards consider single board system to be appropriate for the new common company.

Apart from this, the study will try to answer the following basic questions:

- What is the future interest of those companies in terms of status and corporate governance?
- What are the motives behind the merger?
- Were the companies historically formally or informally connected?
- What are the merger proceedings like?
- What are the reasons for choosing single board system?
- How would the Board of Directors be organized?

The developed European countries tend to offer the possibility of choosing between the two models. The same possibility exists in Croatia. However, researches have shown that introducing the single board system in the countries with transition economies has not met expectations. According to Pučko, the single board system of corporate governance is far less suitable for the environment in the Central European transition countries due to the lack of key preconditions for system’s good functioning. (20, p. 6-8). Having this in mind, dual board system would be more appropriate even in Croatia; this kind of approach points out the external factors of a company. Approaching the EU regulations, the study assumes the "shifting" of choice from country level to corporation level, i.e. it is based on the approach that every joint stock company has to decide for itself which system would be better. Naturally, this does not exclude the level of development of market institutions and capital markets, the judicial system efficiency, etc. as "topics" related to external, wider company environment, besides the factors of internal and industrial environment.

2. Single Board System Main Features

Two main systems of corporate governance have originated and developed within the two considerably different economic and social systems – single board in the Anglo-American system, and dual board in the European system. The former is based on "market" (as in the USA and the UK) and the latter on "relationships" (as in Germany and Japan) (18 in 24, p. 101).

For the American and British markets, which are characterized by dispersed ownership, big independent corporations, dynamic securities trading, developed market institutions and minimal government intervention, as well as a legal system which discourages ownership by banks or other financial institutions, the development of single board system based on "market" is a logical one. On the other hand, in Germany and Japan, where in most companies a dominant share belongs to big shareholders - business groups (concentrated ownership), often bound through cross-holding ownership relations, and where financial organizations (principally banks) and corporations are strongly connected, the financial markets are weaker and at the same time influenced by a strong government intervention, dual board system has been developed, based on "relationships".

In company practice there is no unique model of dual board or single board governance system (primarily due to specific characteristics of certain countries in terms of size, structure and organization of boards and committees). Furthermore, the tendency of convergence of the two models has become increasingly noticeable. (6, p. 370).

When comparing these two main corporate governance systems, one basic difference immediately becomes noticeable: while in the dual board system the management board and the supervisory board are strictly separated, in the single board system these two are united within one body - the board of directors. Both joint stock company systems include the shareholder assembly. Dual board system (*two-tier system*) is designed into two levels in order to separate executive functions from supervisory ones. The supervisory board (top level) consists of non-executive directors and outside directors who can represent shareholders, employees, government, institutional investors. Hence there is a strict separation between executive and management functions and supervisory ones. The management board (lower level) consists of executive directors. In general, countries' Companies Acts do not allow the supervisory board membership to be compatible with simultaneous membership in the management board of the same company. (15, p. 15). The management board is responsible for managing the company, while the function of the supervisory board is primarily supervision, namely, it supervises the conformity of the management board activities with the law and the Articles of Incorporation, but should participate in the strategic management of the company as well. Therefore, the supervisory board should bear the importance of a governing body (based on ownership authority), and not only of a supervisory body (7, p. 695-696). The supervisory board members are appointed by the general shareholder assembly, and the management board members as well as its president are appointed by the supervisory board.

According to the single board system (*one-tier system*), executive directors or inside directors and non-executive directors or outside directors work together in one organizational layer, that is, in a unique board of directors of the company. Therefore there is no strict separation between managing a company's business and supervising it. Within the unique board of directors there are functionally different members who run the company's business (*managing* or *executive directors* in England, that is, *full-time, inside directors* in the USA) and those who have the supervisory function (*ordinary, non-executive directors*, or *outside, part time directors*).

Executive (inside) directors work full-time in the company and run the company's business daily. Non-executive (outside) directors are not company's employees and are not directly related to the company. Independent non-executive directors are directors who have no business, family or any other relationship with the company whatsoever, with its shareholders who hold control rights in the company, with the management or the like, because this would represent a conflict of interest which would prejudice their judgment.

The 2003 Companies Act was amended by the Act on Amendments to the Companies Act (Official Gazette of the Republic of Croatia, No.107 dated 19 October 2007) which provides joint stock companies with the possibility to choose between the two models. The decision of the Croatian legal system so far to choose the continental, that is, the "German" governance model which is closer to us is quite understandable, so is the introduction of the so called "soft" regulations into the choice of corporate governance model at this particular moment of adjusting the Croatian legal system to the EU regulations. Companies are thus left with the possibility to choose the model which suits them best in terms of ownership structure, business activity (competition) and business environment (economic, political and legal system). The companies are free to choose between the offered corporate governance systems and do so by their Statute. During their lifetime companies can change this decision.

According to the Act on Amendments to the Companies Act (hereinafter: AACA), the number of the board of directors members is established by the Statute, and it can include at least 3 and no more than 21 members, depending on the size of capital stock. An uneven number of members is required. Executive directors are appointed by the board of directors, among the board of directors members as well as those who are not members of this board. In case the board of directors includes executive directors, the condition must be met that the majority of members are non-executive directors (Art. 272.1). Executive directors can be recalled by the board of directors. In case more executive directors were appointed, they are authorized to run the company's business solely together.

The board of directors, according to AACA, manages the company's business, sets the basis for performing the company's business activities, appoints and recalls executive directors.

The board of directors is authorized and obliged to manage the company business for the benefit of the company, it is obliged to supervise the way the company business is run as well as to represent the company toward executive directors. The scope of its activities includes the drawing up of the company business plans related to the company's business activities as well as keeping business records.

The question remains what are the reasons for changing to single board system? Research studies have not found a cause and effect relationship between a corporate governance model and business results (5).. The authors (23) put group dynamics, team work and communication between board members, that is, communication between directors and executive management before board structure.

Also, researches have shown that the financial indicators of success and growth potential are the key information for institutional investors, whereas corporate governance ranks very low within the criteria, with the exception of the communication aspect of corporate governance related to providing information on salaries and awards to top management (19 in 14, p. 24). However, the research carried out by McKinsey and Company and Institutional Investor Inc. showed that investors who followed value strategy and invested into undervalued or stable companies, were willing to pay more for quality corporate governance (1 in 14, p. 24).

Contemporary theoreticians define corporate governance as relationships within a company and between the company and its environment, but also offer a holistic model of corporate governance. This model does not focus only on legal and regulatory dimension neither accounting nor ethical dimension, but consider corporate governance using a multidisciplinary perspective. According to this model, shareholders and stakeholders are only two components of the model, the other being corporate social responsibility, human resources management, organizational culture etc. (24, p. 94-108).

3. Principal Assumptions for Merger and Business Situation Description

Merger is one of the ways of achieving company development goals by merging two or more companies, usually similar in size. Mergers appear at the beginning of the 20th century when small companies decided to merge in order to increase their market share, reduce costs and ensure higher products and services prices on the market. They became more often in the 1990s. By the act of merging, companies connect and create a new common company, while previous independent companies cease to exist. The name of the newly formed company usually includes the names of former independent companies, but this does not have to be the case. In practice, mergers are performed by the companies which operate in the same industry, companies which were competitors, as well as companies which formed an alliance and this alliance after some time lead to merger (Note 1).

We can differentiate between several ways of merging (3, p. 8):

(1) horizontal merger – is a merger of two competitive companies which operate on the same market, that is, two companies in the same line of business. This kind of merger can have a great effect as well as a little or insignificant effect on the market. When two little companies merge horizontally, the result is less obvious. On the other hand, when two big companies merge horizontally it affects the whole market, sometimes even the whole economy; (2) vertical merger – happens when a company is merged with a supplier or distributor, that is, when the companies which are being merged work on different production levels of the same product. This kind of merger can be considered a non-

competitive kind since it can often separate a purchasing/distribution company from its competition; (3) conglomerate merger – is a merger of two companies which operate in different industries.

Regardless of the way of merging, companies tend to merge if this merger brings benefit. For example, if one company has a great product but a lousy distribution, and the other an average product and excellent distribution technique, the two companies will benefit from the merger and achieve synergy.

The Companies Act sets the conditions for company mergers and takeovers. Article 533 of the Companies Act prescribes that a merger can be decided upon only after each company has been registered into the Registrar of Companies for at least two years. The Act prescribes that by registering the new company into the Registrar of Companies, the merging companies cease to exist. In addition, in case of joint stock companies, the shareholders of the merging companies become the shareholders in the new company by their being registered into the Registrar of Companies. This is not the case if one of the merging companies holds treasury shares or if they are held by a third party in his/her name but for the account of the company (25, 111/93, Art. 533). Market freedom as well as market efficiency are necessary for the development of a country's economy. Market competition stimulates innovation, reduces prices of products and services, increases their quality and widens choice for consumers.

In the European Union, the European Commission is authorized to ensure that business entities and governments follow the European Union rules on "fair play" in trading with goods and services, thus enabling the governments to intervene if the markets do not satisfy consumers or business entities, or to promote innovation, unique standards or develop small enterprises (10). The Commission can approve a merger under certain conditions or prohibit it in case, after the merger, there is a possibility of this company easily squeezing out the competition or if too few companies would be left on the market – which would consequently lead to the reduction in innovation, products and services price increase, and the choice for consumers would narrow. This calls for the supervision of mergers on the market. In the Republic of Croatia these kinds of activities are supervised by the Agency for Protection of Market Competition. In the European Union, the Commission is usually convened for the purpose of examining big cross-border mergers and in case small companies consider the engagement of the Commission would be much less complicated than going to several member countries individually. Most mergers are allowed in practice. There are many motives for merging companies: (1) company development – bigger, growing company wants to take over smaller competitors in order to become even bigger. The general public opinion is that bigger companies are more stable, safer and more profitable, whereas smaller companies can be more flexible, can react faster and more easily to changes in their environment, therefore the advantages and disadvantages of merger should be seriously considered; (2) access to resources, innovations, technologies, cheap workforce etc. – some companies, especially small ones, tend to merge in order to access material resources more easily, or when faced with the lack of technology and capital. In this case they look for a bigger partner which will provide the necessary capital. Regardless of the resources which are crucial for merger, the most important resources are the human resources and should be paid special attention to. (3) cutting down on expenses and taxes – sometimes managers try to cut down on expenses by integrating operations (sometimes even on a global level).

Optimization of all resources (material, financial and human) leads to the increase of efficiency and competitiveness of products and services on the market. (4) company defense – some mergers happen as a defense or a response to other mergers in order for a company to keep its position on the market.

The advantages of merger are the following: reduction of costs and expenses, easier and better access to resources, innovations, technologies, cheaper workforce, expansion into new markets, market share increase, increase of the number of talented people in the company, faster result achievement, capacity increase, production differentiation etc. The disadvantages are: loss of individual company culture, management nonconformity, possible conflicts in the newly formed company and layoffs, reduction in market competition and innovation, possible narrowing of consumer's choice, difficulties in finding a common company vision, difficulties in establishing good communication and a quality relationship between employees who come from different companies, need for big finance etc.

3.1. Basic Information on Brionka d.d., Puljanka d.d. and Istra d.d. – Ownership, Organizational Structure, Financial Indicators and Employee Structure

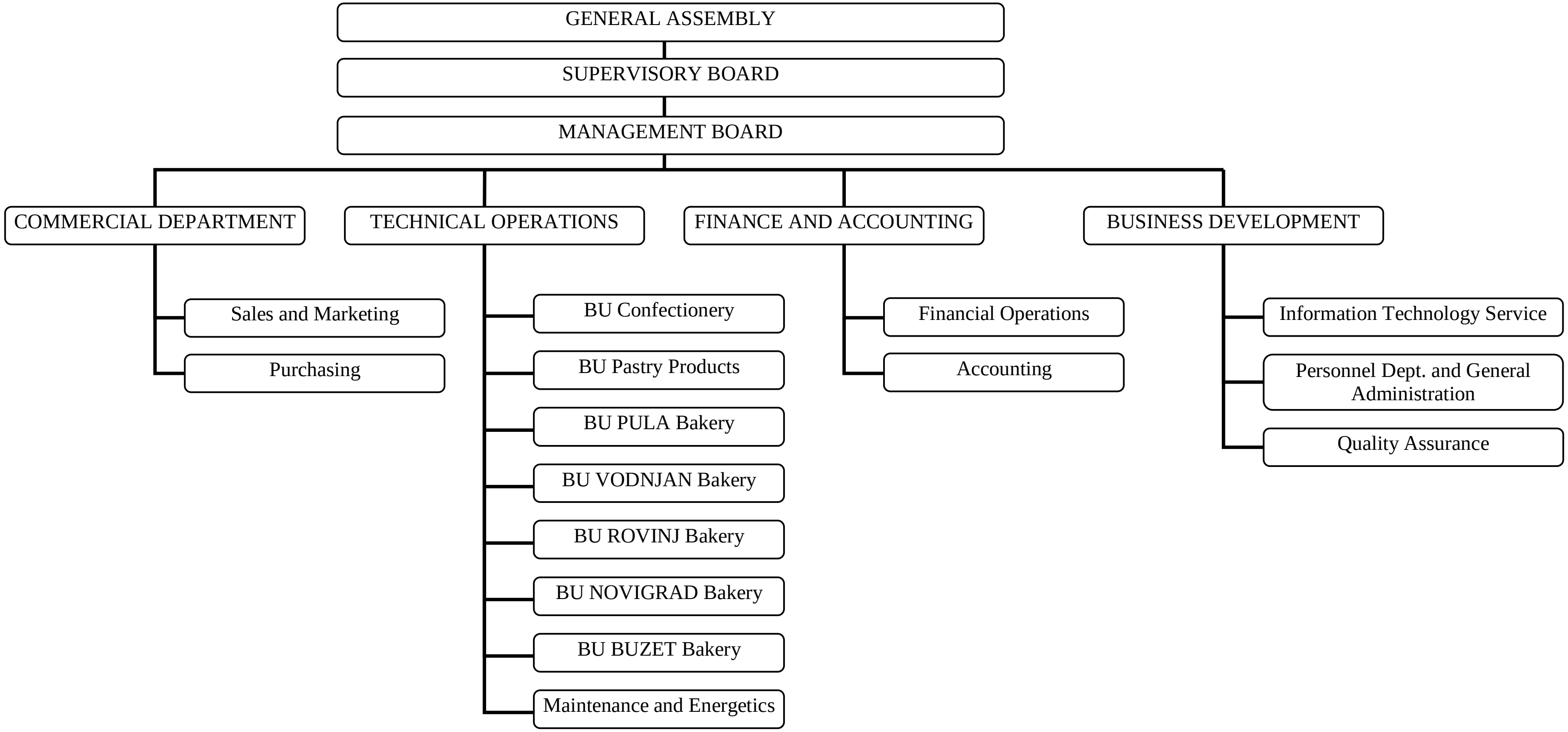
Brionka d.d. is the biggest Istrian producer of bakery products, pastry and pasta products. The company has the capital stock in the amount of HRK 50.315.800, divided into 132.410 shares of HRK 380. It is a concern company and enjoys the status of a controlling company. Brionka is a 100 per cent owner of the Puljanka-Brionka d.o.o. company which operates the main part of their business activity – production of bakery and pastry products.

The beginnings of the foundation of the today's company go back to 1951 when the company called «3. januar» was founded, it dealt with industrial cereal processing. In 1976 the «3. januar» company along with other companies enters the system of a Production Trading and Hospitality Company «Puljanka» , and in 1979 it becomes an independent company again, more precisely, a work organization for the production and processing of flour and flour products. According to the decision of the Croatian Privatization Fund, in 1992 it underwent a transformation process and since 1993 has had the same name it bears today – Brionka d.d.

The organizational structure of Brionka d.d. is shown below as the organization of Puljanka-Brionka d.o.o. (Picture 1.)

Picture 1

Organizational structure of Brionka d.d.

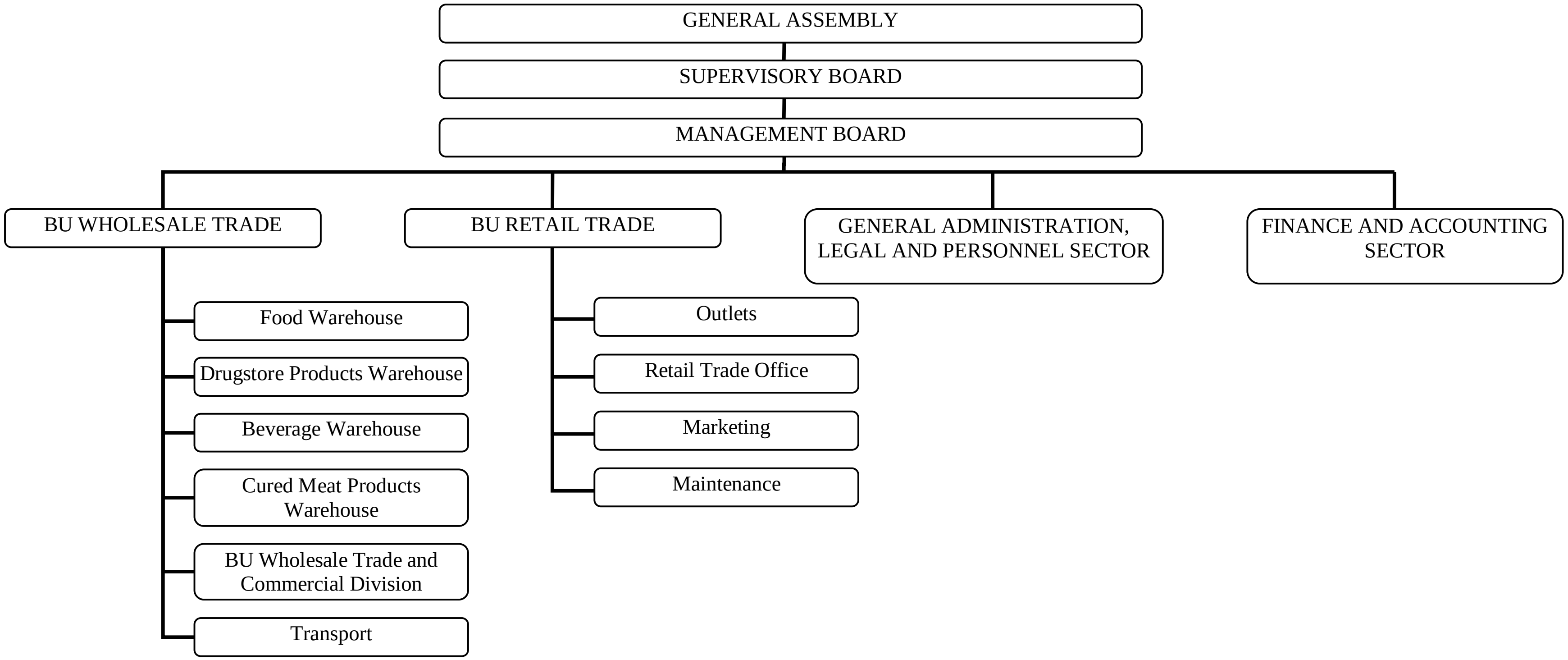


Puljanka d.d. is a concern company with the controlling company status since it holds a 100 percent share in Puljanka-Trgovina d.o.o. Pula and B-voda d.o.o. Buzet, as well as a majority interest in Istra d.d. Pula. Puljanka has the capital stock in the amount of HRK 105.555.800, divided into 1.055.558 shares of HRK 100.

Puljanka was founded in 1947 by the merger of smaller village cooperatives in the southern part of Istria that mainly dealt with agriculture and trade. A number of changes have been introduced during the years in terms of organization as well as management, and based on the decision of the Croatian Privatization Fund in 1992, it underwent ownership transformation and was registered as Puljanka d.d. The company deals with retail and wholesale trade of foodstuffs and non-food products as well as hospitality services. Picture 2 shows the flowchart of Puljanka d.d.

Picture 2

Organizational structure of Puljanka d.d.

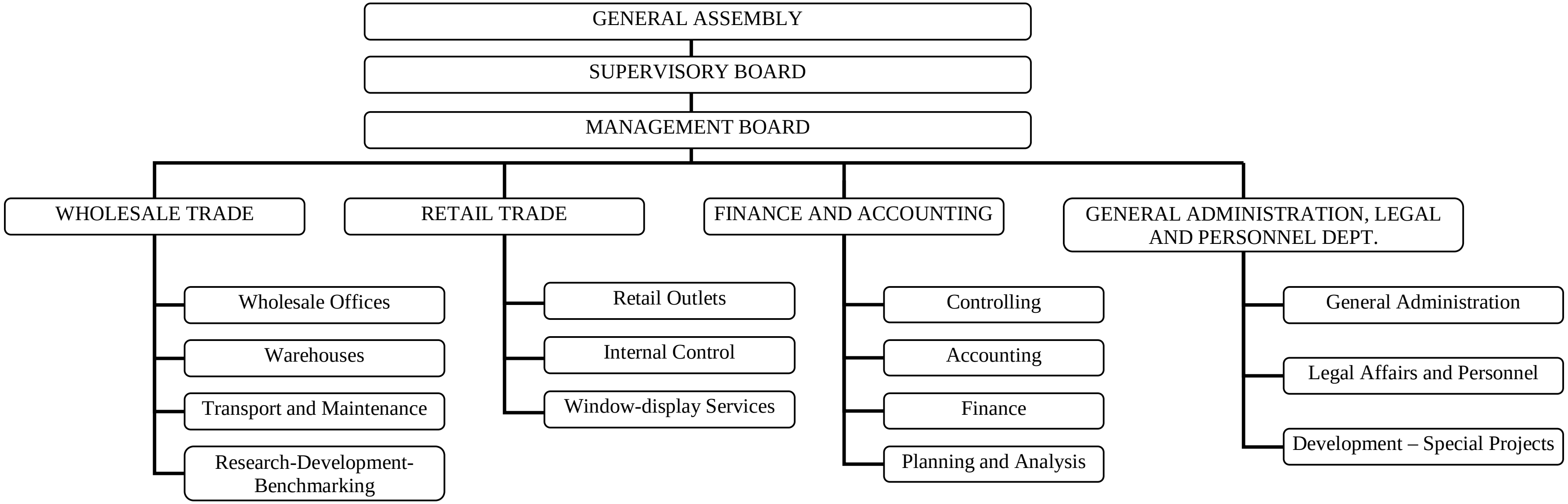


The beginning of business operation of Istra d.d. goes back to 1952 when small grocery businesses started trading in Pula and its surroundings. The merger of these legal entities into a unique work organization was implemented during 1960s when the product range started to expand and market started growing until this day. In 1992, based on the decision of the Croatian Privatization Fund, the company was transformed into a joint stock company. Istra d.d. is a 100 per cent owner of Puljanka-inženjering d.o.o. Pula.

The core activity of Istra d.d. is consumer goods retail in shops and stores, as well as wholesale in a warehouse complex in Pula. Istra has the capital stock in the amount of HRK 110.466.000, divided into 64.980 shares of HRK 1.700. Picture 3 shows the flowchart of Istra d.d.

Picture 3

Organizational structure of Istra d.d.



The presented organizational structure of Istra d.d. and Puljanka d.d. does not show the present executive directors who are the first direct executors and organizers of the companies business. Persons holding these positions, since the Companies Act provided the possibility of implementing the single board system in joint stock companies, should not bear the title of «executive directors» because this could imply they are holding the position of executive directors in compliance with the Companies Act, when, in fact, they are not. However, in terms of function or process they are executive managers who gained their authority through know-how.

Financial indicators of Brionka d.d., which are shown below (Table 1) refer to both companies (Brionka d.d. and Puljanka-Brionka d.o.o.) as consolidated indicators. Table 2 shows the structure of employees.

Table 1

Profit and loss statement on 31 December 2007 and 30 June 2008

ORD. NO.	PROFIT AND LOSS STATEMENT POSITION	**BRIONKA d.d.**		**PULJANKA d.d.**		**ISTRA d.d.**	
		31.12.2007.	30.06.2008.	31.12.2007.	30.06.2008.	31.12.2007.	30.06.2008.
1.	**TOTAL REVENUE**	**87.734.124,47**	**43.410.318,80**	**229.296.072,89**	**107.870.864,03**	**112.739.296,32**	**30.142.508,06**
1.1.	Business Revenue	85.422.881,91	43.102.054,20	202.833.094,75	107.651.198,12	111.744.409,62	29.477.588,35
2.	**TOTAL EXPENSE**	**86.974.745,78**	**46.488.480,99**	**228.655.924,40**	**113.446.740,28**	**88.882.179,72**	**31.438.019,66**
2.1.	Business Expense	84.696.923,90	45.736.980,21	217.299.336,09	108.894.741,33	88.229.667,58	31.048.482,30
3.	Profit/loss before taxation	759.378,69	-3.078.162,19	640.148,49	-5.575.876,25	23.857.116,60	-1.295.511,60
4.	PROFIT TAX	210.894,80	0,00	515.808,71	0,00	584.537,89	0,00
5.	**PROFIT/LOSS**	**548.483,89**	**-3.078.162,19**	**124.339,78**	**-5.575.876,25**	**23.272.578,71**	**-1.295.511,60**
6.	NUMBER OF EMPLOYEES	337	341	393	460	177	179

Table 2.

Employee structure in the companies merged on 30 June 2008

Personnel Qualifications	Brionka d.d.	Puljanka d.d.	Istra d.d.
Level VII (master)	15	11	16
Level VI (bachelor)	11	10	7
Level IV-V (secondary school)	155	279	50
Level I-III (elementary school)	160	160	106
TOTAL	341	460	179

3.2. Formal and Informal Relationship between Companies

The legal predecessors of Brionka d.d., Istra d.d. and Puljanka d.d. appeared in the late 1940s as small production and processing plants of agricultural products, agricultural cooperatives and stores. In 1960s and 1970s, the core activities were determined for each company according to political directives. The legal predecessors of Puljanka d.d. were to deal with foodstuff trade, Istra d.d. with non-food products, and Brionka d.d. with bakery and pastry products. In accordance with the then regulations (Associated Labour Act from 1974), in order to perform each of the above mentioned activities basic organizations of associated labour were structured within the companies (work organizations).

In the late 1970s Puljanka and Istra, along with a local company involved in tourism and hospitality services, merge into a complex organization of associated labour without losing their legal entities as work organizations. Puljanka as a work organization included, among other things, basic organizations of associated labour which dealt with bakery and pastry industry that had come out of the «3. januar» company, the legal predecessor of Brionka d.d. These basic organizations of associated labour had their legal entities, i.e. their organization and company bodies, and appointed their representatives on the work organization level.

According to the 1988 Companies Act, the public companies Puljanka, Istra and Brionka were formed. According to the 1991 Public Companies Transformation Act they are transformed into joint stock companies with mixed ownership (shareholders: employees, retirement fund and Croatian Privatization Fund).

During the 1990s, the observed companies lost their market share and experienced a crisis in their business operation. The cause that lead to this situation can be found in their impossibility to adjust quickly enough to new market conditions, the sluggishness of their organization, growing competition in the form of ever increasing number of chain stores. This especially affects Istra which went into liquidation in May 2000. Puljanka reduced the number of employees and outlets and withdrew from the hospitality services activity.

Starting with 1995, Brionka becomes a part of the Puljanka ownership structure. In 1996 it participates in the purchase of Puljanka's shares in the second public offering. In 2002, the General Assembly of Puljanka d.d. reduces capital by withdrawing shares from the second public offering, and Brionka loses a big share in the ownership of Puljanka. According to the situation in 2008, Brionka owns 14,5% of Puljanka's shares (together with Puljanka-Brionka d.o.o. which is a sole owner).

In 2005 Puljanka purchased the shares of Istra d.d. which was bankrupt at the time (bankruptcy proceedings ended in December 2005) thus becoming the owner of 67,57% of Istra d.d.'s shares, according to the situation in June 2008, it owns 62,94% of this company's capital stock. Brionka d.d. (together with Puljanka-Brionka d.o.o.) owns 8% of Istra d.d.'s shares. Brionka d.d. owns 1,95% of Istra d.d.'s capital stock, while Puljanka-Brionka d.o.o. owns 6,22% of capital stock of the same company. Brionka d.d. is the owner of 13,98% of Puljanka d.d., while Puljanka-Brionka d.o.o. owns 0,55% of Puljanka d.d.'s capital stock.

Three Management Board members of Puljanka d.d. own, i.e. control about 45% of capital stock of Puljanka. At the same time, they are the members of a three-member Management Board of Istra, and one of them is the General Manager of Brionka. The merger of these joint stock companies and the introduction of single board system in the new company would create conditions in which the Management Board members in the Board of Directors of the new company would be in charge of a larger, more powerful company with more competent employees, they would participate in setting company strategies and policies as well as have a supervisory governing function or an executive managerial one.

In a few words, it can be pointed out that the events from the past and the present situation show the relevant companies are formally and informally related. This relationship has been caused by decisions and recommendations of the local government as well as the companies governing bodies: Self-Managing Associated Labour Organization Arenaturist Puljanka Istra (formed by Puljanka and Istra) and the 1978 Puljanka which also included Brionka's Basic Associated Labour Organizations. The relationship reflects itself in common projects of construction of numerous stores of Puljanka and Istra where they perform their trade activities and a common warehouse complex. Furthermore, Brionka is the biggest supplier of goods (bread, pastry, pasta) for Puljanka d.d. This unity and relationship enable them to work together in ensuring best possible operating conditions from the local government (construction plans, common representatives of trading activities and food production).

4. Merger Motives, Legislative Regulations and Merger Proceedings

The actual companies would merge in order to realize common benefit. The merger would eliminate competition between the companies. The companies form an alliance, and according to the Companies Act, Puljanka and Istra make a company concern. Each company deals with retail activity which is the core activity of Puljanka and Istra, and along with production (bakery, pastry products), Brionka has retail outlets as well. The merger can be considered a voluntary and an agreed-upon act. The merger of these joint stock companies will stimulate interest of certain groups which would have a direct or indirect influence on the business situation.

For the purpose of this study the potential activity of the stakeholders is analyzed as follows: **Owners and shareholders** will vote for the merger if they find that their ownership share, i.e. the shares of the new company provide a satisfactory dividend, that is, if the value of the new company shares on the stock-exchange increases. The owners of each company, shareholders, decide on the merger with the votes representing at least 3/4 of the capital stock represented at the General Assembly, when decisions which would approve the merger contract are to be made. **Workers** expect their jobs to be secure, their salaries higher and the working conditions in the new company better. They will influence the present joint stock companies Management Boards through their workers' councils by asking information on all the legal, economic and social aspects which the new company will bring. **Unions** want to keep their members in the new company as well as the social partner position. Their resistance to the merger can be conditioned by demanding new collective agreement negotiations in order to try to increase workers' rights in the new company. **Clients** expect the recognizable quality from tradesmen as well as bread producers which have been in their neighborhood for decades, awaiting for an even more favorable quality/price relationship. They have to be informed that they are losing neither their tradesman nor their bread producer, but can expect even higher quality and accessibility of products and services. **Suppliers'** interest is for their business partner to operate as successfully as possible, to expand its selling capacities, to place larger orders and properly fulfill its obligations. Suppliers will recognize that the future company tends to establish a business policy which would rationalize their business dealings with suppliers in terms of their doubling etc. Nevertheless, the negotiating strength of suppliers is not crucial for this procedure.

Banks in the concluded loan agreements already have a defined obligation of the loan beneficiary i.e. the merging companies, meaning that all statutory changes of the loan beneficiary have to be announced and that the banks can simply terminate the contract in case the statutory change, in their opinion, would complicate the loan payment. Banks need to be presented with the strengthened position of the joint stock companies merging into the new company in terms of a unified capital which would consequently additionally ensure the loan payment. **State administration and local self-government;** the state has a twofold role. On the one hand, it owns the companies' shares, thus participating in the new company ownership. On the other hand, it is the authority which, from the social aspect, demands workers' rights to be respected, and from the financial one, it demands regular budget payments. Various traders **associations,** associations of food producers as well as chambers of commerce want their members (in this case, the new company as trader and food producer) to contribute to associations' goals. From this point of view, it is likely for the new company not to meet the conditions for acquiring membership in the associations which find the interests of traders and producers to be opposed.

The written report which will be drawn up by the companies' Management Boards in order to present the merger agreement to the shareholders, will also include the analysis of the most important stakeholders in terms of their rights, requests or interests in the new company.

4.1. Merger Motives

The following motives can be pointed out as the basic ones: (1) **Development.** Brionka, as a known producer-manufacturer, through this merger, expands its retail network through retail outlets of Puljanka as well as Istra, considering its expansion to shopping centers all over Croatia. It will definitely be much easier for the new company to keep its position on the market than it was for the individual companies which are being merged. (2) **Human capital.** The motive is to unite knowledge, abilities, positive working habits and distribute them in the best possible way all over the organizational structure of the new company. In the companies' organization so far, the intellectual potential of educated professionals has not been «used» enough or these employees «did not find» themselves in the entrusted jobs. The retail sector employs mostly women. The new company plans to implement retail outlet specialization for specific products. This would improve customer service and, at the same time, satisfy the workers' ambition for specialization, for acquiring special know-how for certain products. A significant number of employees have already worked in at least two of these companies, and the closeness between them reflects in everyday contacts of supplier representatives and shop-assistants. The optimization of human resources in the new organization should result in efficiency growth and stronger competition in services on the market. The former departments will be reorganized into new, stronger departments, in terms of size as well as expertise, and they will unify the best know-how of both producers and traders. The management in the new company will have to improve the quality relationship between the companies and the employees so far with even better communication and employee relations. (3) **Lower costs.** The merger of the companies could take place when the actual companies begin with works on the new common location which will include the production plant (Brionka), warehouse facilities (for the three companies), as well as administrative and technical services of the companies. At the moment, these activities take place at five different locations. The merger would enable the integration of many administrative and technical service activities which are today performed separately and sometimes even not efficiently enough. Surely, new production technology as well as new warehouse capacities (today's warehouses have not been properly modernized for the last 30 years) will contribute to the quality of products and services at lower cost.

4.2. Legislative Regulations

At the implementation of this merger the following regulations shall be applied: Companies Act (Official Gazette, No.111/93, 34/99, 121/99, 52/00, 118/03 and 107/07), Securities Market Act (OG, No.84/02, 138/06), Labour Act (OG, No.137/04, (final draft), Market Competition Protection Act (OG, No.122/03) as well as the provisions of their own Statutes.

The Companies Act regulates the statutory company changes and this includes mergers of two or more joint stock companies and their economic continuation in the new joint stock company. The merger is regulated by the Companies Act, Art. 33 and by proper application of the Companies Act provisions which refer to joint stock companies merger. Each of the merging companies is considered an acquired company, whereas the new company is considered an acquiring company. All three companies meet the conditions from Art. 533, It.2 of the Companies Act, namely, they have been registered into the Registrar of Companies for much longer than the required two-year period.

The Labour Act prescribes that before the General Assembly makes the decision on merger as well as before the Management Board proposes such a decision, the Management

Board should consult the workers' council. The Management Boards must provide information on expected legal, economic and social consequences which the workers could face due to the merger of these three companies into one.

It is to be expected from the workers to request a «better and more successful» future. The employer treats their workers properly, respects all the rights which workers were provided with by law, other regulations, collective agreements as well as work regulations. The Management Board (Board of Directors) can expect the workers to request the improvement of economic and social working conditions. Respecting the employees as the fundamental element for success, the Management Boards of the merging companies must provide complete and timely information, i.e. give indisputable arguments for the merger. Among the workers from all three companies there are a considerable number of shareholders, which makes their positive attitude toward the merger very important when the General Assemblies make decisions on the relevant subject.

All three companies deal with retail trade, therefore the approval of market concentration ratio should be requested by submitting the application to the **Agency for Protection of Market Competition**. The market concentration ratio is approved if the Agency, within 30 days, does not deliver to the applicant the conclusion on initiating proceedings. If the proceedings are initiated, a decision has to be obtained which would approve the concentration ratio caused by the merger of these three companies. In case the Agency assesses the concentration ratio as conditionally approved, the conditions will have to be met and measures taken within the time limit set in the Agency's decision. It is highly unlikely for the Agency to initiate the proceedings, because this is only a process of merging companies on the market and has insignificant influence on market competition.

4.3. Merger Proceedings

The Management Boards of the merging companies would conclude an agreement in form of a public document. There are two ways of merging companies regarding financing: (1) merger by acquisition – as the term itself denotes, this merger happens when one company acquires another company; (2) merger by consolidation – by this kind of merger a new company is created, and the consolidated companies are combined under a new name.

Mergers can be financed in different ways: by cash payment, by loans from financial institutions, loans within the company, share exchange and the like. The size of merging companies limits the choice of financing merger, e.g. it is not possible to finance big company mergers by cash payment only. Today's mergers tend to be financed by share exchange.

The nominal value of a share is not the same in these three companies. In Brionka d.d. the value of a share amounts to HRK 380,00, in Istra HRK 1.700,00, and in Puljanka HRK 100,00. In order to make the share exchange procedure simpler, one of the issues on the agenda of the General Assemblies should include the decision related to the distribution of shares. Instead of one share, every shareholder will be issued 19 shares in Brionka, the nominal value of each in the amount of HRK 20,00, 85 shares in Istra, the nominal value of each in the amount of HRK 20,00, and 5 shares in Puljanka, the nominal value of each in the amount of HRK 20,00. At share distribution the provisions of the **Securities Market Act** shall be applied, they define the procedure of share distribution, namely, time limits for notifying the shareholders, as well as the provisions of the Croatian Agency for Supervision of Financial Services, Central Depository Agency and Zagreb Stock Exchange on the conditions and procedure of share distribution and other information relevant to the shareholders.

The Agreement which would be concluded by the Management Boards has to contain the following information: (1) company name and head office of the merging companies; (2) agreement on the transfer of assets of each merging company in exchange for the shares in the new company; (3) share exchange ratio. Since the share nominal value of each company would be HRK 20,00, for every former share of the merging company the shareholder will get a share of the new company in the nominal value of HRK 20,00; (4) the details on the transfer of new company's shares and the information on when these shares start conferring the right to participate in the profit of the new company and the details concerning this particular right; (5) at what time the actions of the merging companies start to be considered as actions taken for the account of the new company, (6) rights which will be conferred to every shareholder by the new company (these rights are to be defined in the Statute of the new company); and (7) possible special benefits which would be given to a member of the Management Boards and Supervisory Boards of the merging companies or to the merger auditor.

The companies' Management Boards would draw up **an extensive written report** in which they would elaborate the merger in legal and economic terms. The Companies Act prescribes that the Management Board of each merging company has to compose a written report, but leaves the possibility for drawing up a common report. The report shall contain the merger motives, future organization of business operation, that is, the elements which justify the merger as well as future efficiency of the new company.

One or more auditors have to revise the Merger Agreement for each company. The companies' Supervisory Boards shall send to the Commercial Court a common request for appointing auditors. In this case, the Court may appoint the same auditors for all three companies. **The auditors** shall draw up a common report. The report has to be concluded with a statement on whether the proposed share distribution ratio is appropriate.

The Supervisory Board of each merging company is obliged to look into the intended merger, based on the merger report of the Management Boards (common report) and the merger report of the auditors (common report), and draw up their own **written reports**. The law does not prescribe the possibility of composing a common written report of the three Supervisory Boards. The reports need to provide additional protection and security to the interested parties in the merger proceedings. We find the report of the Management Boards and the auditors to be the foundation of the review prescribed by the Companies Act, but to the Supervisory Boards these two documents do not have to be a limiting factor, the Supervisory Board members may use other analysis concerning the merger proceedings as well as their own information.

The Merger Agreement is valid if approved by the General Assemblies of the merging companies. Prior to convening the General Assemblies, the Management Board of each merging company has to deliver to its Registrar of Companies (in the Commercial Court in Pazin) the Merger Agreement. The companies are obliged to publish (in the Official Gazette of the Republic of Croatia) that the Merger Agreement was delivered to the Registrar of Companies and that from the day of convening the General Assemblies (the announcement in the Official Gazette), the company shareholders are entitled to examine the following documentation on the company premises: (a) Merger Agreement; (b) Management Boards' reports on the merger, Supervisory Boards' reports on the merger review, auditors' report on the merger audit. In this business situation a common report of the Management Boards would be drawn up, three reports on the merger review by the Supervisory Boards as well as a common audit report; (c) annual financial statements and statements on the company condition in the last three business years for each merging company; (d) new financial statements in case the last annual financial statements refer to the business year which ended more than six months before the Merger Agreement was concluded. New financial statements are determined on the day which has to be within three months from the day of concluding the

Merger Agreement. These statements have to be drawn up in accordance with relevant regulations and with the same methods and the same form as the last annual financial statements.

The decision by which the Merger Agreement is approved has to be made based on the votes which represent 3/4 of the capital stock represented at the General Assembly. Companies' Statutes do not prescribe a larger majority or some additional conditions for the approval decision to be made. In order to obtain the majority vote the proposers of the Merger Agreement approval decision, the Management Board and Supervisory Board, with valid argumentation, have to win the shareholders to vote for such a decision which has to be made by all three companies, otherwise the merger will not happen.

At the General Assemblies the management boards will present the Merger Agreement which is enclosed with the minutes from the General Assembly. Every shareholder is entitled to the following: (1) from the moment of convening until the moment of holding the General Assembly every shareholder can obtain, with no charge, a copy or a transcript of the documentation which he/she has to be presented with (Merger Agreement, reports of Management and Supervisory Boards, audit report, annual financial statements and reports on company condition); (2) at the time of holding the General Assembly he/she shall be provided with a possibility to get an insight into the relevant documentation; (3) at the General Assembly, he/she shall be informed on all the facts about other merging companies relevant for the merger.

5. The Statute of the New Company and Single Board System

One of the items on the General Assembly agenda (in this particular business situation) should be the approval of the new company Statute as well as the approval of the election of the Board of Directors members. One of the assumptions of this study is that the new company will implement a single board system. In presenting the proposal for the approval of the Statute, it will be necessary to explain why the proposers of such a decision (Management and Supervisory Board) consider the single board system to be suitable for the new company. The main reasons for choosing the single board system are the following: 1) **Efficiency.** Better business activities monitoring, solvency, finance and investments by the executive directors who decide on this, thereby the Board of Directors. The executive directors, who keep informed the Board of Directors which supervises them, are at the same time the Board of Directors members as well, i.e. the executive directors would be appointed among the Board of Directors members. (2) **Decision making.** Making important business decisions on one level with a simultaneous supervision. The Board of Directors sets the basis for business activities operation. (3) **Merging the managing and executive directors into one body.** One body (Board of Directors) manages and supervises the production process (bakery products), distribution and sales, and business decisions are made by the executive directors.

For approving the new company Statute as well as the choice of the Board of Directors members, the merging companies' General Assemblies make decisions based on the votes which represent at least 3/4 of the capital stock represented at the General Assembly when the decisions are being made.

The Statute will define that the new company has a nine-member Board of Directors. Eight members of the Board of Directors shall be appointed by the General Assembly. The ninth member shall be appointed by the new company workers' council as the workers representative in the Board of Directors, pursuant to Art. 166 of the Labour Act (OG No.137/04 Final Draft). The Statute determines four members of the Board of Directors as executive directors. The Board of Directors members appoint four executive directors between themselves. Therefore, there will be five non-executive directors in the Board of Directors, which complies with the Companies Act norm which prescribes that the majority of the Board of Directors members must be non-executive directors. The appointed executive directors will not be able to take part in decision making related to appointing or recalling executive directors, their responsibilities or their relationship with the company. Non-executive directors shall appoint a Chief Executive Officer among the executive directors.

All the Board of Directors members (9 members) elect the President and two Vice-presidents between themselves. The law prescribes that the President and the First Vice-president cannot be executive directors. The Statute prescribes that neither the Second Vice-president can be an executive director.

The Companies Act leaves open the possibility that executive directors do not have to be the members of the Board of Directors, while it is possible for some executive directors to be the Board of Directors members and others not. For the purpose of a direct insight of the Board of Directors into the work of executive directors, a better solution would be for them to be the members of this Board. However, all executive directors have equal rights and obligations according to the Companies Act. They run the company business together, unless otherwise regulated by the Statute or the Rules of procedure on the work of executive directors. Executive directors represent the company as a group, as prescribed by the Companies Act. The law allows that the Statute establishes if executive directors represent the company individually.

The Companies Act does not regulate the work of executive directors. Executive directors are responsible for this work organization, therefore they are the ones who will determine the Rules of Procedure which would regulate their work (otherwise, what is stated in the Statute falls within the competence of the Board of Directors). Executive directors have to report to the Board of Directors in the same way the management board reports to the supervisory board. They are obliged to draw up an annual report on the company condition as well as a consolidated annual report. The Statute prescribes executive directors to be the Board of Directors members. An executive director can be recalled by the Board of Directors decision, but he/she remains the Board of Directors member. A Board of Directors member can be recalled by the General Assembly with 3/4 of given votes. Executive directors are managers employed in the company. The Rules of Procedure for executive directors prescribes the work which will be performed daily by certain executive directors, that is, which part of the new company business activities they will manage/run.

The Companies Act regulates the registration of the joint stock companies merger into the Registrar of Companies. The merging companies are obliged to submit an application for the registration of the new company to the Commercial Court in Pazin. By registering the new company into the Registrar of Companies: (1) the former companies assets and liabilities of the merging companies are transferred to the new company; (2) the merging companies cease to exist; (3) the merging companies (Puljanka, Istra, Brionka) shareholders become the shareholders of the new company. In the share structure the new company would have treasury shares based on the universal legal succession. These would be the shares which Puljanka, Brionka and Puljanka-Brionka had as owners of Istra as well as shares which Brionka and Puljanka-Brionka had in Puljanka. The new company does not have to obtain the approval of the General Assembly for acquiring the treasury shares (Art. 233, Section 3, Item 6, Companies Act).

The new company will submit the applications for registering the merger of all merging companies into the Registrar of Companies, but only after the new company registers into the Registrar.

6. Recommendations for Successful Merger and Single Board System Implementation

The success of the merger depends on the time and quality of planning. Researches have shown that the probability of failure at mergers is the most likely during the integration process, specifically due to inappropriate management and unsuitable strategy, cultural differences, communication delay and lack of vision. Cultural overlapping of companies is extremely important, perhaps even more important than strategic overlapping, because it is less liable to change. One of the mistakes of the company which becomes the main company after the merger is that it appoints its own people to all positions. As if forgetting that one of the main reasons for merging was precisely the intention to obtain as many talented people as possible and among them choose the best for certain positions in the company. Some persons feel loyalty toward their «former» company and colleagues, but in order for the new company to benefit from the merger, it needs the best team, made from the people from «former» companies.

The question which now arises is the influence of single board system on the company culture, especially communication as well as the relationship between the new company bodies and its stakeholders who are used to dual board system. If the quality of the persons assuming the rights and obligations of the responsible persons in the Board of Directors, Supervisory Board or Management Board or as executive directors, really exists, then the appropriate results which the company owners-shareholders would have to expect whether from the Board of Directors, Supervisory Board or Management Board with executive and non-executive directors, will not be questioned.

7. Conclusion

The study analyzes the business situation of merging Puljanka d.d., Brionka d.d. and Istra d.d. and the implementation of the single board system in the new company. The merger and the single board corporate governance system are based on theoretical assumptions, legislative regulations of the Republic of Croatia as well as the global business practice so far. There has been no case of implementing a single board system upon merger proceedings in the Republic of Croatia, therefore this study represents a novelty and a contribution to scientific research, and is useful for professionals dealing with this problem area.

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Zakon o zaštiti tržišnog nadmetanja (Market Competition Protection Act) (NN 122/03)

Notes

1. Merger should be differentiated from acquisition. Company acquisition is a situation in which one company acquires another. Usually, a bigger company assumes control over a weaker company, whereat the weaker company becomes a part of the bigger one. The acquired company can keep its own name doing business within the new group, but it loses its business independence and instead of its previous strategy, implements the new group strategy. Acquisition can be friendly and hostile. A friendly acquisition is agreed upon between the owners and the management of the interested companies. A hostile acquisition (takeover) is a situation in which one company acquires another company against its will and in this case the acquired company ceases to exist and becomes a part of the company which took it over.

UVOĐENJE MONISTIČKOG SUSTAVA PRI SPAJANJU DIONIČKIH DRUŠTAVA – OPRAVDANOST NJEGOVOG UVOĐENJA I RAZVOJ EKONOMSKE PRAKSE U REPUBLICI HRVATSKOJ

SAŽETAK

Cilj ovog rada je ukazivanje na mogućnost prelaska na monistički sustav pri spajanju dioničkih društava. Rad analizira poslovno stanje pri spajanju dioničkih društava Puljanka d.d., Brionka d.d. i Istra d.d., kao i organizaciju novog društva u monističkom sustavu. Neizravni cilj je doprinos razvoju ekonomske prakse u Republici Hrvatskoj kao i daljnje znanstveno istraživanje na tom području.

Istraživanje se bazira na pretpostavkama da Uprava i Nadzorni odbor smatraju spajanje dioničkih društava opravdanim kao i da monistički sustav upravljanja smatraju prikladnim u novoj organizaciji društva.

Spajanje i primjena monističkog sustava zasnivaju se na teoretskim pretpostavkama, zakonskim odredbama Republike Hrvatske ali i dosadašnje svjetske poslovne prakse.

JEL: G34, M10, L20, K22

Ključne riječi: spajanje, dualistički sustav, monistički sustav, dionička društva