1. CORPORATE GOVERNANCE IN SLOVENIA

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1.1. Introduction

Historically, the framework for corporate governance in Slovenia was determined by the methods of privatization. The Slovenian Privatization Law (1992) according to the formula defined these "20% + 20% + 20% + 40%". 20% of shares were transferred to two state funds – 10% to the Capital Fund to Pension and Disability Insurance (so-called "KAD") and 10% to the Restitution Fund (so-called "SOD"). 20% of shares were distributed to authorized investment companies and 20% of shares were distributed to the enterprise's employees, former employees, and retired workers in exchange for certificates. The remaining 40% of shares could alternatively be privatized either internally (through internal buyout by managers, employees, former employees, close family members and retired workers) or externally (by public sale of shares and listing on Stock Exchange). Hence, by granting the companies the discretionary power on the allocation of 40% of their shares, the privatization law introduced two main methods of ownership transformation: firms could privatize either internally or externally. This, in turn, led to a "battle for control" between inside owners and outside owners (privatization investment funds, state-controlled funds, other physical or institutional outside owners).

These different privatization methods consequently determined the post-privatization changes in ownership and control of Slovenian corporations and influenced the performance of Slovenian firms. Damijan et al (2004) find that when dominant, insider owners and domestic non-financial companies have a better impact on financial performance of privatized firms than state-controlled funds, while the impact of dominant privatization investment funds on firms' performance was significantly worse. Simoneti et al (2005) find that mass privatization agents, receiving shares mainly for free, are found to be better initial owners than the government and its institutions, but only when they are subject to a fully transparent and regulated economic and legal environment (i.e. when firms are listed on a Stock exchange).

The "battle for control" over privatized companies continued since after the privatization. There were three main competing groups of owners trying to acquire control over the companies: managers (by buying out employees' shares and other external owners through MBOs), foreign strategic investors and state. Unlike other ex-socialist countries in Central and Eastern Europe, the state remained a much more dominant owner in Slovenia, while the role of foreign investors (FDI) was much more limited (see OECD, 2011, for a comparison). In Slovenia, the government has retained large direct ownership or indirect control through state-controlled funds (KAD and SOD) in the financial sector, telecommunications, energy, and transport.

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Both funds have gradually concentrated ownership in a number of "strategic" firms, where government strategy was to stave off foreign strategic investors. These large direct and indirect asset holdings by the state make corporate governance in Slovenia a critical issue. On one side, as the government failed to act as a good shareholder, performance of state-owned and state-controlled firms was held back due to the lack of best practices in selecting high-quality members of the board of directors and consequently due to the absence of deploying high-quality business practices. On the other side, direct and indirect holdings of assets by the state gave the existing political coalition in power a mechanism to exert control over a large number of companies and to engage in the adverse selection of candidates for supervisory boards. Changing the boards of state-controlled funds (KAD and SOD) as well as supervisory boards and boards of directors soon after every election became the political standard. The extent of direct and indirect state holdings has provided past governments with a mechanism to play an active role in nominating politically connected persons into supervisory boards and boards of directors.

This government interference led to the lack of stability and poor management practices in state-owned and state-controlled companies. As long as political coalitions were stable (they were stable for twelve years, between 1992 and 2004), corporate governance of the majority of largest firms remained stable with infrequent changes in supervisory boards and boards of directors. With more frequent changes in the composition of government coalitions since 2004, however, each governing coalition used the mechanism of direct and indirect holdings to impact compositions of supervisory boards with the ultimate goal to replace the boards of directors.

One of the key impulses for improving the quality corporate governance practices in Slovenia was the beginning of the accession discussion with OECD in 2007. As a part of the accession discussion, the OECD Council decided to perform a review of the corporate governance practices in Slovenia. The Review of Corporate Governance in Slovenia emphasized some of the key corporate governance challenges facing Slovenia before becoming a full member of the OECD (in July 2010). According to the Review, a major feature of Slovenia's corporate governance framework as of 2009 was the "*importance of managing State-Owned Enterprises (SOEs) to ensure that there is a consistent and transparent ownership policy; that the state acts as an informed and responsible shareholder; and that SOE boards are appropriately composed to ensure that they have the skills and authority to exercise their functions*" (OECD, 2011b). SOEs were identified as a significant component of both the listed and non-listed sectors and the Government was found to have a significant direct or indirect control over a large number of sizeable companies in the domestic market. The Review stressed that direct holdings are concentrated mostly in infrastructure, energy and financial sectors (banking and insurance) where SOEs hold a dominant position. Indirect holdings were managed mainly through the two state-controlled funds that were established as part of the privatization process, i.e. the pension fund ("KAD") and the restitution fund ("SOD"). The Review recommended a number of improvements in legal environment and corporate governance practices to be adopted by the Slovenian government.

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Indeed, since the OECD Review, Slovenia has undertaken substantial steps to improve the quality of corporate governance, in particular in the area of regulating its SOEs. In 2010, Slovenian government has established a new central ownership agency called AUKN (State Assets Management Agency), which was in late 2012 replaced by the Slovenian Sovereign Holding (SSH) taking the role of SOD and partly of KAD. In 2015, the government adopted a State Assets Management Strategy and the key stakeholders adopted three specific corporate governance codes (for listed, non-listed and state-owned companies).

In anticipating these changes and improvements, OECD concluded its Review in 2011 on a very positive note praising the Slovenian government's efforts to improve the quality of corporate governance of its SOEs as well as improving the treatment of minority shareholders and curbing the potential for "share parking" activities. Certainly, in the last decade, Slovenia has formally established a modern framework of transparent corporate governance system regulating listed and non-listed private companies as well as SOEs. However, despite all these legal and institutional improvements, the practices deployed by either private dominant owners and in particular by the governing political coalitions regarding the management of direct and indirect state holdings did not change substantially.

This chapter is organized as follows. Section 2 gives an overview of the legal framework of corporate governance. Sections 3 and 4 describe the ownership structures of companies and the market for corporate controls, respectively. Sections 5 and 6 explain the board of directors' practices and directors' remuneration practices, respectively. Sections 7, 8 and 9 describe shareholder's rights protection, corporate governance and firm performance and corporate social responsibility issues in Slovenia. The last section concludes.

1.2 Legal framework of corporate governance in Slovenia

1.2.1 Overall Legal framework of corporate governance

The principal sources of corporate governance legislation framework in Slovenia are the Companies Act, the Banking Act, the Market in Financial Instruments Act and the Auditing Act. The Bank of Slovenia issued a set of rules and regulations, applicable to banks, while Ljubljana Stock Exchange issued a set of rules and regulations for listed companies. Both sets of regulations also include provisions relevant to corporate governance.

In 2004, the Ljubljana Stock Exchange adopted the Slovenian Corporate Governance Code for Listed Companies, which was revised twice, in 2009 and 2016. In 2016, Chamber of Commerce and Industry of Slovenia, Ministry of Economic Development and Technology, and Slovenian Directors' Association adopted Corporate Governance Code for Unlisted Companies; while Slovenian Sovereign Holding adopted Corporate Governance Code for State Owned Enterprises. These three specific Codes are

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voluntary, but they do provide an additional set of rules and practices for three different types of companies with respect to their ownership structure.

As already mentioned, in the last decade the key advance in improving the quality of corporate governance practices in Slovenia came from the pre-accession discussion with OECD and the subsequent OECD Review of the corporate governance practices in Slovenia (hereafter: Review).

The Review was in particular critical with regard to the corporate governance practices in the private sector and in state-owned enterprises (SOEs). With regard to the latter, it found that the two state-controlled funds (KAD and SOD) together with direct state holdings provided the government with a strong mechanism to interfere (through the nomination of supervisory boards) with the management of privatized firms and, ultimately, to play an active role in determining ownership changes. In addition, by doing this, past governments had an opportunity to exercise a substantial role in influencing the operation of large sectors of Slovenia's commercial enterprises and in the market for corporate control.

In addition to the critical state of affairs with the SOEs, the Review highlighted many other weaknesses in Slovenia's corporate governance (as of 2009), such as:

- Enforcement of shareholder rights and equitable treatment: while the legal framework in Slovenia provides a relatively high degree of protection for shareholders, the capacity of shareholders to enforce their rights is somewhat constrained. In particular, due to the fact that minority shareholders are widely dispersed, but also due to the slow court system.
- Timely and reliable disclosure: there has been a lack of comprehensive data on government's direct and indirect shareholdings, which limited the transparency of the government's ownership and voting powers.
- Effective separation of the government's role as owner and its regulatory role: the ownership function for SOEs in Slovenia has been widely dispersed, and the lack of central coordination has created difficulties for the effective management of the Government's ownership interests. The SOE ownership function was allocated to the line ministry with responsibility for the industry in which the SOE operates, which in some cases led to situations that ministries used their ownership function to pursue wider objectives. By centralizing, the ownership stakes in SOEs in a new central ownership agency should improve this problem largely.
- Recognizing stakeholder rights and the duties, rights and responsibilities of boards: while the rights and duties of directors are clearly established in the Companies Act and further elaborated through the Code of Corporate Governance, the extent to which these duties can be enforced seems to be constrained by procedural limitations on shareholders bringing actions for breach of duties. This is reflected in the very low number of cases that have been heard for breach of directors' duties; the low rates of success of such cases; and the anecdotal evidence that the use of directors' liability insurance is not prevalent.

Based on these findings, the OECD Review made several recommendations for improving the quality of corporate governance practices in Slovenia, such as:

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- The legislation for the transformation of the pension fund, KAD and the restitution fund, SOD, is a complementary reform to the establishment of the new central ownership agency and should be passed as a matter of priority.
- The new central ownership agency should quickly develop the policy instruments that will enable it to successfully execute its function, such as a robust code of corporate governance, a detailed capital investment strategy as well as the classification of assets into strategic and portfolio investments and the definition of the Government's objectives for these asset groups.
- Slovenia should conduct a formal review of the provisions of the Companies Act within the anticipated period dealing with the treatment of minority shareholders.
- Slovenia should consider further measures to support the financial and operational independence of the Securities Market Agency.
- Regulators and policymakers should remain vigilant in monitoring the potential for "share parking" activities, particularly in relation to takeovers, to ensure that current legislative and enforcement arrangements are adequate to prevent such practices.

1.2.2 Regulation of state-owned enterprises

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Since this Review, Slovenian government initiated significant steps to improve in particular the quality of corporate governance of its SOEs. Already in 2009, the government prepared a Policy on Corporate Governance of State-Owned Enterprises, whose main part was a commitment to pass legislation to establish a separate central ownership agency to coordinate all government ownership actions. The legislation establishing the central ownership agency (the Law on the Corporate Governance of State Capital Investments) was adopted in April 2010. The Policy also proposed legislation to better define the relationship between the government, KAD, and SOD to facilitate implementation of a coordinated ownership policy and transparent approach to their shareholder responsibilities.

As a first step, in 2010, Slovenian government established a central ownership agency called AUKN (State Assets Management Agency), whose main objective was to centrally manage capital assets held by the state. The AUKN agency, however, was involved in several dubious practices and was abandoned in late 2012. It was replaced by the Slovenian Sovereign Holding (SSH), which actually took the role and portfolio of SOD, but was granted management of the portfolio of all other government funds.[1] SSH is the principal manager of state-owned assets responsible in particular for:

- active management of state-owned assets in the portfolio,
- implementation of corporate governance practices that will contribute to the attainment of better-operating results of companies in the portfolio,

[1] Capital Assets of the Republic of Slovenia, Kapitalska družba pokojninskega in invalidskega zavarovanja d.d. (Pension Fund Management), Slovenska odškodninska družba d.d., Modra zavarovalnica d.d., D.S.U., družba za svetovanje in upravljanje, d.o.o. and Posebna družba za podjetniško svetovanje d.d.

- developing suitably designed and transparent procedure regarding the accreditation, nomination, and selection of candidates for members of Supervisory Boards, and
- privatization of assets with the goal of achieving the best result from the proceeds of the sale.

To overcome the weak operation and composition of SOE boards, the government has introduced administrative reforms to board appointments that were supposed to introduce both greater transparency and a greater focus on ensuring appropriately qualified candidates capable of exercising independent judgment.

Regarding the challenges in the sector of listed companies in Slovenia, in particular, the need for more effective protection of minority shareholder interests and consistent enforcement of takeover provisions, the government adopted an Action Plan for Corporate Governance Reform in Slovenia. The latter included a plan to review the legislative provisions protecting minority shareholder rights and increase the capacity of the judicial and regulatory authorities to monitor and enforce compliance with corporate laws.

In 2015, the government adopted a State Assets Management Strategy (hereafter: Strategy). The Strategy follows the OECD Guidelines on Corporate Governance of State-Owned Enterprises, recommending to the Member States to establish a clear and consistent ownership policy, ensuring that the governance of state-owned enterprises is carried out in a transparent and accountable manner, with a necessary degree of professionalism and effectiveness. The strategy is a fundamental document of the state that communicates its goals to the state assets manager (SSH), to shareholders, the broader capital markets, and the general public. In principle, a clearly defined ownership policy eliminates the need for the government to interfere with current affairs with regard to the management of the SOEs since the performance of asset management is measured periodically, by benchmarking the performance against the goals set in advance. The Strategy was accompanied by the classification of assets into strategic, important and portfolio investments as well as the definition of the government's objectives for these asset groups.

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1.2.3 Voluntary corporate governance Codes

Presently, in addition to the principal corporate governance regulatory framework as laid out in the Companies Act, the Banking Act, the Market in Financial Instruments Act and the Auditing Act, there are three specific voluntary Codes regulating corporate governance in Slovenia with regard to the ownership type:

- Slovenian Corporate Governance Code for Listed Companies (as of October 2016)
- Slovenian Corporate Governance Code for Unlisted Companies (as of May 2016)
- Corporate Governance Code for State Owned Companies (as of March 2016)

All three specific CG Codes were modified and amended in 2016. Main reasons for modifications are international changes in the regulatory environment in the field of corporate governance as reflected in the amendments to Companies Act (ZGD-1) as well as to the G20/OECD Principles of Corporate Governance and OECD Guidelines on

Corporate Governance of State-Owned Enterprises. In addition, in the meantime, many domestic initiatives led to improved guidelines and recommended best practices for corporate governance in different types of companies.[2]

Slovenian Corporate Governance Code for Listed Companies (hereafter: CG Code for LCs) adopted by the Ljubljana Stock Exchange Inc. and the Slovenian Directors' Association in October 2016 amends the code from 2009, which was in force since January 1, 2010. The CG Code for LCs defines the governance, management and leadership principles based on the "comply or explain" principle of companies listed on the Slovene regulated market, but other companies can also apply their recommended practices. While the changes to the CG Code for LCs from 2016 are mainly editorial and nontechnical, there are some substantial changes, such as:

- a new institute, Diversity Policy, is added, whose purpose is to stipulate a clearer definition of recommendations regarding the diversity and gender balance in management and supervisory bodies;
- recommendations regarding equal treatment of shareholders were improved;
- recommendations on self-assessment of supervisory boards were updated, recommendations for the chairman and secretary of the supervisory board were supplemented and recommendations for additional training of supervisory board members were introduced;
- recommendations regarding the management board succession planning were amended;
- definition of independence was amended and the criteria for the conflict of interest were updated;
- recommendations regarding the transparency of operations were harmonized with the changes in legislature and the Ljubljana Stock Exchange Rules, leading to the proposal for unified tables regarding the composition and remuneration of the managing and supervisory bodies.

The Corporate Governance Code for Unlisted Companies (hereafter: CG Code for UCs), adopted by the Chamber of Commerce and Industry of Slovenia, Ministry of Economic Development and Technology, and Slovenian Directors' Association in May 2016, is intended for all companies other than publicly traded companies. While the Code is appropriate for all unlisted companies, it was designed as a reference code for companies' subject to audit of their accounts (in accordance with Article 59 of the Companies Act (ZGD-1)) and that are obliged to include in their business report a corporate governance statement as a separate section of the report (in accordance with point 1 of paragraph (5) of the ZGD-1). It is important to note, that the recommendations of the Code for UCs are not additional regulations and are not binding on any company;

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[2] These are: Guidelines for Audit Committees, 2016; Practical Guidelines for Quality Explanations and Corporate Governance Statements, 2015; Guidelines for Selection and Recommendations for the work of Supervisory Board Chairmen, 2014; Guidelines for the Selection and Work of the Secretaries of the Supervisory Boards and Boards of Directors, 2014; Code of Professional Ethics of Slovenian Directors' Association, 2014; Recommendations for Reporting to Supervisory Boards, 2014; Slovenian Guidelines for Corporate Integrity, 2014; Communication Guidelines for Supervisory Board Members at Companies they Supervise, 2014; Guidelines for the Functioning of Boards of Directors, 2013; Practical Guidance for Members of Management Board Recruitment, 2012; Supervisory Board Assessment Manual 2011; Supervisory Board Self-assessment Matrix, etc.

however, companies that are subject to an audit and have chosen the Code for UCs as their code of reference are, in accordance with the principle of "comply or explain", required to disclose in their corporate governance statement any deviations from individual Code recommendations and to clarify their own alternative practice that they opted for in this area.

Hence, the Code for UCs is complementing the Code for LCs with the aim of contributing to a transparent and understandable governance system in Slovenia that promotes both domestic and foreign investor confidence in the Slovenian corporate governance system, but also the confidence of employees and other company stakeholders.

The Corporate Governance Code for State Owned Enterprises (hereafter: CG Code for SOEs) is a third specific CG code. It was adopted by the Slovenian Sovereign Holding in March 2016 and replaced the previous Corporate Governance Code for Companies with Capital Assets of the State (adopted in December 2014). The CG Code for SOEs addresses state-owned enterprises (SOEs), but it should be applied also by subsidiary companies in the group, where the controlling company is a company with state's capital assets. The main aim of the Code is to set the standards of governance and supervision in SOEs and to create a transparent and understandable system of corporate governance in SOEs. By raising the quality of corporate governance in SOEs, its objective is to improve the performance of SOEs.

1.2.4 The effectiveness of the changed corporate governance framework

Using a survey among company managers, recent EBRD Corporate Governance Assessment 2016 assessed the Slovenian corporate governance framework as moderate. While the legal and voluntary corporate governance frameworks (transparency and disclosure, stakeholders and institutions) have been assessed as moderately strong, rights of minority shareholder as fair to moderately strong, structure and functioning of the board as well as internal controls have been assessed as fair.

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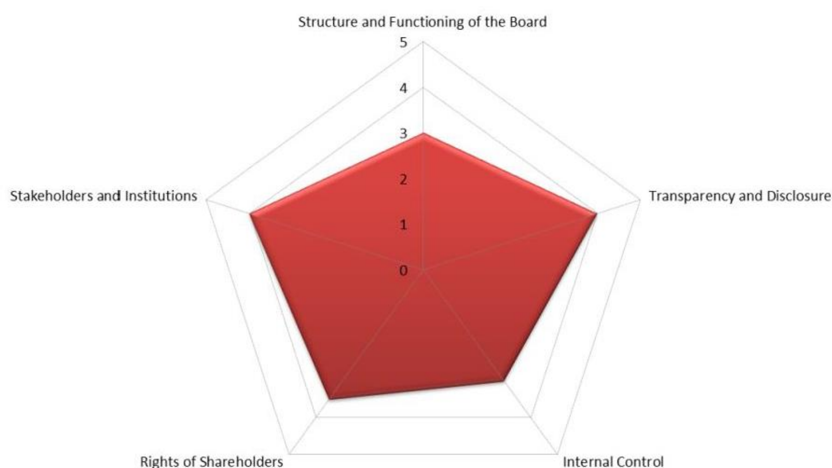
Figure 1.1 Quality of corporate governance assessment for Slovenia



Source: EBRD, Corporate Governance Assessment 2016

The above EBRD Corporate Governance Assessment is based on assessing the legal and institutional framework in place, which is a result of the described changes in legal and framework and updated voluntary corporate governance Codes. When it comes to practice, however, corporate governance in Slovenia is still facing a number of challenges. In particular, the compliance with corporate governance code increased over years and number of firms that declare full compliance is higher each year. However, the information provided by firms is of low quality or mostly does not correspond to reality.

Severe financial difficulties and collapse of several large companies (such as Istrabenz, Pivovarna Laško, Merkur, SCT) and a number of mid-size companies initiated by the global financial crisis reflect the fact that inefficient corporate governance practices have been a permanent part of reality in the Slovenian corporate system. In the past during the mass privatization, most problematic issues seemed to be conflicts of interest between the supervisory and management boards, dubious corporate governance practices, such as "share parking", the performance of managing and several supervisory functions in various companies, and lack of regulatory intervention. Ironically, the severe financial crisis did clear up a number of these inefficiencies and fraudulent or inappropriate practices that neither legal framework, voluntary corporate codes nor regulatory intervention was able or willing to address or actively engage in fighting them. With disappearance or sell-off of such companies, the corporate governance system has become healthier. In addition, many companies learned from that experience, while regulators might become more active in monitoring the compliance with the legislation.

Regarding the SOEs, however, despite the complete overhaul of the corporate governance legal and institutional framework in order to comply with the OECD Guidelines on Corporate Governance of State-Owned Enterprises, the practices deployed by the governing political coalitions regarding the management of direct and indirect state holdings have barely changed as compared to before. With the change in political regime after the parliamentary elections, the supervisory board of the central state ownership agency State Sovereign Holding is replaced, which then nominates a new board of directors. The latter in turn suggests changes in supervisory boards in companies that are governed by the SSH before their terms are over with the determination to replace the management boards in companies under concern. Hence, as these processes involve politically connected persons, the quality and stability of management in state-controlled companies are constantly undermined.

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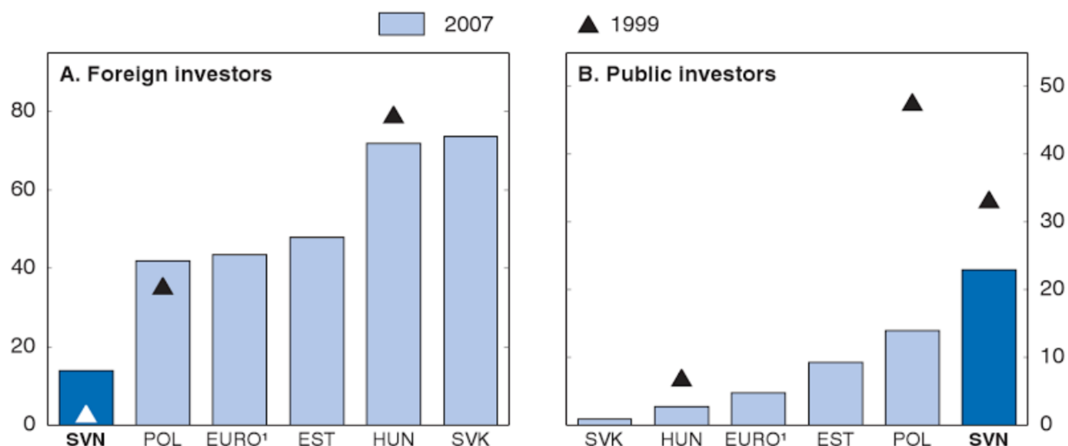
1.3 Ownership structures of companies in the country

Among EU new member states (EU-NMS), Slovenia is an outlier in terms of the ownership structure. It is characterized by the lowest share of foreign-investment enterprises (FIEs) and by the largest share of state-owned enterprises (SOEs). While in most EU-NMS the share of FIEs is between 40% and 80%, in Slovenia it is still below 20%. Similarly, in other EU-NMS the share of SOEs is far below 10% (except Poland), but in Slovenia, it is almost 25%. While the share of FIEs in Slovenia has increased and share

of SOEs has decreased between 1999 and 2007, the overall picture in 2007 was still preserved.

Figure 1.2 Ownership structure (as % of total)



Source: OECD Economic Survey Slovenia 2011, OECD.

Slovenia maintains a relatively high share of state-owned firms as compared to other OECD countries, which has even increased further during the financial crisis. Namely, the compulsory compositions and bankruptcies of companies have forced banks to swap loans for equity holdings in companies, and the State to recapitalize the state-owned banks. This resulted in a direct and indirect increase in the shareholdings owned by the state in companies. According to the data by IMAD, the share of the equity capital of companies in which the state holds a majority stake in the total capital of Slovenia's corporate sector increased further during the crisis: from 16.4% to 23.2% in 2012, and to 30% including the companies in which the state has more than a 25% ownership stake. This ranked Slovenia among the OECD countries with the highest share of state-owned enterprises.

In the Country Report Slovenia 2015, the European Commission, drawing from the OECD data, has concluded that the state involvement in the national economy is among the highest in the European Union. As shown by Figure 1.3, the share of companies with a shareholding owned by the state that is larger than 50% (according to the book value in the share of GDP) is the highest in the EU. When taking into account companies with the state-owned assets in equity amounting from 10% to 50%, Slovenia is ranked second. In terms of share of employees employed by the state in total employment, Slovenia is ranked as the third highest (see Figure 1.3).

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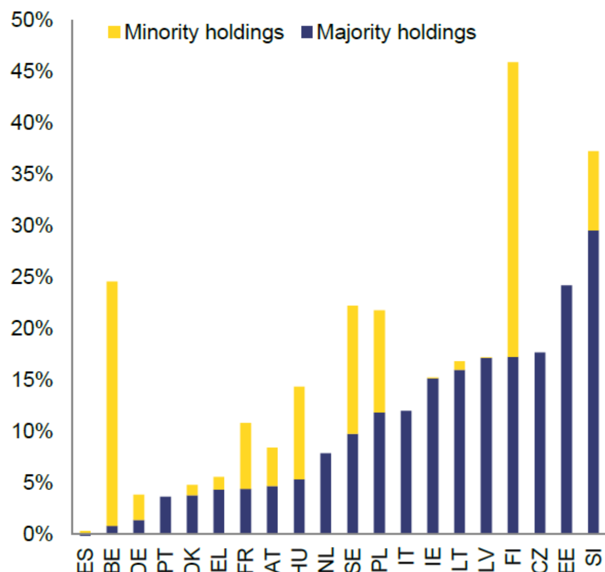
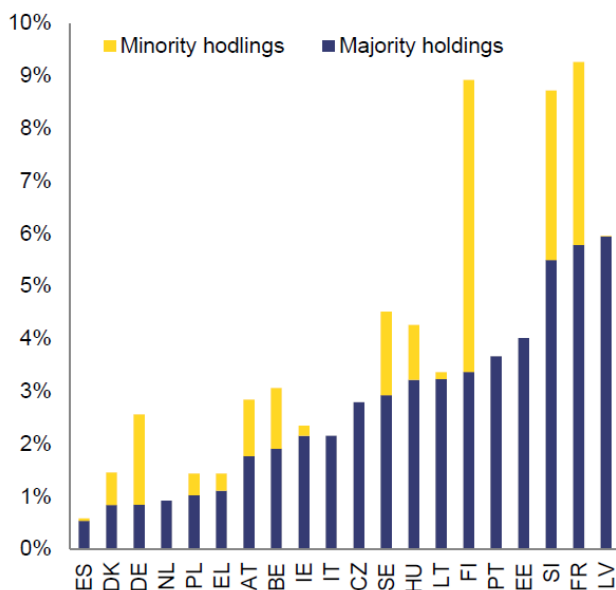
Figure 1.3 Book value of state-owned enterprises in the European Union (as % of GDP)



Source: Country Report Slovenia 2015, European Commission.

Notes: "Minority share" – companies with state-owned assets held in the company's equity that amount from 10 % to 50 %; "Majority share" – companies with state-owned assets held in the company's equity that amount to more than 50 %.

Figure 1.4 Employment in state-owned enterprises in the European Union (as % of the total employment)

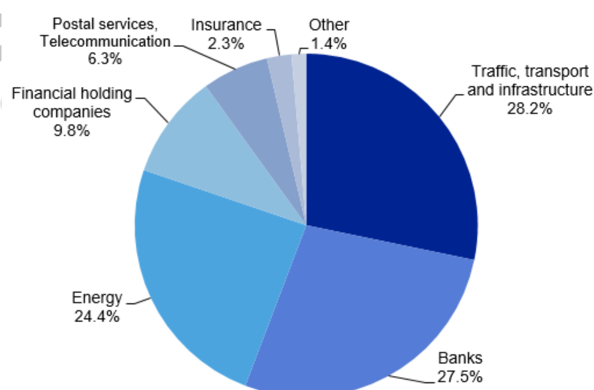


Source: Country Report Slovenia 2015, European Commission.

Notes: "Minority share" – companies with state-owned assets held in the company's equity that amount from 10 % to 50 %; ** "Majority share"« – companies with state-owned assets held in the company's equity that amount to more than 50 %.

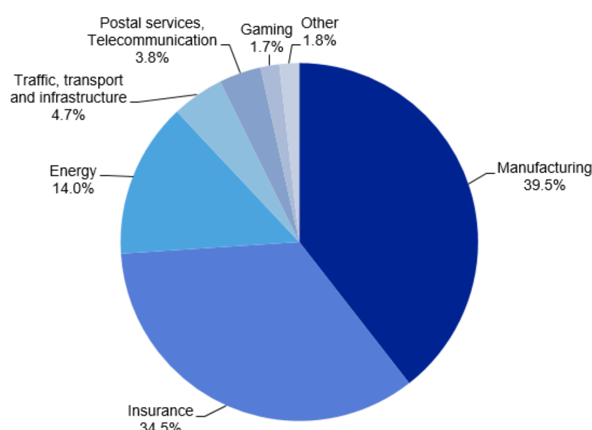
As revealed by Figure 1.5, Slovenian state is mainly involved – through direct holdings – in three sectors: transport and infrastructure, energy and financial sector (mainly banks), that comprise almost 80% of the state's total equity holdings. On the other side, the indirect holdings of the state that are in the SSH's direct ownership are mainly concentrated in manufacturing (40%), insurance (35%) and energy (14%). This division is partly determined by the nature of holdings (such as road and rail infrastructure as well as energy) and the level of strategic importance (such as a bank). These are in state's direct ownership. Important and portfolio state holdings (in particular in manufacturing and insurance) are mainly directly owned by the SSH and are more flexible in terms of potential privatization.

Figure 1.5 Equity holdings in the Republic of Slovenia's direct ownership (book value as of 31 Dec. 2015)



Source: Slovenian Sovereign Holding.

Figure 1.6 Equity holdings in the SSH's direct ownership (book value as of 31 Dec. 2015)



Source: Slovenian Sovereign Holding.

1.4 Market for corporate controls (M&A)

After the political change, between 2004 and 2008, Slovenian corporate sector has witnessed a so-called second privatization round. It was initiated by the government's new strategy regarding selling off non-strategic capital assets but was supplemented by huge liquidity inflows. Both together led to massive buyout/takeover transactions that were very poorly regulated as acquirers were not sanctioned for utilizing questionable techniques to acquire control over companies. There was very weak or non-existent enforcement of the takeover legislation allowing acquirers to use practices, such as "acting in concert" and "share parking" (holding shares in another name). The weak performance of the regulator (Securities Market Agency) was additionally deteriorated by the extension of the takeovers legislation to non-listed companies, which has significantly increased the burden on the regulators.

After the financial collapse in 2008, there have been some improvements in the enforcement remedies available to the regulator. Legislators and regulators have taken important steps to address the concerns regarding the conduct of takeovers. In particular, the use of "share parking" was monitored more closely and sanctioned. The new legal framework established an expanded definition of "acting in concert" and the regulator has been afforded powers to withhold voting rights as a remedy for breaches of the mandatory bid provisions of the legislation. This revised regime has been matched with an increased level of enforcement reflected in many actions taken against companies in breach of the takeover legislation.

Practically no court actions regarding the described anomalies and utilized questionable techniques have taken place in the first twenty years of the existence of corporate governance in Slovenia. Criminal prosecutions and claims for compensation among the corporate stakeholders were very rare. Only until recently, the court cases have not suggested the possible ways or present results in relation to media reports and phenomena of corporate governance in Slovenia. It will remain an open question whether more frequent enforcement remedies, such as regulatory actions and claims for compensations (damages), regular and extraordinary audits and revision processes in the corporations, would contribute to the development of better practices in corporate governance in Slovenia.

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1.5 Board of directors practices

Board of directors, as the highest authority in the firm, has a significant impact on firm performance (Kiel and Nicholson, 2005; Westphal and Bednar, 2005). What makes a board effective as a governance mechanism is one of the key issues concerning corporate governance (Nicholson and Kiel, 2004; De la Rosa, 2006; Schmidt and Brauer, 2006). Literature defines effective board of directors as the ones that "ensure firm's prosperity", "add value to the organisation", move the firm closer to its goals" and similar (Nicholson and Kiel, 2004; Pye and Pettigrew, 2005; Aguilera, 2005).

In order to be an effective board of directors need to have clearly defined roles (Huse, 2005; Aguilera, 2005). There are two streams in the literature on defining their roles. One stream argues board of directors' roles are the direction (by providing strategic guidance) and control (monitoring of the management such as hiring, compensation, replacement of senior managers, etc.), reporting to shareholders, ensuring compliance with the law (Nicholson and Kiel, 2004; Aguilera, 2005). The other stream sees the board of directors' roles based on the actual involvement of each board member and their accountability (Huse, 2005; Roberts et al., 2005).

Another debate concerns the structural elements of board, which influence how effective a board governs the firm. One side of the argument is that board structure and composition is of utmost importance (Sherwin, 2003). This is referred as a *mechanical issue*. The other argument is that firm effectiveness is the result of *organic issues,* how well boards communicate, interact and how mutual respect (Roberts et al., 2005).

Slovene Company law (ZGD-1) offers an option to have either a dual board system consisting of a management board and a supervisory board or a single tier board of directors. Most firms use the dual board system where the firm is managed by the management board. The management board is appointed by and supervised by the supervisory board. The board of directors is a single tier managing body that consists of executive and non-executive directors. The board of directors' members that are representatives of the company's capital are appointed by the general shareholders' meeting. For every three full members of the board, one of them must be appointed by the workers' council and may be recalled by the same council. The executive directors may be elected from non-members and may be recalled anytime.

The members of the management board (or board of directors) are primarily responsible for the legality of the business operations of the firm. Naturally, they are also responsible for the business operations of the company. They must show the diligent performance of their duties according to a so-called "businessperson" standard, which is defined on a case-by-case basis. The courts accept the business judgment rule as a theoretical guideline for assessing a board member's liability.

The main responsibility of the management board is to keep the company financially solvent. They are required to act quickly and must provide measures for mitigation of financial difficulties. If such measures fail, the management board is required to propose adequate insolvency or other liquidation procedures for the firm. Should the management board fail to uphold these duties, the supervisory board is obliged to perform them. Currently, one of the main issues regarding the liability of a management board is the required *pari-passu* approach to creditors' claims in situations of pre-insolvency financial distress.

Other specific duties of the management board include the maintenance of proper books and records that accurately record the company's business, as well as keeping track of operating permits, filing tax forms, keeping safe and healthy working conditions, being compliant with labor law requirements, etc.

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1.6 Directors' remuneration practices

Prior to the transition, firms in Slovenia were "socially owned" as they were governed jointly by managers, employees and political organizations (Gregorič at al, 2010). These specifics of firm governance were also reflected in the characteristics of remuneration system, top managers, and all other employees' salaries were determined in a general wage pool at the country level.

During the early transition period between 1987 and 1993 witnessed first market reforms and wage liberalization causing an adjustment in the salaries of management board members (Orazem and Vodopivec, 1997). The following year in 1994, the Association of Slovenian Executives proposed executive pay to a level of 5:1 relative to the pay of the average employee (Gregorič at al, 2010). When the guidelines *Criteria on Executive Pay* were published in 1997, pay differentiation for Slovenian managers was introduced to reflect the firm size classifying the executive compensation to 4, 6 and 8 times the average for small, medium and large firms (the Slovenian Company Act, 1993). Thus, their salaries increased by up to 25% of the base pay if a firm outperformed the industry average and were entitled to a bonus (up to 30 percent of base pay), provided they met performance targets (Gregorič at al, 2010). Some of the performance criteria included net earnings, the growth of exports and employment, return on equity (ROE) or on assets (ROA), market value and value added per employee. As well, bonuses were paid from firm profits and were subject to double taxation making it altogether less attractive (Slapničar, 2002).

These first changes were in the mid-nineties, at the same time when the major vawe of privatization happened after the break of Yugoslavia, bringing for the first time »proper« owners to former socially owned firms (Gregorič at al, 2010). Now, almost 30 years after Slovenian independence, new regulation and guidelines[3] have been implemented in the aftermath of the financial crisis in order to regulate executive and officers´ remuneration. The main changes the Amendment of the Companies Act brought was that the General Meeting may determine the income policy regulating the incomes of the company's management and supervisory board's members, taking into account that such policy should increase possibilities for a long-term existence of the company and that the remuneration should be proportional to the results and financial situation of the company. It also determined in which cases the managers are entitled to the severance payment. Furthermore, the Act Regulating the Incomes of Managers of Companies owned by the Republic of Slovenia and Municipalities provided for implementing the same principle for determination of the remuneration and severance payments of the chairmen and members of Manager Boards, Executive directors, managers and procurators of companies, of which the preponderant part of the ownership is owned by the Republic of Slovenia and Municipalities in the manner determined in the respective regulation on

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[3] Amendment of the Companies Act (Official Gazette of RS, No. 42/09, hereinafter the "Amendment CA-C"); Act Regulating the Incomes of Managers of Companies owned by the Republic of Slovenia and Municipalities (Official Gazette of RS, No. 21/10); Slovenian Corporate Governance Code for Listed Companies (2016); The Corporate Governance Code of Unlisted Companies (2016).

setting the highest correlation of basic payments and the rate of variable remuneration of directors.

Also, according to the newly adopted Corporate Governance Code for both, listed and unlisted companies, sets the remuneration system consisting of a fixed and a variable part enabling firms to acquire suitable members of the management board. Variable part depends on the predetermined short-term and long-term performance criteria set on a yearly basis in proportion to the company's financial situation. Aside from operations, the performance criteria include non-financial criteria such as compliance with the company's current rules and ethical standards in order to facilitate the company's sustainable development.

The fixed part of remuneration allows the firm to withhold payment of the variable part due to non-performance of the management board members. Upon payment of the variable part of the remuneration, the payment of the part exceeding the total fixed remuneration during the past year is postponed to another year. If the variable part of remuneration is given in share, the shares are not paid out for at least 3 years after they are awarded.

Severance payments are only allowed if members of the management board are early dismissed due to no-fault reasons or in the event of the consensual termination of employment for anticipated reasons such as illness. Moreover, they cannot exceed the fixed part of the annual remuneration.

The practical impact of the new regulation and guidelines since their implementation is yet to be seen. In particular, when it comes to changes in the executives' salary as the Act Regulating the Incomes of Managers of Companies owned by the Republic of Slovenia and Municipalities determines compulsory obligations of members of supervisory boards of companies, of which the preponderant part of the ownership is owned by the Republic of Slovenia and Municipalities to implement the maximum salaries of the managers. If the salary of the manager of the above-mentioned companies is higher than the maximum salary, such contractual provision would be deemed null and the salary determined in the respective regulation would apply. Such strict regulation was implemented because the previous non-binding recommendations were not enforced in practice (i.e. the salaries were higher than determined in the recommendations). Therefore, we can expect that salaries of managers in the companies, of which the major part of the ownership has government of the Republic of Slovenia and Municipalities will decrease after the enforcement of the respective regulation.

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1.7 Shareholder's rights protection

As a legacy of the former socialist regime, the state continues to maintain a strong presence in Slovenian firms, especially when it comes to large publicly traded companies. Besides, Slovenian economy witnesses a strong ownership concentration causing the capital market to be relatively undeveloped and illiquid.

According to the Slovenian corporate governance legal framework, firms need to implement a governance system that will respect and equally treat all shareholders and

protect their rights by encouraging them to be active and responsible in enforcing their rights, voting and engaging in mutual dialogue. However, due to strong ownership concentration relations with shareholders attests to be a systematic problem. Namely, major shareholders, as a rule, nominate their own representatives in supervisory boards and dominate the general meetings of shareholders. Thus they have almost unlimited control of the firm. Minority shareholders mostly cannot influence any change or improvement in corporate governance of firms. One of the corporate governance principles states that shareholders exercise their control over a company through a right to be informed. However, minority shareholders are rarely able to obtain additional explanation on corporate governance statements from the management board.

In situations as described above, soft law measures are not the most appropriate instrument due to limited monitoring by shareholders. In Slovenia, auditors do the monitoring, but it is limited only to whether firm signed *comply or explain* statement without going into details of the content. Ideally, there would be a market-wide monitoring on a regular basis by financial market authorities and stock exchanges. In addition, even though there were recent changes in corporate governance framework with regards the relations with shareholders, equal treatment of shareholders remains a challenge.

1.8 Corporate governance and firm performance

As for the first decade after privatization, Damijan, Gregorič, and Prašnikar (2004) found that method of privatization did matter for the post-privatization performance of Slovenian firms in the period 1998-2002. They find that when dominant, insider owners and domestic non-financial companies have a better impact on financial performance of privatized firms than state-controlled funds, while the impact of dominant privatization investment funds on firms' performance was significantly worse.

Simoneti et al (2005) stress the importance of regulation and legal environment for post-privatization performance of Slovenian firms. Using the data for 1994-2001, they arrived at two important findings. First, mass privatization agents, receiving shares mainly for free, are found to be better initial owners than the government and its institutions only when they are subject to a fully transparent and regulated economic and legal environment. Second, firms sold to foreign or domestic strategic owners by the government are performing better than firms sold by mass privatization agents. Though again, the superiority of the government in selling firms to efficient owners is not confirmed in the case of well-regulated mass privatization in listed firms.

Most firm-level studies for new EU member countries consistently show that performance (in terms of a number of indicators) of foreign-owned firms is superior, followed by private domestic and state-owned companies (see Damijan et al, 2003 and 2013).

More recently, IMAD (Economic Issues, 2015) shows that the SOEs in Slovenia experience weaker performance results as compared to other companies operating in the same industries, measured according to productivity, ROE, and EBITDA. Their results

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are particularly poor about the operating profit, thus showing that these companies experience issues with their main activity. This indicates that SOEs need either better management in line with performance-based indicators set by the SSH or government should consider which of the companies could be efficiently privatized without jeopardizing strategic goals of the state.

On the other side, Blagojevic and Damijan (2013) study how the efficiency of business environment and corruption (informal payments and state capture) in the interaction with the firm ownership affect the microeconomic performance of firms. Using the microdata collected by the Business Environment and Enterprise Performance Survey (BEEPS) for 27 transition countries for the period 2002-2009, they find somehow surprisingly that private firms (domestic private and foreign-owned) are more involved both into informal payments as well as state capture activities. Their results also reveal that foreign-owned firms that are involved in informal payments are likely to benefit from these corruption practices. On the other side, state-owned firms are more likely to experience negative effects of involvements in corruption practices on productivity growth. After accession to EU in 2004, the involvement of firms in corrupt practices diminished and their negative impact on firm performance dissipates indicating an improvement in the stability of the business environment and law enforcement after the EU entry.

1.9 Corporate social responsibility

Managers are often confronted with the question to whom they need to be socially responsible and what decisions and actions they need to take to enhance the welfare and interests of society. From a social responsibility perspective, the internal and external environment represents a variety of stakeholders' firm need to be responsible to (Daft, Marcis, 2001, p.118). Efficient corporate governance makes sure that long-term firm's strategic objectives and plans are established, and the adequate management structures are in place to achieve those objectives, while at the same time ensuring maintaining integrity and accountability to its relevant stakeholders.

There are three levels of firm responsibility (Lahovnik, 2008). First and the principal level is the responsibility to achieve material obligations to shareholders, employees, customers, suppliers, and creditors. The second level, Lahovnik argues, are the results of firm's primary tasks. The third level takes into account interaction between firm's business and society in a broader sense.

For Slovenian firms, consolidation of business activities was a strategic priority during the first period of transition between 1991 and 1998. Then in the early twenties, the most important strategic objective was the growth of firms. Creating value for various stakeholders has become recently strategic objective for Slovenian firms, but in a relatively small number of firms in practice as well and not just in words.

There is no mandatory law on corporate social responsibility, although a large percentage of the Slovene economy is state-owned, where corporate social responsibility

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is promoted through the choice of supervisory board members or boards of directors on a personal level.

1.10 Conclusions

This chapter gives an overview of the legislative framework of corporate governance in Slovenia and the evolution of corporate governance practices over the last two decades. It identifies the reasons for the past poor functioning of corporate governance in the privatization methods used, in the past strategic considerations by the state and in poor performance of regulators.

There were two "game changers" that bear some promises with regard to potential improvements in corporate governance practices: the financial crisis started in 2008 and Slovenia's accession to the OECD in 2010. As for a private sector, the financial crisis deprived many management-owned companies of a control over the companies, while government finally involved in some changes in the regulatory framework to fight peculiar corporate governance practices (such as "acting in concert" and "share parking"). As for the state-controlled firms, the biggest change was introduced since the accession to the OECD in 2010 and the need to formally comply with the OECD Guidelines on Corporate Governance of State-Owned Enterprises. This resulted in the establishment of a separate central ownership agency (Slovenian Sovereign Holding) to coordinate all government ownership actions, in adopting the State Assets Management Strategy, some other legislation, and institutional changes that helped to improve the corporate governance practices of SOEs.

However, while Slovenia has gradually formally established a modern framework for a transparent corporate governance system, regulating listed and non-listed private companies as well as SOEs, the practices deployed by the parties are still far from transparent, adequate and professional. In private sector, compliance with corporate governance code increased over years and number of firms that declare full compliance is higher each year. However, the information provided by firms is mainly of low quality or mostly does not correspond to reality.

On the other side, despite all legal and institutional changes, the practices deployed by the governing political coalitions regarding the management of direct and indirect state holdings have remained virtually the same as before. They are more transparent, but not necessarily more professional, which was one of the objectives set by the government with the decision to centralize government ownership actions under one umbrella and defined in the State Assets Management Strategy.

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