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WHERE IS THE BULGARIAN CORPORATE GOVERNANCE MODEL HEADING TO?

The paper critices two hipothetical trajectories for development of the Bulgarian corporate governance model (BCGM) as not feasible, and offers a different solution. The first opposed variant assertsthat BCGM would imitate a converging model, which follows the convergence of the two global CG systems. Its alternative strategy is formulated as adapting the corporate governance system to our national specific with its inherent cultural and political norms. The paper insist that both of the above models are discarding important national features of the BCGM; when taken into account they will reveal a quite different picture for that model, one of lagged model, with charackteristics already overcame in the present day developed countries. Respectively the trajectory it has to follow is quite different from those of the two critisesed hypothesses.
JEL: G30, G38

Introduction

The study discusses possible trajectories of the Bulgarian corporate governance (CG) and model, criticizing two premised theses and offers a different solution. The criticized theses are as follows:

1. The strategy of corporate governance system in Bulgaria can *imitate a converging model*, which follows the convergence of the two global CG systems.

2. The alternative strategy is *to adapt* the corporate governance system *to our national specific* with its inherent cultural and political norms.[2]

The first one includes two moments – the existence of convergence between the two global corporate governance models in general; and the second one, the opportunity to imitate this convergence model in Bulgaria.

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[2] See more in Corporate Governance Models. Convergence or Divergence. – In: Mintchev, V., R. Petkova, P. Tchipev and V. Boshnakov. Public Companies and Stock Exchange Development in Bulgaria. "Marin Drinov" Academic Publishing House, 2007, Sofia, p. 50-77 [in Bulgarian].

The second thesis suggests that no matter which global corporate governance system develops in Bulgaria, its implementation will be adapted, to the local conditions.

Here, as in most cases, attacking an issue from diametrically posed positions is based on a deep and sincere misunderstanding of the problem. Moreover, and regrettably, our problem, despite its whole complexity, turned out so actual, that we can easily call it modern. Before discussing in essence the construction of the problem, it is needed a:

Short reconstruction of the corporate governance problem

The reconstruction's goal is to set the problem in its actual context, since often you "cannot see the forest for the trees", by the fortunate expression of Hegel.

The theory of modern corporation is based on the concept that the separation of ownership from control precipitates a fundamental problem or conflict of interests between owners and managers of a firm. The same problem can be thought as a problem between majority and minority owners, or even between the bigger and smaller voting packages in a certain corporation. In short, it is the problem ***who*** appropriates the so-called residual income in the firm and who determines (i.e. ***whose interest***) the strategic long-term development of the firm. In less developed countries, which have weaker protection of property rights and/or of minority interests, the problem can increase to a degree of complete expropriation of this residual income by the managers (or the majority owners) on the account of the small owners. It can lead even to a complete erosion of the ownership, or, to say it other way, of the investment, made by the weaker presented economic agents.

This problem is far not just a problem of the public (nor only of the large) companies. On the contrary, it exists also in the private companies and even in other forms of legal company organization, like limited liability companies for instance. I will remind of a case from the Bulgarian economic life few years back, when two of three partners in a daily newspaper company, agreed and threw out the third one based on a legal formality, eliminating completely his economic interest, or if we choose the other expression – expropriating completely his investment in time and money, thus setting the beginning of a heavy long legal process with uncertain end.

Set in this context, the problem of corporate governance constitutes to a problem of finding an adequate mechanism of ***control*** over the managers (respectively over the majority owners), or even over the ***politically empowered*** owners, who can use their status to abuse the interests of the other owners or investors groups. In this sense, the contemporary corporate governance theory distinguishes two principally different mechanisms of exercising such governance – *an Anglo-Saxon and a German (Japanese) one*. The first one is based on developed stock exchanges, mostly in USA and UK, and the second one – on active involvement of the bank system in Germany, Japan and to a smaller extent in the other part of continental Europe.

That is the problem and those are the existing systems for its solution, which with certain variations and prevalence of one or the other form, constitute the picture of all market economies.

We have to state one more issue – the studied problem has many dimensions: it is revealed as a matter of the source of corporate financing, as well as a matter of the legal system, revealing information, construction of corporate boards, etc., but essentially it always remains the same problem. Respectively, the mechanisms for corporate governance remain the same.

From a first glance this triviality actually turns into a very serious trip-stone for the expressed above theses, since they are based on some deeply false formulations, which I will discuss briefly here:[3]

a) Classification of the corporate models by different way of financing

Already more than 10 years ago Colin Mayer, a leading economist on the matters of corporate governance (CG), destroyed in many articles the thesis of the different financing in Anglo-Saxon and German models.[4] Based on corporate financing data in 8 countries, he writes: “In all countries the self-financing from profits is firmly and definitely the most important resource of financing: in UK in certain analysis it is responsible for over 100% of the capital expenditures of the corporate sector (revealing the fact that the British corporations are net receivers of financial resources); where external resources are used, they come first from the bank sector. For the last 20 years (the middle of 1970s to the middle of 1990s, *author's note)* the banks are an especially perceptible source of financing in Japan. Surprisingly, though, the German banks contribute only a ***modest*** (*author's italic)* proportion to the total German corporate financing from other sources. … The stock markets are relatively minority source of financing in ***all*** (*author's italic*) countries. Financing from stock markets reaches only less than 10% of all gross sources in all countries, and in many countries it is significantly under this level.”[5] And again there: “Therefore the traditional division between bank and market sources of financing is misleading.” I presented this long citation exactly for this misleading, which is recreated in Bulgaria 10 years after its discrediting. The conclusion is clear: there is no reason the corporate governance models to confront each other based on difference in financing – both models are principally based on equal ratios between the different sources – self-financing from own revenues is always the main one.

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[3] Ibid, p. 61.

[4] See an article as if deliberately written for our debate: Myths of the West: Lessons from Developed Countries for Development Finance. World Bank DP, 1990; Financial Systems, Corporate Finance and Economic Development. – In: Hubbard, G. (ed.) Asymmetric Information, Corporate Finance and Investment. Chicago: NBER, 1990.

[5] Mayer, C. In the Image of the West: Creating Financial Systems in Eastern Europe. World Bank DP, October 1992, p. 4.

b) *Division of CG mechanisms as "market ones" (Anglo-Saxon) versus "hierarchical ones" (German)[6], [in another context A-S mechanism is seen as based on wider diversification of ownership plus developed capital markets and the G mechanism - as based on less developed capital markets]*

The absurdity of these statements is obvious to everybody who knows better the German model. It is neither hierarchical, nor with concentrated ownership. Just 2 figures to confirm my statement: they are from Nunnenkam and are based again on studies of Colin Mayer from 1995. "However, their (the banks', *author's note)* role as direct stakeholders remains significantly under what can be expected from the so-called bank-oriented system."[7] – here a figure shows that in 1990 the banks hold only 10% of the whole shareholding ownership in Germany. And again there: "… and the banks are even more insignificant as large stakeholders (they number less than 6% of the shareholding packages, sized over 25% of the firm capital)."

The conclusion is similar to the one for the previous formulation – both CG systems develop in the conditions of developed stock exchanges and diversified ownership of the public companies. Of course, one can argue which one is more or less diversified, but most certainly a 10% package is not a concentrated ownership. Even if we assume that the Anglo-Saxon model can be determined as a market one, since it is realized through the securities market, this by no way makes the German model a hierarchical one, since the small size of the bank involvement in the capital of the German firms does not give them hierarchical opportunities for control.

c) *The raising of the role of the **stakeholders** or the so-called resource-providers to **a dividing principle** between CG models.*

Here, a strong objection arouses again. The objection is against the suggestion that the market model does not count for stakeholders, while the bank model does. Their role is strongly vulnerable in both cases. We can state neither that the Anglo-Saxon system totally denies the right and opportunity to take into consideration the interests of a wider circle of people in defining the residual income pretenders, nor that the German system accepts them. It is a fact that the co-determination system in Germany allows in decision-making the notions of the representatives of the employees in the firm, but it is too far from effective considering their interests equally to the owners' interests.

So, as a rule, the claims of the stakeholders should be considered rather in the light of improving the CG practices ***regardless*** the model, than as defining principle for the model.

[6] Mintchev, V., R. Petkova, P. Tchipev and V. Boshnakov. Public Companies and Stock Exchange Development in Bulgaria. "Marin Drinov" Academic Publishing House, Sofia, 2007, p. 63. [in Bulgarian]
[7] Nunnenkam, P. 1995, p. 8.

d) *The* ***division of the models on the basis of the legal systems,***[8] *which is developed as another type of classification of the models, is also arguable.*

In reality it is the same as the division to Anglo-Saxon and German-Japanese or continental one. It is a fact that the countries with common law have higher protection of the outsiders, and it is a fact that it is significant to the preferred CG model, but this emphasis on the legal system in no way changes the character of the already adopted classification of the models.

The most controversial statement in this sense is that the legal definition of the corporate governance models sets the question of their convergence, since it rests on the presumption of the common law converging to the European continental legal systems, deriving from the Napoleon code. This convergence of the legal systems is not only observed as undesirable, historically unacceptable for the two large groups of countries, following different legal philosophy, but it is also impossible, since the sources of the law in them are diametrically contradictory. Even if we assume that both CG models converge, this convergence will be based on implementation mechanisms and not on convergence of the legal systems between the common and constitutional law.

The question of the convergence of the models

is in the basis of the whole discussion and deserves more attention by itself.

It is a fact that part of the contemporary researchers speak of a "pressure" for convergence of the legal frame for corporations functioning. The enormous efforts of both World Bank and OECD to develop codes for a good corporate practice are also a fact.

With many doubts we can also accept the statements that the American system starts to resemble the German one, since the share of the insiders ownership expands – in reality such practices have always existed.

It is even harder to accept the statements from the mentioned project that the "cross ownership, characteristic of Germany, begins to disintegrate".[9] At least the evidences by Marco Becht and Colin Mayer (2001) are not such. These authors determine substantial commitment of the power towards building complex systems of controlling sets of voting rights in the shareholding assemblies of the corporations in continental Europe.

The problem, however, is not in the facts, but their interpretation. Whether the codes for good practices for corporate behavior increase or decrease and whether the cross ownership grows or not in Germany is not a problem, which addresses the main question of the discussion – whether there is or not a convergence between the

[8] Mintchev, V. et al., op. cit., p. 65.
[9] Ibid, p. 67.

models. Because the good corporate practices, as well as the ways, in which the rules of disclosing information and the rules of defining the voting blocks and the "unified" requirements for the corporate boards; all they concern the question of a better functioning of the corporate governance systems. The question of more effective matching of the interests of large and small stakeholders, of stakeholders and managers and not the issue **which institution and in what way** implements the rules of good corporate governance.

And the latter is exactly the issue for the convergence. There is some "convergence" process there, as far as both models strive to improve their efficiency through similar governance and control mechanisms. Although, both models differ from one another not by the question, which one gives better results, but by that, how much the banks are active, what are the existing mechanisms of voting by proxy, of accumulating many votes of outsiders and their forming into big voting blocks.

The difference is in the whole philosophy of interrelations between the agents in both models. The Anglo-Saxon model is based on the so-called hostile takeover, while in the German one the hostility is rather an exception, which is applied after exhausting the other means. And, of course, the legal systems, in which this division is realized, and for which we say it is impossible to converge to one another; they suggest different behavior, different motivation of the economic agents, even though usually this is not outlined enough.

The question is quite wide and complex to be addressed sufficiently in details in such presentation, so I will stop here. Moreover, essentially, there is no importance and influence for the current

corporate governance issue in Bulgaria,

whether the two systems diverge or converge in a global and European perspective, since its specifics are such that it cannot enter the context of the European and global model of contemporary corporate governance. These are features, which are present in Bulgaria and which do not allow its inclusion in any of the analyzed so far systems. They are the following:

First and most important: the **Bulgarian ownership is over-concentrated**. The many carried out studies by Bulgarian authors after the mass privatization show that initially set goals for diversification of the ownership are not reached. On the contrary, there is a process of continuous concentration,[10] which leads to predominating establishment of private majority owners in the public companies.

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[10] See Tchipev, P. Corporate Control Structure in Enterprises, Privatized after the Mass Privatization. – In: Tchipev, P. and M. Prohaska. Corporate Control Establishment on a New Emerging Market: Bulgaria. Centre for Study of Democracy, 2000, No 8; Tchipev, P., R. Petkova and V. Mintchev. Corporate Control Structure in Mass Privatization Enterprises. – Economic Studies, 2000, No 1; Petranov, S. Capital Concentration in the Public Companies, Protection of the Investors on the Capital Market in Bulgaria: 1997-1999. – Economic Thought, 2000, No 4.

Second, this concentration **crowds out the minority and small owners** and effectively isolates them from any participation in the ownership. Essentially, this is the reason for the next national specific.

Third, **lack of liquidity and scope** of otherwise formally well-regulated stock exchange and trade in stock.

Fourth, bank system **isolated** from the governance processes of the corporations due to lack of substantial legal mechanisms, as well as due to inherited negative past and lack of sufficient interest in such involvement.

Even just these specifics are sufficient to state that *in Bulgaria **was established** a corporate governance model, which is common neither with Anglo-Saxon, nor with German-Japanese model of corporate governance*. It is a model of family concentrated ownership, which was characteristic of Europe and the world in the first half of the 20th century. This model cannot converge to neither of the known models before it overcomes its internal restraints and develops the necessary additional features.

In short, it is the development of the necessary legal mechanisms for involvement of banks. It is a necessary but not sufficient condition, since they will still remain aside until more or less *stable* ownership structure is formed.

And second, it is the forming of certain, even though limited, critical mass of public companies, which assets will overcome the existence of liquidity market.

Even this is not enough, since direct or indirect *choice* between the two models will still be necessary. It is something, which today is deliberately avoided by all political powers.

These arguments are sufficient also for formulating the weakness of the second of the mentioned at the beginning theses – of the national specific. Bulgaria does not face the necessity to make a specific national choice in the way we have always done it – in a semi-European, semi-Balkan way. Bulgaria has to overcome the imposed primitive model of concentrated ownership and choose one of the global systems.

Whether the country is completely free in thus formulated alternative is another issue?

Whether both opportunities are equidistant from us and whether it is a matter only of governance choice which one to be chosen.

The problem how to overcome the inherited model is even more complex. Really, it is impossible to seriously believe that those, who concentrated their ownership with so many efforts, will voluntarily give up their power by dividing their control packages. It is even more unserious to think of some administrative measures for

dividing this ownership. It is obvious that there is a need for complete and well-thought system of measures, which will make the registering as a public company acceptable for the corporations; the financing through the stock exchange enticing and beneficial; the good treating of the minority stakeholders – prestigious.

However, at least declaring the direction, which the government bodies will strive to follow, is necessary. Because it is not possible to work simultaneously in both directions. For now, though, there are neither discussions, nor seeking for solutions. There is reliance on the hypothetical convergence, which will solve the problem by itself, and the natural European choice we face even only due to our recent accession to EU, is neglected.

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