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THEORETICAL AND METHODOLOGICAL ASPECTS OF FORMATION OF CORPORATE CONTROL SYSTEM IN UKRAINE

This article suggests theoretical and methodological approach to corporate control system formation in Eastern Europe (case study of Ukraine). It considers historical and controversial aspects of corporate control implementation and suggests the systematization of subjects and objects in terms of corrective actions and outlines of corporate relations. Existing types of corporate control in Ukraine have been investigated on the basis of legal and regulatory framework and corporate practice. The article suggests measures in respect of management of the corporate control system development, based on the improvement of certain components of corporate control implementation and structural peculiarities.

JEL: G30; K22

Problem setting

Economies of Eastern Europe (including Ukraine) have entered the stage of transformation to become market economies and are yet transitional, in fact, as shown by, first of all, poor market infrastructure, unstable and incomplete regulatory framework, often too active and non-professional administrative regulation of economy, which damages creation of the competitive environment.

The amount of direct investment needed for the development of the national economy has recently increased in Ukraine, but its level remains the lowest in Europe. Investment incorporation into further economic development of join-stock companies requires effective corporate control, which provides reliable protection of investors' rights, openness and transparency of corporations. Inconsistency of existing corporate control system to requirements of a modern corporate governance system makes it essential for the study to clarify the nature of tasks, subjects and objects of corporate control.

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Formation of national system of corporate control is one of the key directions in corporate relations system. At the same time, Ukrainian studies in economics pays insufficient attention to the factors, which hinder the development of national economy.

Recent research and publications analysis. The issue of the formation and operation of corporate control was studied in papers by the leading researchers, including G. Mians (1962), A. Berle (1963), A. Carroll (1979), A. Williamson (2008) and others.

However, not all aspects of this issue have been fully detected, which causes a necessity to determine objectively theoretical basis of formation of corporate control system and preconditions of its inception.

The aim of this article is to analyze theoretical and methodological aspects of formation of corporate control regional systems and develop recommendations as for the formation of corporate control system in Ukraine.

The main part

The origination and development of corporate control system is the result of market transformations, accompanied by changes of organizational and legal forms of former state enterprises. In the end of the last century, the national corporate sector was formed as a result of mass privatization of Soviet industry. Joint stock companies became the dominant legal form. The necessity to survive and develop in response to new economic conditions required the formation of a totally new system of economic relations and the balance between the interests of stakeholders. It is impossible to solve this problem without an effective system of corporate control in Ukraine.

The following typical negative phenomena have been caused by hindered development of the corporate control system from transformational processes (Kuzheliev and Britchenko, 2013):

- redistribution of property in favor of management board members of a joint-stock company at the expense of minority shareholders' rights violation;
- limitation or absence of free sale of shares on the secondary securities market;
- nominal managerial power of supervisory boards, which results in monopolization of power by corporation's executive body;
- attribution to the scope of confidential information, which shall be disclosed according to law and international standards;
- lack of qualified experts on corporate governance.

However, attraction of investment for further economic development of both certain joint-stock companies and the state, in general, requires effective corporate control implementation, which provides adequate protection of investors' rights, reliable

functioning system, including a valid management system, openness and transparency of companies' activities (Shershniova, 2005, p. 13).

Emergence of a "corporate control" category is closely interconnected with corporate structures appearance and corporate relations formation even at *the first stage* of their development. Establishment and development of corporate economic sector lasted for a long historical period. From the process of tribal system disintegration, separate unions began to form on the basis of the expression of participants' (members') free will in respect of certain private interests coordination and the subordination of their common goal – collaborative exercise of economic activity or to support such activities in property for profit, to withstand other producers' competition or to protect common interests in the market. From those days two main categories of such unions' participants began to form – the organizers and the owners of business, and the participants, limited in property shares. The first mentioning of such unions can be found concerning ancient Assyrians, Phoenicians, Greeks (Dmytrychenko and Khimchenko et al., 2012).

Such corporate forms as contractual sociable union – *societas*, corporate type organization, which became the prototype of legal entity institute – *universitatis corpus*, and publicant society – *societas publicanorum (vevigalium)* as a mixed form of *societas* and *universitas* (Kashanyna, 1999, p. 27). In other words, at that time, the very first processes of economic system corporatization began, and the Roman private law became the first model of corporate law.

During *the second stage*, in the Middle Ages corporate forms of management spread all over Europe. This period includes the processes of "socialization" of corporate structure and building the social position vertical, i.e. strict hierarchy and the place of each individual in society was determined. One more important peculiarity of this stage was the emergence of the term corporation (*corporatio*) in the contemporary sense of the word. Corporate law, which begins to defend professional, moral and legal interests of corporate relations subjects, faces some transformation too, backgrounds of corporate control system formation.

The third stage of corporate relations formation began between XVI and XVII centuries, when first joint-stock companies began to appear. The English East India Company (1600) and the Dutch East India Company (1602) can be considered as the first prototypes of modern corporate structures. During the period of discovery, corporatization processes became especially topical, as only this corporate form was able to provide large amounts of capital. Further corporate relationships were intergrading constantly, spreading and became the key form of business organization in most developed countries of the world over the past two hundred years (Klejner, 2005, p. 32). The corporate control system was developing concurrently, because during this period control function took on special significance for shareholders and other stakeholders (including states).

The fourth stage of corporate relations development is the formation/establishment of first business association of independent legal entities and monopolies. John R. Rockefeller, who created a trust "Standard Oil" in 1882 by combining multiple oil corporations on the basis of trusts, was a pioneer in this area. Following Rockefeller's oil trust, three other trusts appear in the USA: oil-cotton (1884), oil-linen (1885), distillery, sugar, lead (1887).

At this stage, the production was concentrated. For example, Morgan and Rockefeller' group on the eve of World War II had 56% of all US equity capital (\$2 billion of shares) (Dmytrychenko and Khimchenko et al., 2012). Later in 1890, after the Sherman Anti-Trust Act had been adopted new organizational and legal form of corporate structures arose, called holding. Of course, in terms of production concentration, requirements to the corporate control system rose.

The fifth stage of corporate relations persuasively began after the World War II. Transformations were inherent to this stage. Material and non-material human needs led to the expansion of product and service range based on diversification of production functions, and caused the revision of forms of motivation for employees' productive work. These innovations required a scientifically grounded tool for decision-making and new approaches to protect the interests of stakeholders, that is, the system of corporate control enters a new development stage.

Regarding Russia, the establishment of joint-stock forms began in XVII-XVIII centuries. "Russian company trading in Constantinople" established in February 24, 1757 was considered to be the first corporate structure. It was established on the initiative of Venetian merchants who wanted to trade between Venice and Russia across the Black Sea and provide trading house or office on the Don river for that matter (Bandurin, 2003). This company was actively trading and existed until 1762. In 1758 Persian trade company was founded, and in 1794 another trade company – a Russian-American one. By the beginning of 1820s the development of corporate structures in Russia was accelerated and their number increased significantly: by November 1917 there were about 2 850 commercial and industrial joint stock companies (taking into account liquidation and reduction of capital during the World War I) with registered capital of 6040 million rubles (Kuzheliev and Britchenko, 2013).

After the Great October Revolution of 1917 all joint-stock companies and other corporate structures were nationalized and evolution process of corporate sector was interrupted. The situation changed slightly during the NEP (New Economic Policy) period. Thus, in January 1922 first joint-stock company of the Soviet period was founded, a joint-stock company of internal trade and import of leather stuff "Shkirsyrovyna" (Bandurin, 2003). At that time corporate control was replaced by administrative command system of "corporate" relations. In the late 20's of the 20th century corporations were transformed into state associations, i.e. corporate relations ceased to exist temporarily. However, some corporatization basics reflected in the Soviet industrialization process.

The current stage of corporate relations formation in Ukraine began after the Law of Ukraine "On Business Associations" was adopted in 1991, which formed a collective organizational and legal form of ownership, based on combining members' property (1991). The law determines the formation of different types of business associations in Ukraine, but, as above stressed, joint-stock companies, which form the basis of national corporate sector in the modern context, became the most widespread. The dominance of corporations was quite objective and was the result of the former USSR's state property privatization, which began in late 1991 and got widely spread in 1995-1997. Privatization of former state enterprises caused substantial transformations in the structure of Ukrainian economy. Thus,

all the objective conditions for the national system of corporate control formation and development in Ukraine were created.

Concerning the corporate control as a system of economic relations, according to some researchers, its formation was caused by the business development and by the separation between owners' and hired managers' institutions (Mullahmetov, 2009). It is difficult to accept this idea, since it provides corporate control acquisition only under the condition that a corporation gets hired professional managers, who assume management and agent conflicts emergence. But an owner of the capital, investing in his stocks, acquires certain corporate rights from the moment of purchase and acquires the power to influence certain management decisions that he is already endowed with rights to preside the corporate control. It means that the moment when a shareholder makes assets to the statutory fund of a corporate structure and the moment of acquiring the corporate control are indissoluble.

The second group of researchers interpret the corporate control in both legal and physical sense. Thus, from legal point of view corporate control is the fact that the major shares in the charter capital of the company or an asset with a certain right belongs to a stakeholder (Ioncev, 2005). I.e. corporate control appears only if someone owns over 50 percent of issued shares. Physical control in the current context is a complete absence of any obstacles to the realization of the above rights. It is difficult to accept this idea too, since it is based on the idea that only a major shareholder acquires the corporate control. But the owner of the corporation is endowed with certain corporate rights (including the possibility to exercise corporate control) in case he purchases at least one simple share. The level of such a control is definitely weak and token, but it exists and has to be taken in consideration and get a protection.

The third group of researchers (Popov, Kotov, Zaitseva, 2009) believe that certain shareholders or their groups, management staff, finance partners and labor groups, consumers and suppliers, state authorities and the public. This point of view is false too, since corporate control provides certain property law on corporation property. But the important thing in this approach is that corporate control is assigned to shareholders de jure, and de facto corporate control belongs to other groups of stakeholders (for example: majority shareholders and top management).

This point of view is found in studies of M. Radieva (2008) who also observes the possibility of corporate control transition from shareholders (especially in cases of high diversification of a stock ownership) to management. That is, disintegration of corporate property disables the realization of corporate rights of "ordinary" owner (minoritary) and led to the loss of ability to control actions of the management.

Kovalska and Rak (2008) also focus on an increasing role of implicit management control of corporate structures with a great number of shareholders and, as a result, are characterized by disintegration of the stock capital.

Gubin's (1999) thought regarding the essence of a corporate control deserves attention. He defines corporate control as the ability of entities of stock relationship to provide a continuing impact on rendition of strategic management decisions. But subjects of corporate relations: market counterparts, public organizations, state authorities, which do

not acquire the corporate control de jure, can also influence activity of a corporation, which means that this point of view is also false.

Key attention to issues of corporate control is given to the Organization for Economic Cooperation and Development (OECD), which declares that good corporate governance should provide proper incentives for the board and management to pursue objectives that meet the interests of the company and shareholders and should facilitate effective monitoring, thereby encouraging firms to use resources more efficiently.

The Law of Ukraine "On Joint Stock Companies" (2008) gives the following interpretation of the term "control": the decisive influence or the ability to exercise the decisive influence on business activity of an economic entity, which, in particular, is exercised by realization of the right to own or to use all the assets or their major part, the right of profound impact on the composition formation, voting results, adoption of a decision by governing bodies of an economic entity, and also the right to execute the deal that enables to determine conditions of business activity, to give binding instructions or serve as the governing body of the economic entity.

Thus, the concept of "corporate control" means a management function, which consists in the ability of stakeholders of corporate relationships to make constant decisive influence on tactical and strategic decisions of corporate association, dispose of capital and property of the association on the basis of property authority or a personal one, aimed to effectuate corporate relations and set targets in general. This interpretation of the concept narrows the circle of subjects of corporate control to shareholders and managers, since they have an opportunity to exercise the constant decisive influence on a current work of the joint stock company, to make strategic decisions, to dispose company's capital (Kuzheliev and Britchenko, 2013).

The control is carried out by a system which, if functions properly, should include legal regime, management decision-making, owners' rights, reliable finance accounting and a corporate culture. An effective corporate control system determines powers of each participant of corporate relationships, equality of their rights is the component of the corporate governing, and is based on some general principals of information disclosure, managers' accountability, sharing responsibilities and proper internal control (Cherpak, 2004, p. 30).

In our opinion, corporate control is a specific form of control, resulting in a sufficient number of rights in a joint stock company, which provides the continuing impact on making strategic and tactical decisions, and also provides proper protection of investors' rights, reliably functioning system and transparency of corporation activity aimed to present authentic information to stakeholders, protection and preserving of valuable resources and the invested capital (Kuzheliev, 2012, p. 52).

In the modern practice of corporate governance complex mechanisms that contribute to the resolution of the contradictions that arise in corporate control are formed. The following directions of corporate control are distinguished within this system:

1. *Control of the workforce*. This type of control provides employers and managers of corporations, while exercising their functions, not to separate their own interests from the interests of the workforce (Ped'ko, 2008, p. 21).
2. *Control of management corporations*. This type of control is in joint stock companies where management has a significant stake, resulting in the division of interests of company' leadership and employees, but has no strong external shareholders (Ped'ko, 2008, p. 21).
3. *External control*. This type of control is the result of distribution of ownership functions and business conducting. Management of the corporation acts in this case as hired from outside shareholders. Practical realization of powers belongs to shareholders (Kuzheliev, 2012, p. 29).
4. *Share control* is a possibility for shareholders who have the required number of shares to accept or reject the decision.
5. *Management control* – is the ability of individuals and/or entities to ensure the economic management of the company.
6. *Financial control* is an opportunity to influence the decisions of the company through the usage of financial instruments.

Formation of corporate control is possible only in the case of implementation of the following ***corporate control principles***:

- *the principle of legality*, which assumes that all subjects of corporate relations conscientiously follow all legal standards of the society;
- *the principle of objectivity*, which provides that corporate relationship is a reflection of material reality and the corporation is unable to influence significantly some of them;
- *the principle of combining the interests of all stakeholders* while implementing control, which provides the balance of the interests of all groups of stakeholders as the main objectives of corporate control;
- *the principle of effective management of the corporation*, does not provides, but confirms that the main objective of building a system of corporate governance is ensuring the effective functioning of corporations and profit maximization;
- *the principle of sharing controlling powers* of involves separation of functions of corporate control initiation and implementation among different governing bodies of the corporate structure and among external controllers, including auditors, public organizations and trade unions;
- *the principle of control actions' balance* is a coherence of internal and external orientation of corporate control, providing optimal degree of control;
- *the principle of timely implementation* provides early warning control actions to prevent conflicts of interest of stakeholders and significant deviations of the corporation from established standards to ensure its financial security;

- *the principle of continuity of corporate control*, which provides permanent control by the subjects of corporate relationships for the realization of certain interests and objectives;
- *the principle of coverage* that is possible on the basis of constant monitoring of objects of corporate control;
- *the principle of mechanisms standardization of corporate control*, which involves the development and implementation of certain formalized procedures for the realization by subjects of corporate control their powers and rights;
- *the principle of disclosure*, which provides access for the subjects of corporate control to the necessary and comprehensive information needed for the implementation of corporate control. It should be noted, that disclosure requirements in developed countries is enshrined in law;
- *the principle of credibility*, providing matching of control information with the real financial performance and results of the corporation activity;
- *the principle of comparison*, which requires comparison of two or more economic indicators having normative and the actual value or a comparison of economic indicators of the corporation and indicative coefficients of system of financial security or comparable according to the industry, country;
- *the principle of unity of corporate control elements* that requires the formation of elements of the control system that can ensure its effective functioning and development;
- *the principle of independent external assessment*, which necessitates the involvement of auditors, experts, consultants and other subjects of market to the process of corporate control and publishing the results of their inspections in the media, the Internet and so on.

Principles of corporate control subjects enable subjects of corporate control to model corporate relationships according to the interests of all stakeholders (Shersh'n'ova, 2005, p. 16-17).

The structure of a system of corporate control includes the following structural elements:

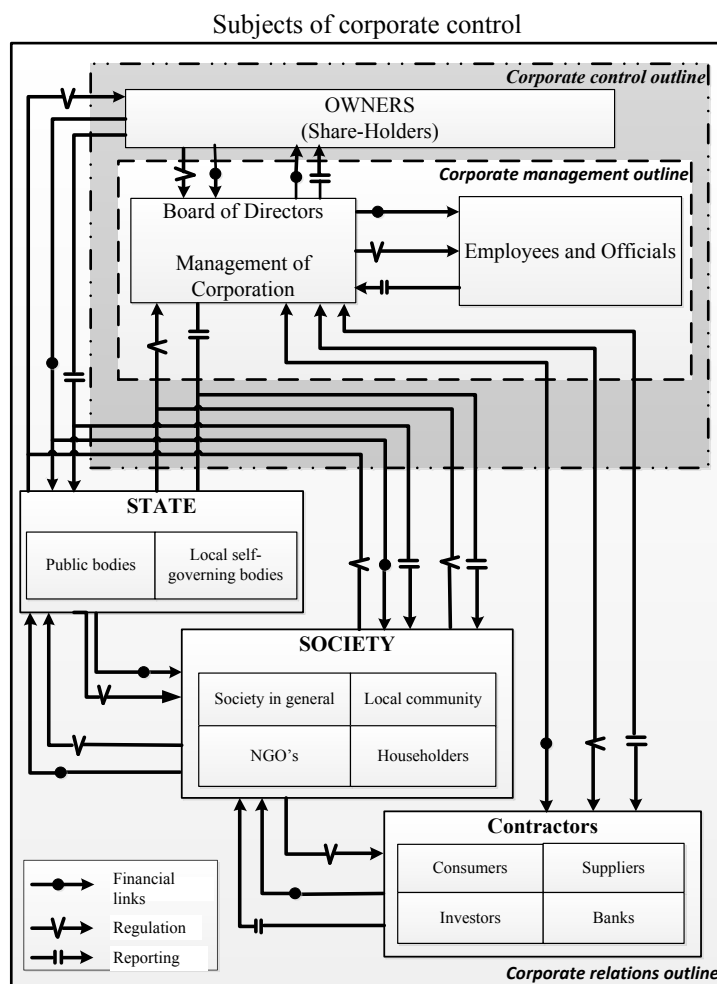
- subjects of corporate control;
- objects of corporate control;
- instruments of corporate control.

We believe that the subjects of corporate control are combination of private individuals and legal entities who have a legitimate right and ability to implement systematic monitoring and corrective impact on objects of corporate control on the basis of usage of complex methods and models of strategic and tactical management taking into account all stakeholders (Kuzheliev, 2012, p. 52). Structure and interrelations of subjects of corporate

control are shown in Fig. 1, where three basic outlines of corporate control are represented: financial management outline; corporate governance outline; corporate relations outline.

The first outline includes a combination of relationships existing between management corporation headed by the board of directors and the workers and officials of the company. The corporate control outline is characterized with relationships between corporation owners, i.e. shareholders and the board of directors. The entire set of interrelations between the corporate governance outline and blocks "State", "Society" and "Market counterparts" (figure 1) represents the outline of corporate relations in the corporate control system. For better understanding of relationships between the subjects of corporate control connections are divided according to belonging to financial flow, circulation of normative documents and accounting which is presented in figure with relative types of arrows.

Figure 1



Let us consider the flows in the financial management outline in details. Company workers and officials perform their productive functions according to the staffing table in accordance with the Statute and other normative documents – all this is the regulatory flow. Corporation management monitors the implementation of the estimated indexes through the system of accounting, marked in figure 1. Financial flows in the given outline represent receiving the remuneration for labor (salaries, allowances, premiums, bonuses etc.) by workers and officials.

The outline of the financial management is fulfilled with flows of financial connections, regulatory documents and accounting between corporation owners and board of directors which forms a corporate governance outline. Company shareholders invest their incomes and savings in securities, anticipating dividends and increasing of market value of shares, which is the basis of financial connections of the outline. As corporation owners, shareholders set certain requirements to the board of directors and management through the regulatory channel and have the right to receive accounting and information regarding the sizes of benefits flow, brought by business.

It is believed that the market value of a company is the most important financial indicator of corporate governance effectiveness. If the market value of the company in the financial market increases, the management and the board of directors get a positive assessment of their activity from owners and material remuneration (royalties, bonuses, corporate rights and so on). The management shall also take care of creditors and shareholders to receive the full income, which they expect, and to leave the money for further development of the corporation.

Corporate relationships outline is characterized by plurality, complexity, and variety of connections between the subjects of corporate control.

“State” and “Society” interact through the following channels:

- financial connection is that the state fulfilling its social functions (education, culture, sport, medical care, law enforcement, etc.) provides their funding from the state budget; on the other hand to apply these functions certain fiscal policy is provided, i.e. households pay established taxes and mandatory fees.
- regulatory connection provides the state with the establishment of certain “rules” that shall be followed by all members of society; on the other hand the society establishes goals and objectives for the state.

“Society” and “Market counterparts” interact through the following channels:

- regulatory connection provides the society to establish social expectations system: job creation, participation in national and regional socio-economic programs and projects, adhering to the requirements, protection of the environment, etc.;
- financial connection is that market counterparts, fulfilling social expectations, implement some financial measures, for example, such as patronage, volunteerism, financing, environmental and social measures, execution of the tax legislation;

- accounting provides systematic composing and submitting the report on the implementation of public expectations of society.

“Society” and “State” form regulatory instruments, which regulate corporation activity. In addition, the “State” sets clear legislative restrictions that regulate the conduct of corporation owners and the “Society” complements them with social regulations. Certain regulatory connection exists between “Market counterparties” and corporation management. On the one hand, counterparties set series of requirements regarding corporation activity: management assessment (availability of strategy, knowledge, experience, dependence of business on the “key personalities”), availability of peculiar risks for the corporation in the given region, indicators of economic environment (investment climate, value of capital, interest rates). On the other hand, management sets its own regulation regarding financial and economic situation of market counterparties (probability of substitute product, the ability to attract other suppliers and creditors or to enter new markets).

Accounting channels in the outline of corporate relationships are represented by the following connections:

- “corporation owners – the state” – rendering legislation tax reporting and competition law compliance, reporting on made transactions in the financial services market;
- “shareholders – society” – adherence to set standards of investors’ social conduct;
- “corporation management – the state” prescribes preparation, provision and promulgation of legally approved regarding corporation activity;
- “corporation management – society” – formation, verification and promulgation of the social report of the corporation, provision of transparent activity of the company and observance of norms of information disclosure;
- “corporation management – market counterparties” involves the establishment of a two-way relationship: on the one hand, corporation management shall provide market counterparties with (investors and financial creditors in the first place) necessary information and accounting; on the other hand, management has the right to require certain accounting from market counterparties for management decision-making and adjustment of its conduct to market environment.

In the Fig. 1 financial connections in the outline are represented by the following pairs:

- “shareholders – the state” – provides for the payment of taxes according to the current tax legislation norms;
- “shareholders – society” – describes the connections which occur between the owner and non-governmental institutions, public organizations, territorial communities (philanthropy);
- “management – market counterparties” characterizes financial flows, which occur in the process of financial and economic activity implementation through financial intermediaries in the financial services market.

Objects of corporate control are trends of interest monitoring, which are determined as subjects of corporate control for the implementation of certain adjusting measures. That is, the system of objects of corporate control allows to solve the interest conflict of a stakeholder to a certain extent and to provide the effective development of the corporate structure. Basic objects of corporate control in terms of the implementation of adjusting measures of subjects are given in the table 1.

Table 1

Objects of corporate control in terms of the implementation of adjusting measures of subjects

Subjects Objects	Board of directors, corporate management	Corporation owners (shareholders)	Workers and officials of a corporation	State	Society	Market counterparties
Dividend policy						
Investment policy						
Conflict of interests						
Financial results of activity						
Structure of owners						
Level of activity transparency						
Corporate social responsibility						
Observance of norms of a current legislation						
Strategic decisions						
Tactical decisions						
Operational decisions						

Source: Developed by the Authors.

Instruments of corporate control are the complex of methods and models of strategic, tactical and operational management, used by subjects of corporate control to implement certain adjusting measure to objects of corporate control. The system of corporate control is a component of corporate relationships, aimed to balance the interests of its participants in the process of corporate activity, basic. Its basic subsystems are systems of external and

internal control, including accountability and communications. The objective of corporate control is to define deviations from current laws, standards and violations of the principles of corporate governance, namely legitimacy, effectiveness, feasibility and economic resources management, and to bring corporate governance functioning in the right direction (Shershn'ova, 2005, p. 30-31).

The objective of corporate control is to determine deviations from the applicable laws, standards and violations of the principles of corporate governance, namely legitimacy, effectiveness, feasibility and economic management of resources, and in bringing corporate governance to function in the right direction (Shershn'ova, 2005: 30-31).

Thus, there are **two subsystems of corporate control**: external and internal. *External corporate control subsystem* includes the following components:

- system of regulatory authorities, powers and duties of which, criteria of relationships with market participants are clearly identified, as the transparency hierarchy is defined between them;
- system of detailed standards of participants, investor rights, corporate practices;
- broad diversified system of sanctions that can be applied to violators of the current legislation, corporate governance standards, the balance of interests of interested in companies' activity people .;
- disclosure system (ensuring the transparency of the company) in the interest of interested in companies' activity people.

Internal control as management subsystem is implemented at all stages of the corporation management. Internal control system focuses on sustainable corporate position on the market; recognition of the organization of subjects on the market and society; timely adaptation of production systems and management of organizations in the dynamic environment.

Thus, the purpose of internal control in the corporation is information support of corporate management to create effective solutions for its further operation and development (Cherpak, 2004, p. 30-31).

On the basis of corporate sector experience in Ukraine **the most common transitional forms of corporate control** of a joint stock company can be identified: private enterprise; collective property managers; concentrated outside ownership; dispersed ownership; mainly state control (Williamson, 2008).

The model of private enterprise provides that on the basis of former state enterprises in the privatization process corporate structures have been created combining ownership and management functions. In the ownership structure director dominates (usually of the former state enterprise) while small stakes belong to managers, workers or the state. This model is inherent in medium and a relatively small business, which operates in sectors oriented on the consumer market (light and food industry) or in the segments of narrow specialization (woodworking, pharmaceuticals, drilling and power equipment, etc.). The model of private enterprise is inherent in close ties between majority owner (former "red director") and

municipal authorities (former part functionaries) who do not interfere in the internal affairs of the corporation and regulating its activity only in the local market.

Corporate relationships among such company are paternalistic in its nature, majority shareholder provides others with work, finances certain social programs and, in general, has the support from the workforce. That is, often the interests of municipal authorities, owners, managers and employees are balanced.

The disadvantages include an authoritarian management style (corporate control is concentrated in the hands of one person or family) and certain opportunism from the middle managers. Furthermore, smallholders have no access to corporate control, and new investors are not allowed to the company. This system may be destroyed by bankruptcy or criminal structures in the process of redistribution of property in the region.

The model of managers' collective property also provides a combination of ownership and management functions. In the ownership structure none of majority shareholders has a "blocking" stake, but the share of director exceeds the share of any of large owners and is close to the "blocking". This type of model of corporate control is quite common and has no clear sectorial binding.

The advantages of the model include the interest of top management in the effective functioning of the corporation, low probability of opportunism provided by the middle managers. However, there are risks of conflicts of interest within majority shareholders that can lead to a split. In addition, this model does not allow to release the owner manager, even if the quality of his work is unsatisfactory.

One more problem consists in the difficulty of motivating corporation non-owner managers, if they are found in the corporate control system. It should be noted, that exacerbation of conflicts of interest is likely to appear, as well as the split in the long term perspective as a result of age replacement of owner-managers with young non-owner managers. Domestic practice shows that many corporations evolutionary transition from this model to a model of private enterprise, due to the increasing role of general director in the corporate control system.

Model with concentrated external ownership is quite common among large corporations, controlling interest of which is in the hands of external owner. The advantages of models with concentrated external ownership are that the owner of the company disposes a controlling interest, and may decide to change the model of corporate control. In addition, a major owner is interested in the development of the company and updating of production technologies, equipment, training of employees.

The main risks of the model are a high probability of opportunism by both middle and top management. Managers within this model feel no confidence concerning the future and try to solve their personal financial and career issues. This is understandable, because the replacement of a top manager involves the replacement of almost the whole team.

Other side represents relationships of small owners and majority shareholders. Within this model the owner of the controlling interest often deduces all the profits through transfer

pricing mechanism to other personal enterprises, and minority shareholders do not get dividends for ages.

The model of dispersed ownership is characterized by the fact that the manager (or team of managers) has a stake which is less than blocking. Other shares are dispersed among a large number of small shareholders, both insiders and outsiders, or a small part of the statutory fund belongs to the state. This model of corporate control inherent in large corporate entities that operate in dysfunctional markets and have great social commitments. Such enterprises often depend on state order and have large accounts payable (defense companies, some large housing and communal enterprises). Distinctive features of this model are the lack of control of management, which sometimes led to the withdrawal of part of the corporation assets.

Corporations with *the model of state control* functioning in the least efficient sectors of economy, are burdened with social obligations and the greatest credit debts. The main characteristic feature of the model is low controlled managers' activity, impossibility to raise a share in ownership, so such enterprises need business restructuring with investment intakes. The model is stable if there are no long-term fluctuations in economic system. Bankruptcy of such enterprises is prevented by public authorities and managers (Britchenko and Knjazevych, 2013).

Experience of corporation development in economically developed countries proves that only combination of public interests with institutional ones and those of investors, employees, managers of all ranks in respect of developing corporate structures under civilized conditions of interaction can make it possible to achieve expected results and form an effective system of corporate control.

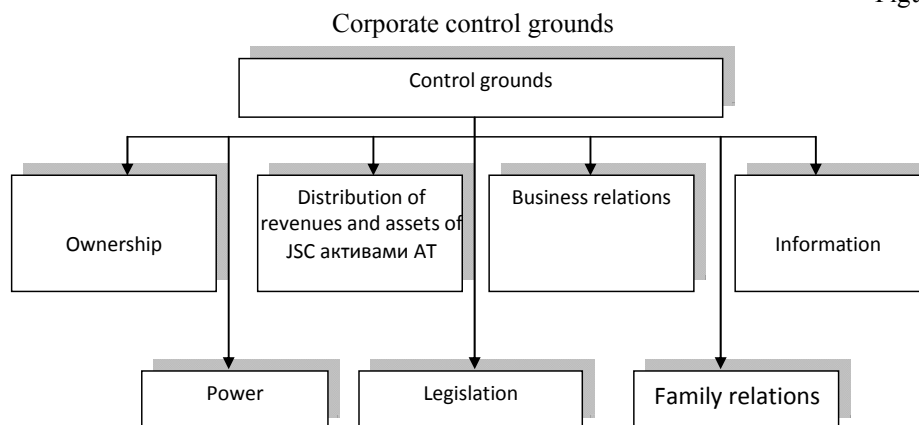
However, a deeper research of theoretical basis of corporate control is impossible without studying the *origins of its emergence*. The motivation of corporate control is connected with accumulation and concentration of possibilities, which brings to the corporate governance directed at agreed corporate interests (Gubin, 1999, p. 18-20).

The study of sources of corporate control in Ukraine is rather disputable. Thus, Gubin (1999, p. 20) believes that the grounds for control can be the following: the formation of technologically extended distributional and financial chain; concentration of resources; integration of markets or formation of new markets, expansion of corporate share in the existing market; defence of capital owner's interests; stronger positions of the administration board, i.e. redistribution of rights and authorities of corporate control entities; elimination of competing interests and corporations; redistribution of cash flow and floating capital; the change of profit and cost centres; the change of a corporation value, profit redistribution, property growth. A.B. Pedko (2008) singles out the sources of control basing on the system approach.

In other words, corporate control is based on three fundamental economic-and-social counterparts: power, property and opportunity to distribute the corporation revenues, connected with one another by a certain reason-result dependance. It means that corporate control is based on private ownership of an individuum, his/her administrative power and

opportunity to distribute corporation revenues, though real sources of control are greater in number (figure 2).

Figure 2



Source: Developed by the Authors.

The ownership is considered in this case as a set of relations of capital wealth belonging to certain individuals with relevant rights of ownership, based on this ownership. An important condition for corporate control is power as an ability of certain individuals to control the process of managerial decision making and implementing.

The distribution of assets, operations and revenues of a joint-stock company serves as a reliable ground for corporate control. The most frequently found ground can be a source of control linked to other sources.

Legislation regulating the relations of control would be reasonable to divide into four groups: legal regulations; contract law regulations; internal-corporate law; court decisions on corporate disputes.

Information plays an important role in establishing, strengthening and distributing control over joint-stock companies. Confidential information as of a JSC that top-managers large shareholders, and banks have, can be grounds for them to control the corporation activity. Gaining the control such groups strive to monopolize the access to confidential information and use it exclusively in their own interests. Family relations are used in world practices to retain the control over family companies. In our countries, as well as in Europe, “family” companies are the basis for small, medium-sized and partially of large business (Ped'ko, 2008, p. 78).

The basis for the control of majority shareholders is their right of ownership for shares, in particular the following (Pedko, 2008, p. 76):

- Right to elect the board of directors and take part in decision making as of the main issues company's activity;

- Right to get dividends;
- Right to compensate costs after the company's liquidation;
- Right for beneficial price for shares of future emission;
- Right to control and obtain the information, personally or through control bodies;
- Right to freely take away shares and single out owner's authorities;

The legal grounds for corporation control from majority shareholders is the principle of shareholder's law, according to which at the general meeting capitals can "vote" not shareholders. Besides, to retain the dominating position the shareholders owning large stocks of shares use a wide range of additional "impact tools", such as increased property and property rights value, included into the statutory capital of a corporation as non-monetary assets; procedural limitations of minority shareholders' rights; division of shares etc.

Financial-and-credit bodies base their control on the following factors: ownership, power, current legislation, non-formal business relations. The broader is the range of financial services provided to financial-and-credit establishments to a certain corporate client, the greater is the probability of putting them under financial control.

State has objectively institutional-legal grounds for putting a corporation under certain control. Moreover, intrusion of public bodies into the activity of a corporation can always be justified by social interests.

A world practice shows that owners' control of debt liabilities of a corporation is often stronger than that of the state. This group of objects of corporate relations has legal rights to claim for the bankruptcy of a corporation, create a committee of creditors, and appoint a manager of the assets of a debtor company. The grounds for putting a corporation under control are a right of a claimer to control the debtor's property.

The control over a corporation carried out by criminal forces can be of different forms. A corporation can be under influence or partial control, experience pressure of criminal structures.

Parity control means that no influential group can control a corporation on its own, i.e. there should be a parity of votes of several groups. The model of parity control is a scheme of distribution of economic power, most widely-spread in modern corporations abroad (Ped'ko, 2008, p. 73-87).

The analysis has proved that modern research of the mechanism of realization of corporate control has been made rather superficially. First of all, it concerns the research of the nature and mechanism of corporate control in the national corporate sector. Under the mechanism of corporate control we understand a scheme describing the process of control in joint-stock companies. Such a mechanism is put into action and directed by interests of controlling group (Dmytrychenko and Khimchenko et al., 2012).

The main *components of corporate control implementation* are as follows:

- Directed corporate control;
- Bodies of corporate control implementation;
- Possibility and form of control centre participation in such bodies;
- Methods and tools of corporate control implementation.

The corporate control centre, led by its interests and chosen control direction, appoints bodies to implement control, forms of its own participation in the bodies and certain methods and tools of corporate control implementation. Actually, particular features of different companies can cause the changes in the algorithm of choosing certain components of the mechanism, though the set of components stays the same.

The main *methods of control implementation* include the following:

- Appointment and dismissal of members of the board and other top managers of the corporation;
- Directive governance of the corporation by issuing orders, regulations and decrees;
- Assessment of managerial decisions and imposing “veto” over decisions, unprofitable for the control centre;
- Informal pressure on the corporation administration to make them follow the interests of a certain group.

A characteristic feature of corporate control process under conditions of dynamic external environment is a complex character of controlling measures and combination of different forms and methods of influence over the corporation. Therefore management of corporation, understanding real functional possibilities of the control centre keeps to the policy which meets interests of the latter; at the same time the control centre may not make pressure over the corporation.

Practices prove that in most cases control is implemented through the board of directors or supervisory board of the corporation. The choice of the board of directors is traditionally made by the control centre. The tactics of a controlling group as of the board of directors consists in appointing their own representatives to the key positions and completing the rest of the board by loyal people. In Ukrainian joint-stock companies the importance of supervisory boards is now gradually increasing.

Though the board of directors is the main pusher of the control centre’s interests in corporations abroad, the latter can dictate its policy through continually acting bodies, and certainly, through regular or extra meetings of shareholders.

To conclude with, corporate control is a managerial function, which consists in ability of interested subjects of corporate relations to perform continuous decisive impact on making tactical and strategic decisions of corporate company, distribute the capital and assets of the company on the grounds of property authorities or their own authorities in order to achieve the set purposes by the subject of corporate relations and company as a whole.

As a result of formation of the national market of financial services and system of corporate control lagging behind the transformational processes in its development, a lot of negative features have appeared in the corporate sector, which require regulating. Under such conditions the subject matter of protecting the rights of investors, owning securities, have become really vital. As a result of privatization of public property over 20 mn citizens of Ukraine became shareholders (The National Commission on Securities and Stock Market, 2015). Taking this into consideration, we understand that today's main objective is to build an efficiently operating accounting system with relevant legal provision of investors' rights protection and formation of efficient corporate control system.

The analysis of the corporate relations system in Ukraine has proved that the norms, regulating the rights of owners have been fixed in the articles of laws "On Joint-Stock Companies" (Koval's'ka and Rak, 2008), "On Securities and Stock Market" (2006), in Recommendations from the Best Practices of Corporate Governance for Joint-Stock Companies of Ukraine (The National Commission on Securities and Stock Market, 2002) and other laws and legal acts.

Thus, the article 25 of the Law of Ukraine "On Joint-Stock Companies" (2008) contains the following rights of corporate structure owners:

- participate in governance of a joint-stock company;
- participate in distribution of profit of the company and gain its part (dividends);
- obtain, in case of liquidation, a part of its assets or value;
- gain information about the economic activity of the joint-stock company.

However, shareholders can have other rights as well, which are fixed in the legislation and charter of the corporation, which determines the necessity to create in Ukraine a corporate control system.

The corporate management level and assessment of its attractiveness for investors are affected by the way the minority shareholders are protected, or if they are protected at all.

Therefore the process of state-owned property privatization in Ukraine has resulted in the fact that a great number of small investors, owning stocks of shares up to 1-2% statutory fund of a corporation (The National Commission on Securities and Stock Market, 2015). This category of shareholders is the least protected one in corporate relations, while rough violation of their rights by the management board of the company and large shareholders are "normal" in Ukraine.

The reason for this is not only the weakness of the acting legislation but also a low level of general corporate culture. Shareholders often do not know about their rights and cannot protect them with the help of legal means.

Besides, minority shareholders do not have sufficient financial resources to protect their rights and oppose the alliance of majority shareholders and corporation managers, who can use all the resources.

It should be mentioned that the corporate legislation of Ukraine has experienced certain progress as of the protection of minority shareholders' rights. Thus, the article 28 of the Law of Ukraine "On Joint-Stock Companies" (2008) contains the possibility to protect shareholders' rights, if they are also the employees of the company, by the ban to require from them to reveal the information concerning their decisions during voting at the general meeting.

Most often the issue of protecting the rights of minority shareholders emerges when one of shareholders (or a group of shareholders) gain control over the corporate structure (table 2) (The Verkhovna Rada of Ukraine, 2008).

Table 2

Kinds of Corporate Control in Ukraine

Stock of shares	Owner's rights	Corporate practice
From 1 share to 5%	<ul style="list-style-type: none"> • Participate in general meetings; • Vote at general meetings; • Make propositions as of the agenda of general meetings (decision as of inclusion of propositions to the agenda is made by the board); • Be a member of administrative bodies of the company; • Claim to court against the company (including the claim as of admitting the general meetings invalid); • Demand the redeem of appropriate joint stock shares in cases, implied by the legislation. 	Minority share holders have no real right to influence the decision. The protection is ensured through the court or opportunity to require the redeem of shares by the company
5% + 1 share	<ul style="list-style-type: none"> • Make changes in the agenda of general meetings; • With representatives of the National Commission of Securities and Stock Market, control the registration of shareholders for the participation of general meeting; • Require extra general meetings of shareholders at any time and for any reason; • In case of the refusal by the board, they can call general meetings on their own; • Require the check of financial-and-economic activity of the board by the revision commission. 	Minority share holders have opportunities to make decisions that can influence the activity of a corporation
25% + 1 share	<ul style="list-style-type: none"> • Only with the consent of the owner of the general meeting may decide on the following matters: • Amendments to the charter of the company; 	Small "blocking" package

	<ul style="list-style-type: none"> • The creation and liquidation of subsidiaries, branches and representative offices; • The decision on the termination of the company. 	
40%	<ul style="list-style-type: none"> • If such an owner is not present at the general meeting there is no quorum, which means the general meetings are blocked 	Big "blocking" package
50% + 1 share	<ul style="list-style-type: none"> • The stock of shares which allows to make decisions at general meetings on any issues that do not require a qualified majority of votes; • The stock of shares is not sufficient to make decisions as of the issues that require a qualified majority of votes; • The stock of shares is not sufficient to provide quorum at the general meetings. 	Control stock of shares
60% + 1 share	<ul style="list-style-type: none"> • The stock of shares is sufficient to provide quorum at the general meetings; • The stock of shares may be not sufficient to make decisions as of the issues that require a qualified majority of votes. 	Control stock of shares
75% + 1 share	<ul style="list-style-type: none"> • The stock of shares is sufficient to carry out general meetings and make decisions on any issues single-handedly 	Control stock of shares that gives minority share holders no opportunity to influence the decision at the general meetings
90%	<ul style="list-style-type: none"> • The stock of shares is sufficient to carry out general meetings and make decisions on any issues single-handedly; • The stock of shares that actually blocks any means of protection of minority rights stated in the Law "On Joint Stock Companies". 	Control stock of shares that gives minority share holders no opportunity to influence the activity of the company

Source: Developed by the Authors.

Gaining control over the corporation means the possibility for a person or a group of people to have considerable influence on governance.

The simplest scheme of gaining control over the company is purchasing the control stock of shares. But the modern practice of functioning of corporations shows several kinds of "control stock", which give the owner certain means of corporate control: from obstruction of general meetings of shareholders to strategic decision making on behalf of the whole company. It is worth mentioning that the size of control stock of shares is not a constant, for it depends on the degree of "dispersive character" of share capital and the number of "voting" shares, whose owners attend the general meeting.

The positive changes of legislation include the fact that the Law of Ukraine “On Joint-Stock Companies” (2008) contains a set of regulations directed at the protection of minority shareholders’ rights:

- 1) Per cent border for proposition making has been reduced from 10 to 5% (part 4, art.38);
- 2) Cumulative voting for the election of members of supervisory board has been introduced (art.53): minority shareholders have obtained a right to appoint their representative in the supervisory board;
- 3) The increase of qualified majority, needed for important decision making, from 75% to all the shareholders including those absent;
- 4) The distribution of the number of issues, whose decisions need qualified majority of votes, including the decisions on annulling the redeemed shares; change of company kind, distribution of shares, change of statutory capital size of the company etc. (art.10 of the Law);
- 5) Regulated procedure of establishing the size and payment of dividends within 6 months after the reporting year is over (part 2, art.30) (though the Law does not solve the problem of non-payment of dividends in case the company gets profit);
- 6) Introduction of the obligation for the person purchasing the control stock of ordinary shares (50% and more), to make an irrevocable offer to all the shareholders to buy their ordinary shares by market value with delayed payment up to 30 days (art. 65). But this norm should increase the value of control stock of shares and buyer’s risks;
- 7) Mandatory purchase of shares by the company on the requirement of shareholders, who voted against the most important decisions: reorganization of JSC, change of type from public to private, signing a significant contract by the company (about 25% value of assets of JSC), change of statutory capital amount (art.68).

The world practice has proved that protection of shareholders’ rights is an objective reality of corporation existence, for its activity can cause certain conflict of interests and civilized solution of conflict problems and efficient mechanism of protection of shareholders’ rights are key characteristics of corporate governance development in the country.

It is worth saying that to create a strong mechanism of protecting shareholders’ rights means not only protecting individual interests of a person, but also a way for the corporation to achieve its goal carrying out its activity. It is the possibility of civilized solution of conflicts and efficient mechanisms of protection of rights of owners are key characteristics of developing the corporate control system in Ukraine.

The protection of rights and legal interests of shareholders has to be realized by the method of establishing, applying and implementing the norms of corporate legislation and culture. Efficiency and productivity of mechanisms of implementation and protection of rights and interests of small owners are closely connected with legal guarantees for the realization of such rights, including the right for protection of legal interests. Legal guarantees for the rights of owners are expressed first of all in the fact that, according to the Civil Code of Ukraine, norms of joint stock legislation determine a circle of rights and obligations of

shareholders, and also provide the protection of their rights and interests (part 1, art. 1 “On JSC”) (2008). Such an approach to the definition of legal guarantees is of great importance because establishment and provision of the balance of interests of all interested parties, as well as efficient mechanism of their rights protection are one of the most significant issues for the legal regulations of corporate sector regulation.

The system of guarantees of legal rights as of corporate control consists of two elements: a regulative component and an `organizational component.

Corporate interest of each owner is realized both through realization of rights given by Law and inter-corporate acts of the company and indirectly, through the activity of administrative bodies of the joint-stock company (organizational component) (Kuzheliev, 2012).

The regulative component consists in defining by corporate legislation the means and legal procedures, helping the owner of corporate rights to implement legally meaningful actions, determined by its legal status: legitimate rights of owners of ordinary shares, participation in corporate governance and realization of the right to vote at general meeting of shareholders, availability (reveal) of information about the activity of corporation, right to obtain a part of profit (dividends) of corporation, termination of relations with the joint-stock company, restoration of legal rights etc.

The regulative component of guarantees of rights of a share owner and inter-corporation mechanisms providing realization and protection of rights of owners are interconnected (Kuzheliev and Britchenko, 2013). Thus, the organizational component of corporate control gives a possibility to use efficient means of realization of shareholders' rights. First of all, it is guaranteed by the board of directors of the corporate structure, whose competence is stated in the Law of Ukraine “On Joint-Stock Companies” (2008) and the corporation charter. It is the board of directors that is to provide general conditions for realization of owner's rights, and take measures to restore the violated rights of shareholders.

Besides, the realization of certain rights of owners of the corporation is to be provided by other bodies of corporate governance system, in particular: head manager, revision committee, internal audit, and in some cases, institutes of the national depository system.

Thus, *the system of guarantees of owners' rights in a corporation can be defined as a combination of regulatory and organizational means and procedures of providing property and non-property rights of owners, defence and protection of their rights from possible violations.* An important element of the system of special guarantees of owner's rights is a principle of right protection that are to correlate with the principle of corporate governance (Dmytrychenko and Khimchenko et al., 2012). We consider it important to provide the following principles of owner's rights protection:

- principle of decent behavior of stakeholders of corporate relations and impermissibility of excessive use of rights and opportunities;
- principle of real and guaranteed protection of violated rights of corporation owners;
- principle of priority protection of rights of small owners;

- principle of correlated corporate and private interests of stakeholders while using means of owner's rights protection;
- principle of real restoration of violated rights of an owner.

Legislatively fixed principles of the corporate control system can be observed in some well-developed countries, which provides effective means of realization and protection of minority shareholders' rights. The fixation and implementation of the system of corporate control principles in Ukraine in legislation could result in significant changes in corporate sector operation and to some extent could eliminate the possibility of excessive use of rights in order to violate the rights of other shareholders. The practices in our country show that the main reason for excessive use in the sphere of corporate control is lack of boundaries, stated in the legislation of the country, as of the corporate right protection, indefinite terms of court hearings concerning the legal aspect of use of different means of realization and protection of violated rights, lack of liabilities for excessive use of rights in corporate legislation.

A certain experience in solution of this problem can be found in legislation of other countries. For example, courts in the USA do not consider claims of corporate right owners, if they know that it is issued inadequately in relation to the corporation owners who have already claimed to the court to protect their own interests or interests of the corporation. It means that a share-holder has to give grounds to prove that his claim is not a result of the desire to use court jurisdiction in vested interest (Kuzheliev, 2012). In France to solve corporate control issues the shareholders and courts use a legal concept of "excessive use of right", the limit of corporate control right is determined by the fact that rights and interests of other interested parties are not violated.

In Great Britain, according to the doctrine of "protection of minority" it is prohibited to approve any managerial decisions by corporation administration, if they involve violation of legislation, excessive use of authority or have a purpose to deceive minority shareholders.

Ukrainian practice shows that excessive use of right for protection has become a special kind of civil offence, frequently used by larger shareholders and their groups to use prohibited forms of pressure over small shareholders, or to carry out illegal takeovers.

To ensure no misuse of rights corporate relations need to improve the rules of civil law, corporate law should include provisions that prohibit corporate entities exercise control activities with the intent to cause harm to other shareholders and the corporation as a whole or hinder implementation of the legitimate rights of other shareholders.

Consequently, there is an objective necessity of regulatory consolidation in the corporate legislation system of principles concerning protecting the rights of shareholders, which will increase the level of corporate ethics and corporate culture, exclude the possibility of an improper application of the law when considering the corporate disputes.

From the foregoing, it follows that the formation of a national system of corporate control is at the stage of initial formation. Protecting the rights of shareholders – an important component of the mechanism of realization of rights of participants of corporate relations.

The conditions in which today develops corporate legislation of Ukraine does not allow to assert its excellence and the real possibility of its application. Despite the fact that in the Law of Ukraine "On Joint Stock Companies", it remains the protection of shareholders' rights, that will not disappear in the future and because of the importance and significance of this institution, which is the corporation.

One of the main obstacles to an effective system of corporate control in Ukraine - is insufficient and inadequate corporate and criminal law. Thus, the rules governing the rights holders, secured in some articles of the Law "On Joint Stock Companies", "On securities and stock market", the "Recommendations on best practices for corporate governance of joint stock companies of Ukraine" and other laws and normative acts. However, in a high degree of dispersion of equity and control of corruption, these legal norms do not work properly, and the corporate interests of minority shareholders, and sometimes state as owner, grossly violated mazhorytaryamy and management of domestic corporations.

Conclusions

Thus, summarizing all the above-stated, the following conclusions can be made:

1. In terms of transformation of the national economic system and its structure formation in the corporate sector issues receive special urgency effective functioning of corporate control. Most of the problems and conflicts that arise between the subjects of corporate relations, to some extent related to the lack of Ukraine normative legal prerequisites of the national system of corporate control, which also increases the lack of desire to comply with the corporate culture in practice functioning national stock companies. Thus, the formation of corporate control in Ukraine – is one of the priorities of reforming the national economy.
2. Corporate control, as a system of economic relations, was quite complex transformational change centuries-old way and today is the effective protection of legal rights of corporate governance (especially of minority shareholders) in countries with developed market relations. As for Ukraine, certain legal conditions for implementing control subsystems in practices of the corporate sector already exist, however, the practice say that the system of corporate control function is not necessary. Not enough attention is paid to this issue and by domestic scientists and economists.
3. Building a system of corporate control should be comprehensive and systematic nature, which is impossible without determining the basic principles of forming system. Therefore, the study of principles proposed formation of an effective system of corporate control. The ability of the proposed principles in Ukraine were discussed in terms of the application under transitional most common forms of corporate control over a joint stock company (private company; collective property managers; concentrated outside ownership; scattered possessions).

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