

## **CORPORATE GOVERNANCE AND INFORMATION SOCIETY**

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### **Abstract**

Information and communication technologies are an important cohesive factor in developing global economy and binding up capital markets. Corporate governance has its place in the process of creation of new capital flows. Financial instrument markets are connected in their existence with relevant information and their dissemination, so that information technologies contribute to the efficiency of their organization and functioning. By its nature, technological changes, which influence the market, encourage the change of structure and processes which make the system of corporate governance. Application of new technologies helps easier problem solution regarding numerous corporate governance issues such as: rational apathy of shareholders, principal-agent problem, transparency, information transfer, etc. The application of technology within a public company should help in distribution of corporate power and contribute to balance of numerous divergent interests within a company, which is very important in terms of achieving primary goal – providing long-term well-being of the shareholders and the public company. On the external plan, application of technology can contribute to better quality of relations among the participants on the capital market. New technologies should help public companies to be successful in a long run by providing more efficient functioning of corporate governance by encouraging shareholders to effectively use their rights. Inability, disinterestedness and inertia of the shareholders will open doors to activities which direct company resources towards satisfying other interests (e.g. management interests) but not interests of the shareholders. Application of information technology can contribute significantly to more effective protection of both basic rights of the shareholders and higher level of more complex managerial enterprises (effective shareholders assembly, material distribution, accepting agenda, discussing and exercising voting power of all shareholders, particularly important for cross-border shareholders, voting in absence etc. The Internet and other technologies provide opportunity for everyday interactive communication between the public company and the shareholders. Interactive communication through on-line forums on the Internet provides instantaneous access of great number of shareholders and an opportunity to find answers on questions they are concerned with in a more effective way. The use of new technologies can reduce these costs of communication in a great deal, for it is possible to send piles of documents important for assembly sessions and decision making to an endless number of e-mail addresses (financial reports, auditor's report, supervisory board report, board of directors report regarding business operations of the company, as well as reports on corporate governance).

**Keywords:** Corporate governance, information technology, shareholders

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### **I. In Medias Res**

Information and communication technologies are an important cohesive factor in developing global economy and binding up capital markets. Corporate governance as a foundation stone of these markets has its place in the process of creation of new capital flows. Financial instrument markets are connected in their existence with relevant information and their dissemination, so that information technologies contribute to the efficiency of their organization and functioning.

Keeping and processing relevant information, an easy access to important data by an endless number of beneficiaries in real time and effective transfer of information to all interested persons, are the

characteristics which new technologies bring about and make them a factor of cohesion.

Corporate governance influences the capability of a company to access the capital market (by issuing securities) and control risk more effectively. At the same time it influences the share price, stability and efficiency of the market. By its nature, technological changes, which influence the market, encourage the change of structure and processes which make the system of corporate governance. Application of new technologies helps easier problem solution regarding numerous corporate governance issues such as: rational apathy of shareholders, principal-agent problem, transparency, information transfer, etc.

Technological solutions remove numerous barriers in capital flow (the difference between domestic and foreign capital is diminishing), make

particular markets compatible with parts of the world market and contribute to higher level of protection of participants and effective functioning on the capital market. Application of new technologies should provide easier flow of capital, with reduced costs and without any barriers, towards secure and liquid markets and entities which fulfil certain standards of corporate governance<sup>6</sup>. That flow has to be done via information system which is reliable, safe and harmonized with business operations and adequate system of data protection.

Based on timely, complete, correct and relevant information, there is no doubt that contemporary capital markets are fields on which changes are confronted, having been brought about by on-line business and e-governance. However, they are the source of numerous challenges placed in front of legal, managerial and judiciary function of all modern states.

### **I-1 Corporate Governance Problems and Technological Development**

Numerous problems arise on the capital market regarding application of new technologies. A part of the problem refers to the very trade of securities during electronic transfer where numerous issues arise (identity, irrevocability, trust and integrity of the document, etc)<sup>7</sup>. Another problem addresses the relations within joint stock companies whose shares are on the stock exchange (inner segment of corporate governance system). The third group of problems refers to relations among relevant entities on the capital market (external elements of corporate governance system). The fourth group of problems treats destructive elements on the capital market which in certain segments tend to limit its development, while in some other segments they tend to act illegally and abuse technological innovations. Problems do not end by such listing which is logical due the complex and complicated structure of corporate governance as a system of measures which tend to direct synchronized functioning of numerous heterogeneous elements (bearers of public and private interest) towards protection of investors and effective functioning of the capital market. Adequate application of information technology can have a key role in that process

In this article the focus is on the issues of applying technologies in processes which go on within a company and which are discussed in terms of better distribution of corporate power..

<sup>6</sup> Alen H. (2002) Electronic trading in wholesale financial markets: its wider impact and policy issues, 50 [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=708142](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=708142)

<sup>7</sup> Gururajan R, Ryle A, Hafeez-Baig A.(2004), Legal and Regulatory Issues of Implementation of Electronic Signatures, p. 3-6. <http://conf.isi.qut.edu.au/auscert/proceedings/2004/gururajan04legal.pdf>

### **I-2 Relevant regulation**

Regulations in modern countries must support application of technological innovations in economic activities. Company laws, codes of corporate governance, e-commerce laws, laws regulating protection of the personal data and electronic signature, regulations on the capital market, tax and other regulations relevant for structure and processes of corporate governance, contain numerous terms which, in order to improve management of public companies and appropriate monitoring mechanism present on the capital market (activities of the securities commissions, securities registries, intermediaries, analysts, rating agencies, etc) direct entities towards more intensive use of information technology and other similar means of information transfer.

### **I-3 Interlinking relationships**

The application of technology within a public company should help in distribution of corporate power and contribute to balance of numerous divergent interests within a company, which is very important in terms of achieving primary goal – providing long-term well-being of the shareholders and the public company.

That kind of approach means better system of communication among the shareholders (shareholders of any class), between shareholders and members of managing and executive board, better functioning of internal monitoring bodies (protection of insider information, risk follow-up and harmonisation of business with regulations) as well as between the company and stakeholders (employees, creditors...)

On the external plan, application of technology can contribute to better quality of relations among the participants on the capital market. We think that the capital market is homogeneous enough to be united in a unique information system in which advantages of e-governance would be notable (registration, monitoring, quality communication of the state authorities and participants, fighting against corruption, etc). Such system would provide space to development of on-line court<sup>8</sup> which has become more and more common in the world (and on-line Alternative Dispute Resolution), quality reporting to investors via web page of the company, better cooperation with analysts and rating agencies, technological opportunities for access to the relevant information data-base (judiciary, governance and business practice, etc), on-line communication on the Internet forums<sup>9</sup> and on-line education, etc.

<sup>8</sup> See Her Majesty's Courts Service as an example.

<sup>9</sup> Like Yahoo! Enron message board.

## **II Waking up Shareholders**

New technologies should help public companies to be successful in a long run by providing more efficient functioning of corporate governance by encouraging shareholders to effectively use their rights<sup>10</sup>. Separating ownership from the function of management and control and its diversification (great number of shareholders), respecting and executing rights of the shareholders becomes one of the most important issues of corporate governance and the foundation stone of the investment process.<sup>11</sup>

It is very important for the investors to know whether there are factors which provide or neutralise the shareholders power in the public company. Inability, disinterestedness and inertia of the shareholders will open doors to activities which direct company resources towards satisfying other interests (e.g. management interests) but not interests of the shareholders. Such state would not attract investors and would unfavourably affect the investing climate.

In addition, the shareholders are not homogeneous group and among them conflicts of interest arise (in relation minority-majority, institutional and non-institutional, domestic and foreign, shareholders employed with a company and those who are not, etc). Protection of shareholders rights goes between the rules which are cogent in nature and those which are dispositional, that is between regulations and self-regulations. Good protection of shareholders' rights entail legal and organisational instruments of incentive and monitoring in order to achieve the desired behaviour of all participants. Application of information technology can contribute significantly to more effective protection of both basic rights of the shareholders and higher level of more complex managerial enterprises.

### **II-1 Basic Rights and Technology**

Minimum shareholders' rights assume that there is a method of safe registering of ownership, and then secure transfer of shares. A typical example of effective application of new technologies is the establishment of the Central registry for securities, custody and clearing. Central registry keeps unique evidence on owners of all securities (and other financial instruments) and communicates with its members via e-communication through sending SWIFT messages.

The fact that capital markets are based on the information leads to the existence and respecting of another basic right of the shareholders. It is the right of the shareholders to be regularly and timely

informed about all relevant events. New technologies bring about endless possibilities in terms of keeping shareholders fully informed. This is the main condition that has to be fulfilled in order to enable a shareholder to exercise his/her ownership right and participate in the work of the shareholders assembly. In this way they are able to participate regularly in voting procedure in their own interest.

Transferring the function of management from the shareholders to the members of management brings about the need to give a shareholder right to elect and replace the management. The right of the shareholder to be paid dividend, which is the main engine of the capital market, should not be ignored, for the final purpose of investment in the company is represented by the participation of the investor/shareholder in the profit of the company.

### **II-2 On-line Communication**

Application of information technology can contribute to more effective realisation of the basic rights of the shareholders thus contributing to finding solutions for the issue of «rational apathy of shareholders». It is necessary to further analyze concrete solutions in terms of technology application in functioning of the shareholders' assembly, being a body which approves basic corporate decisions, balance statement and financial reports, decisions on profit and loss distribution, increase and reduction of basic capital, disposing of property of great wealth and appointing members of the board of directors and an external auditor.

New technologies can significantly contribute to effective shareholders assembly, material distribution, accepting agenda, discussing and exercising voting power of all shareholders (particularly important for cross-border shareholders).

The Internet and other technologies provide opportunity for everyday interactive communication between the public company and the shareholders<sup>12</sup>. That is a big step forward in terms of surpassing traditional ways in which shareholders meet once a year. (more often only in case of emergency assembly), rarely exchange opinions among each other, analyse financial reports once or several times a year depending on the law-abiding obligation to submit financial reports.

Interactive communication through on-line forums on the Internet provides instantaneous access of great number of shareholders and an opportunity to find answers on questions they are concerned with in a more effective way. Members of management can also be involved in the exchange of information and attitudes and give suggestions for which they can easily find out if they can obtain support or not. New technologies provide on-line dispute resolution which

<sup>10</sup> Nathan R. (1996) *Corporate Governance at the Speed of Light*, p. 1 (<http://www.catalaw.com/logic/doc/rn-corpgov.html>).

<sup>11</sup> Kim K. Nofsinger R.J (2007), *Corporate Governance*, Pearson, p. 3.

<sup>12</sup> Nathan R. (1996) *Corporate Governance at the Speed of Light*, p. 1 (<http://www.catalaw.com/logic/doc/rn-corpgov.html>).

may arise among the shareholders, or with the management, and especially conflict resolution procedure. Also, this on-line method can be used in the voting procedure. Advantages of on-line communication, voting, access to information and judiciary activities lie in the fact that all shareholders are in an equal position, and entail all shareholders no matter whether they are cross-border or employed with the same public company. Technologies bring extraordinary possibilities to corporate governance providing considerable growth in information liquidity, increase capability of the shareholders to actively participate in the process of making strategic decisions thus protecting their own interests more effectively. At the same time, competition has been created among companies to provide better forms of communication with investors, improving their chances in access to capital markets which are founded on information.<sup>13</sup>

### **II-3 Advanced Assembly Procedures**

In order to provide effective exercising of rights of the shareholders to participate in the work of the assembly, take part in discussions, give suggestions, ask questions and get answers, a certain technical and technological connection is required between the shareholders and the public company. It is very important to establish permanent communication (appointment of a particular person in charge of communication). Public companies have to provide contact details on the Internet page of the company.

The obligation to inform and communicate with the shareholders, especially where there is a huge number of shareholders, exposes public company to huge expenses. The use of new technologies can reduce these costs in a great deal, for it is possible to send piles of documents important for assembly sessions and decision making to an endless number of e-mail addresses (financial reports, auditor's report, supervisory board report, board of directors report regarding business operations of the company, as well as reports on corporate governance).

Instruction containing explanation on the rights of shareholders and the way in which these rights can be exercised should be clearly visible on the web page of the company (should be placed on a special part of the web page separate from business information about the company). The web page of the company should contain information on the time and venue of the shareholders assembly. It is necessary to establish additional systems of communication in order to encourage shareholders in terms of cost benefit.

Sessions are summoned by sending notice in writing to shareholders, which provides opportunity for e-mails and mobile communication. However, one should be aware of a low level of information culture development so that at this stage communication can

not be reduced to the Internet or e-communication but it should be followed by traditional communication.

The notice given to the shareholders (including the members of the board, the external auditor, etc) can be sent effectively, cheaply and automatically to all shareholders via e-mail. The public company has to provide participation of the presidents of the commissions for appointments, fees and auditing via implementation of modern means of communication (teleconferencing and other audio and visual communications).

The Internet technology provides opportunities for the investors to find out about the rights of any kind and class of shares prior to purchasing shares, and particularly about the existing voting rights, as well as voting rights which are given by shares publicly offered.

Custody banks provide specific ways of protecting the rights of the shareholders. Custody bank should exercise its voting right according to previously defined interest of the shareholder regarding a concrete issue which is subject of voting. Here technological opportunities help in establishing full communication not only between custody bank and shareholders but between the shareholders themselves, thus reducing the risk of being uninformed, i.e. so called «the prisoner's dilemma». The same situation can be applied to any person which is the owner of the account of shares on his/her behalf and on the account of the legitimate owner.

Technologies can contribute to determining census, especially when some decisions require different majorities in decision making.

The code allows the public company which has no more than ten shareholders to hold phone assemblies (no physical presence required). In order to organise such session, the public company should have on its disposal appropriate technical capacities which enable communication among the shareholders (i.e. their representatives). Rules for voting in absence should be applied.

### **II-4 New Voting Procedure**

The application of information and other technologies is very important in voting in absence. It is necessary that a company provides, at its own expense, technical possibility to its shareholders or their representatives (teleconferencing and other audio-visual communication equipment) to participate in the work of assembly and vote without being physically present there. Persons who participate in this way in the work of the assembly are considered to be present in the assembly. It is crucially important to check the identity of the persons who vote in absence.

Instruction for voting in absence should be placed on the Internet page of the public company.

Voting in writing is also one of the important possibilities of exercising the shareholders' rights. Instruction should be given on the Internet page (especially important in checking out identity of the

<sup>13</sup> Lefebvre R. (2008) *Corporate Governance in Canada's Capital Markets*, p. 5.

voters) thus providing effective insight in the procedure. Application of the Internet technology would make withdrawal of votes given in writing very efficient.

Public company should provide on its Internet page relevant information and instructions on voting via power of attorney. Power of attorney could be given in a special form enabling shareholders to give it in electronic way.

Public company should remove any obstacle in order to provide easier and simpler participation of the shareholders with the residence abroad, in the work of the assembly. Modern technologies provide the same opportunity to this group of shareholders. It is good if the board of directors establishes a special commission for protection of such shareholders and provides on-line communication with that category of shareholders. This procedure should be governed by rules and such rules should be announced to the investors.

Voting should be organised with the assistance of technology which provides clear identification of the voters (if voting is not secret), scope of their voting right and safe way of votes counting which guarantees correctness. When there is a huge number of voters and huge number of shares with voting power it is necessary to adjust voting lists to computer processing in order to provide efficiency, speed and correctness.

Technology can play a significant role in the process of separating voting procedure in essentially separate issues (e.g. it is necessary to separate decisions on salaries, dividends, approving board of directors' report, report of an external auditor, supervisory body report, etc).

The company should have commission for voting (one minority shareholder representative member) and it is very important that public company puts a report on its Internet page on the work of that commission after each session (including explanation given by the member who has not wanted to sign the report).

## **II-5 Institutional Shareholders**

Development of investment and pension funds has led to strengthening of institutional shareholders. Their main duty is to act in the best possible interest on behalf of their investors which brings them in a bit controversial position: on the one hand they have obligations towards their investors (diversification of risk and maximisation of returns) and on the other they have obligations towards company in which they possess shares.

Institutional shareholders have to decide in a transparent way whether they would exercise their shareholders rights. If they estimate that it is useful to exercise their shareholders rights then institutional shareholders actively influence management in the public company. Their pressure on management encourages growth of the scope and quality of relevant information offered to the shareholders. That

procedure is directed towards independent and non-executive members of the board of directors.

The Code of corporate governance should impose obligation to institutional shareholders to publish their policy of exercising voting right on their Internet page at least once a year. Also, they should publish report on whether they have voted in the assembly every three months and if so, they should announce how they voted.

The board of directors in the public company is obliged to publish explanation given by the institutional shareholders on the company's web page regarding the way they voted on each issue in terms of evaluating corporate governance, and especially in situations in which they do not agree with the activities of the company.

Investment shareholders make indirect pressure on public company by prescribing certain standards of reporting which company has to fulfil as a precondition for their investments<sup>14</sup>. Such pressure is made by stock exchanges as well, securities analysts, rating agencies and specialised journals. This resulted in the need for direct communication between the public company and information beneficiaries.

Control by the shareholders could be enhanced by serious liability (actions against directors and auditors) and special investigation (do detect misconduct).<sup>15</sup>

## **III) Instead of conclusion: Tempora mutantur, nos et mutamur in illis<sup>16</sup>**

New technologies change the world and remove barriers on capital markets, integrating it in one whole. That process uncovers a whole range of issues among which legal ones can be found as well. But law and judiciary, being traditionally conservative areas, resist to these changes. On the other hand, the life dynamics which depends on technological changes, requires adjusting. As a result of law facing the dynamics of economic development, legal rules have been created which regulate electronic communication, data bases and their protection, electronic communication and trade, electronic governance, application of IT in financial services, etc.

Informatics, which manages people and devices, interferes in functioning of complex biological, mechanical and social systems<sup>17</sup> thus changing economy and the whole world. By these characteristics, informatics is firmly bound to corporate governance and capital market. Capital market is a space homogenous enough and it would

<sup>14</sup>Nathan R. (1996) *Corporate Governance at the Speed of Light*, p. 1.

<sup>15</sup>Hopt J. K. (2007) *Modern Company and Capital Market Problems: Improving European Corporate Governance After Enron*, <http://ssrn.com/abstract=356102>, p. 486

<sup>16</sup>Times change and we change in time.

<sup>17</sup>Lilić S, Prlja D. (2008) *Pravna informatika*, Pravni fakultet, Beograd. p. 12.

be very useful to unite it in legal and IT sense. It would entail on-line communication and exchange of electronic documents among all participants on the market.

Application of new technologies helps in realisation of each segment of structures and processes which make good corporate governance. They contribute to establishing effective relationship within a public company and better correlation of such a company with other participants on the capital market. New technologies should encourage the synergy of the heterogeneous factors of influence (internal and external).

Companies are facing ever increasing requirements to accept the most modern techniques of company management and to announce the results of such management in public. It is about accepting standards which provide risk control, clear rules of conduct, balanced interests of all participants which share the risk in the public company, predictability of the court decisions, etc. New technologies can help to establish responsibility for results, to make the process of decision-making more effective and more transparent, to create better quality information system (better communication between information-user), to improve financial and other statements and achieve better legal protection.

Information technologies provide more effective protection of the shareholders (solving problem of separation of the owner from the management function in the public company). Concretely, they provide better protection of ownership over the securities, effective work of the shareholders' assembly, better quality of the system of information transfer, etc. Application of technologies contributes to realisation of the equality principle among the shareholders. It is particularly visible in the case of cross-border shareholders, prevention of the insider information abuse, more transparent dividend policy, etc. Good corporate governance means that shareholders and other stakeholders have to be effectively protected in legal terms, and their interests met, for it is a very important condition on which the investors' community insists. We can conclude that the quality of legal protection is important in these relations.<sup>18</sup>

System of corporate governance is based on responsibility. Responsible companies and individuals are fundamental in acquiring trust on the market. Such responsibility entails removal of possible dangers of the principal-agent conflict. Responsible management undertake their activities in the interest of all shareholders and the public company. New technologies provide an equal access to information by all shareholders, preventing the majority

shareholder (or institutional) to be better informed than the others. Efficient system of communication and disclosure is important when shareholders decision-making embody public takeover bid and remuneration of directors.

Corporate governance as a system does not only rely on relations which exist in inner structure of the public company. Participants on the capital market, both those who protect private and those who protect public interest, are the part of that system. Synergy of internal and external factors of the system of corporate governance can have an impact on the destiny of a public company as well as the effectiveness of business operations of the whole capital market.

Technologies have not only to penetrate the inner structure of public companies and establish systems of transparency, communication, control and incentives, but to form strong and continuous bond between public company and all other institutions and participants on the capital market (intermediaries, analysts, Commission...).

Informatics, as a scientific and methodological discipline which brings dynamics and huge potential for technological development, does not stop. The moment this text has been completed, it has already changed something. Changing world requires us to change.

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<sup>18</sup> Porta L. R , Silanes L.F, Shiefer A, Vishny R. (2002) Investor Protection and Corporate Governance, Harvard University, <http://www.columbia.edu/~sm756/investorprotection.pdf>. 1. (January 2002), p. 2.