

CORPORATE GOVERNANCE IN SLOVENIA: WORKING AT LAST?

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Abstract

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Because of deploying specific methods of privatization that favoured domestic over foreign owners and that enabled both internal owners and state-controlled funds to gain control over companies, corporate governance in Slovenia used to be a cumbersome issue over the last two decades. This led to an on-going battle for control over companies. On one side, in addition to management buy-outs, internal owners used peculiar methods, such as “shares parking” at related companies to gain control over companies of interest without having to engage in a takeover procedure. On the other side, the government used its state-controlled funds to gain control over strategic companies in specific sectors, such as finance, energy, transport and telecommunications. Combined with direct holdings of assets by the state, this gave the existing political coalition in power a mechanism to exert control over a large number of companies and to interfere with the management of privatized firms through an adverse selection of candidates for supervisory boards and board of directors. The victims of these unsound corporate governance practices were usually small shareholders and suboptimal performance of companies. For a private sector, the “game-changer” was a financial crisis that deprived many management-owned companies of control over the companies, while government involved in some changes in the regulatory framework to fight peculiar corporate governance practices. However, while Slovenia has gradually 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.

Keywords: Corporate Governance, Privatization, Transition, Firm Performance, Firm Ownership, The Board of Directors

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1. INTRODUCTION

Historically, the framework for corporate governance in Slovenia was determined by the methods of privatization. These were defined by the Slovenian Privatization Law (1992) according to the formula “20% + 20% + 20% + 40%”: 1) 20% of shares were transferred to two state funds; 2) 10% - to the Capital Fund to Pension and Disability Insurance (so-called “KAD”) and 10% - to the Restitution Fund (so-called “SOD”); 3) 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; 4) the remaining 40% of shares could alternatively be privatized either internally (through an internal buyout by managers, employees, former employees, close family members and retired workers) or externally (by a 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 allowed for either internal or external methods of ownership transformation. 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 privatization methods had an effect on the ownership and control of Slovenian corporations after the privatization and affected 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 the 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 are more efficient owners than the government is in a transparent and regulated economic and legal environment.

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 the state. Unlike other ex-socialist countries in Central and Eastern Europe, the state remained 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.

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 a 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 substantially control many companies in the domestic market. The Review stressed that direct holdings are concentrated mostly in infrastructure, energy and financial sectors (banking and insurance). Indirect holdings were run 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 the legal environment and corporate governance practices to be adopted by the Slovenian government.

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, the 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 three specific corporate governance codes (for listed, non-listed and state-owned companies) were adopted by the key stakeholders.

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 paper 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 the paper.

2. THE LEGAL FRAMEWORK OF CORPORATE GOVERNANCE IN SLOVENIA

2.1. The overall legal framework of corporate governance

The principal 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 regulation applicable to banks, while Ljubljana Stock Exchange issued regulation for listed companies. Both sets of regulations also include provisions relevant to corporate governance.

Slovenian Corporate Governance Code was adopted in 2004 by the Ljubljana Stock Exchange 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 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 for progress in 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 allowed for the government to be able 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 extensively influence the operation of large sectors of Slovenia's commercial enterprises and 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 Slovenian legislative framework allows for high shareholders protection, 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*: complete information on the government's direct and indirect shareholdings was missing, 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 has been broadly

disseminated, and the management of the Government's ownership interests was ineffective due to poor central coordination. The SOE ownership function was allocated to the line ministry responsible for the industry in which the SOE functions, which in some cases led to situations that ministries used their ownership function to seek broader intentions. By centralizing the ownership stakes in SOEs in a new central ownership agency should improve this problem to a large extent.

- *Recognizing stakeholder rights and the duties, rights and responsibilities of boards*: while the rights and duties of directors are defined by the Companies Act and the Code of Corporate Governance, they seem to be procedurally limited. This is shown in the low number of cases where there were breaches of directors' duties; the low success rates when there were such cases, and the use of directors' liability insurance not being prevalent.

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

- Transformation of the pension fund, KAD and the restitution fund, SOD should be a priority along with the establishment of the new central ownership agency.
- The new central ownership agency should develop a robust Code of Corporate Governance, a thorough capital investment strategy as well as classify the assets into strategic and portfolio investments along with defined Government's objectives for these asset groups.
- The Companies Act needs to be reviewed in terms of timely dealing with minority shareholders.
- Additional measures to support the financial and operational independence of the Securities Market Agency.
- To continue monitoring any possibilities of "share parking" activities, especially when it comes to takeovers, and make sure that such practices are prevented.

2.2. Regulation of state-owned enterprises

Since this Review, the 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 establish an independent central ownership agency for harmonization of government ownership actions. The Law on the Corporate Governance of State Capital Investments that established the central ownership agency entered into force in April 2010. The Policy also called for the more transparent and better-defined relationship between the government, KAD and SOD.

As a first step, in 2010, the 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 allow for improved operating results of companies in the portfolio;
- developing proper and transparent accreditation, nomination and selection of candidates for members of Supervisory Boards;
- privatization of assets with the aim to achieve the best result from the proceeds of the sale.

To overcome the weak operation and composition of SOEs boards, the government initiated administrative reforms to board appointments, also allowing for greater transparency and competent candidates able to exercise impartiality.

Regarding the challenges in the sector of listed companies in Slovenia, in particular, the better protection of minority shareholder interests and consistency of takeover provisions, the government adopted an Action Plan for Corporate Governance Reform in Slovenia. The latter introduced a legislative review of the protection of minority shareholder rights and envisaged better monitoring of compliance with corporate laws.

In 2015, the government adopted a State Assets Management Strategy (hereafter: Strategy) according to the OECD Guidelines on Corporate Governance of State-Owned Enterprises, recommending a well-defined and coherent ownership policy, transparent, accountable, professional and effective governance of state-owned enterprises. Through this strategy, the government communicates its goals to the state assets manager (SSH), to shareholders, the broader capital markets and the general public. In principle, this causes less government interference of managing SOEs as their performance is benchmarked against the goals set prior. The Strategy was accompanied by the categorization of assets into strategic, important and portfolio investments as well as the definition of the government's objectives for these asset groups.

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 corporate governance Codes were modified and amended in 2016. Main reasons for modifications are international changes in the regulation 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, many domestic initiatives led in the meantime to improved guidelines and recommended best practices for corporate governance in different types of companies.

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 their commended practices can also be used by other companies. While the changes to the CG Code for LCs from 2016 are mainly editorial and nomotechnical, there are some substantial changes, such as:

- a new institute, Diversity Policy, is added for better diversity and gender balance in management and supervisory bodies;
- equal treatment of shareholders was improved,
- self-assessment of supervisory boards was revised, recommendations for the chairman and secretary of the supervisory board were enhanced and capacity building of supervisory board members was 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;
- the transparency of operations was harmonized with the legislative changes and the Ljubljana Stock Exchange Rules, leading to the proposal for cohesive 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 relevant for all companies except for publicly traded companies. While the Code is appropriate for all unlisted companies, it was established for companies subject to audit of their accounts (in accordance with Article 59 of the Companies Act (ZGD-1)) and with mandatory inclusion of a corporate governance statement as a distinct section of their business 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 do not represent further rules and are not compulsory for any company; however, companies that are subject to an audit and use the Code for UCs need to, in accordance with the principle of "comply or explain", reveal in their corporate governance statement any divergences from the Code recommendations and to provide an explanation for the different practice.

Hence, the Code for UCs is complementing the Code for LCs with the aim of contributing to a transparent and plausible governance system in Slovenia promoting domestic and foreign investor confidence in the Slovenian system, but also the staff confidence and other company stakeholders.

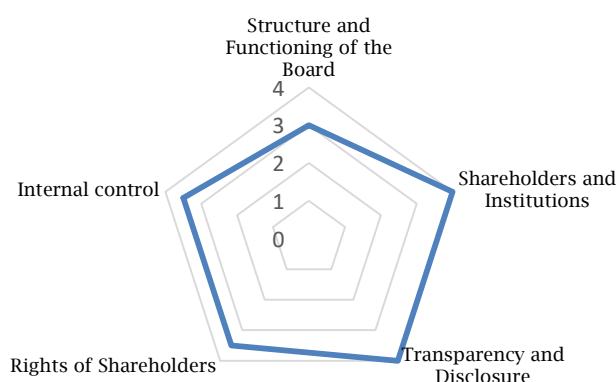
¹ Capital Assets of the Republic of Slovenia, Pension Fund Management, Slovenska odškodninska družba d.d., Modra zavarovalnica d.d., D.S.U., družba za svetovanje in upravljanje, d.o.o. and Posebna družba za podjetniško svetovanje d.d.

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 is relevant also for subsidiary companies in the group, where the controlling company is a company with the state's capital assets. The main aim of the Code is to set the governance principles and supervision in SOEs and to create a transparent and plausible system of corporate governance also in SOEs. By raising the quality of corporate governance in SOEs, its objective is to improve the performance of SOEs.

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.

Figure 1. Quality of corporate governance assessment for Slovenia



Source: EBRD, Corporate Governance Assessment 2016

Note: The extremity of each axis represents an ideal score, i.e., corresponding to the standards set forth in best practices and international standards (e.g., OECD Corporate Governance Principles). Key: Very weak - 1, Weak - 2, Fair - 3, Moderately Strong - 4, Strong to very strong - 5.

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 having vast challenges. In particular, the compliance with corporate governance code increased over the years and the number of firms that declare full compliance is higher each year. But, 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 privatisation, 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.

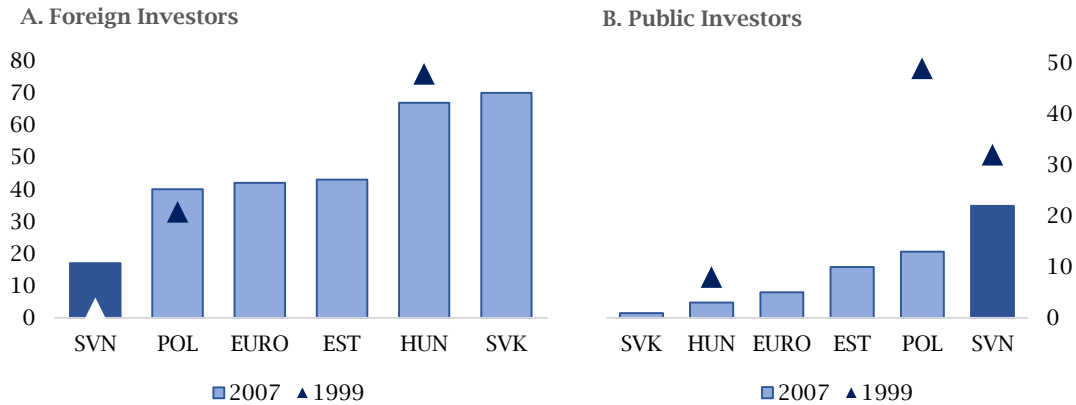
Regarding the SOEs, however, despite the complete overhaul of the corporate governance legal and institutional framework in order to comply with the OECD Guidelines on Corporate Governance of State-Owned Enterprises, the practices deployed by the governing political coalitions regarding the management 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.

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

Figure 2. Ownership structure (as % of total)

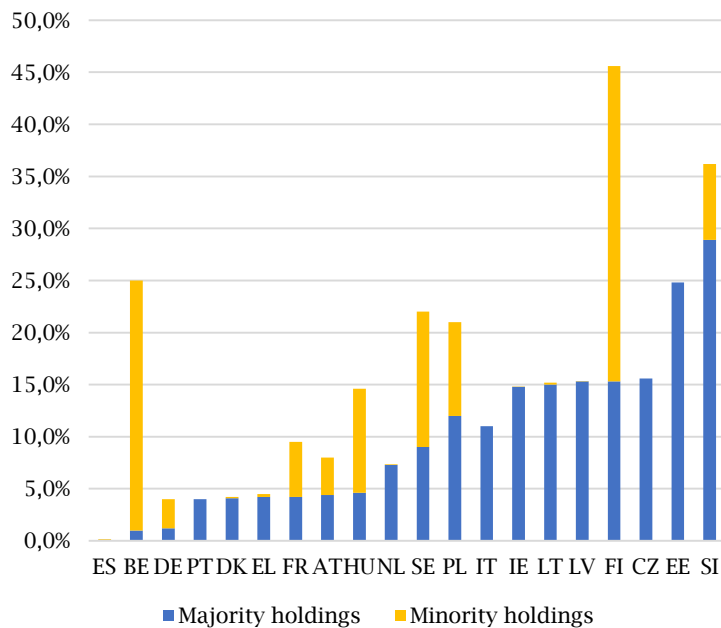


Source: OECD Economic Survey Slovenia 2011, OECD.

Slovenia maintains a relatively high share of state-owned firms as compared to other OECD countries and after the financial crisis the share directly and indirectly even increased. Namely, the obligatory structures and insolvencies of companies resulted in banks changing loans for equity holdings in companies, and the State to recapitalize the state-owned banks.

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 is even bigger after the crisis increasing from 16.4% to 23.2% in 2012, and to 30% in which the state has over 25% of ownership. In turn, this caused Slovenia having the highest share of state-owned enterprises in comparison to other OECD countries.

Figure 3. Book value of state-owned enterprises in the European Union (as % of GDP)



Source: Country Report Slovenia 2015, European Commission.

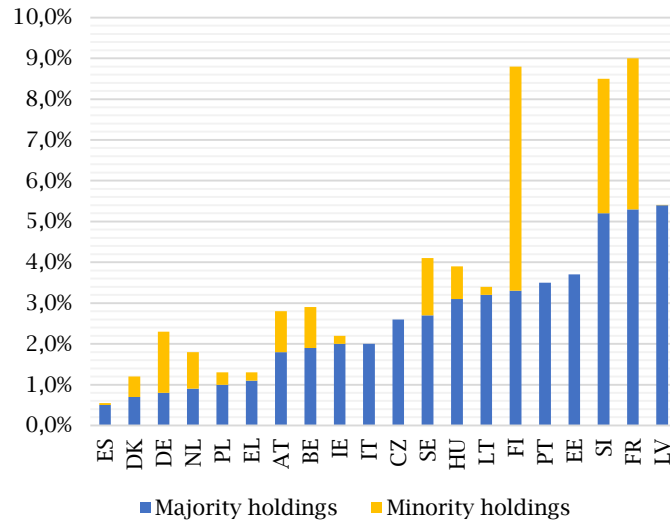
Notes: "Minority share" - companies with state-owned assets held in the company's equity that amount from 10 % to 50 %

** "Majority share" - companies with state-owned assets held in the company's equity that amount to more than 50 %

In the Country Report Slovenia 2015, also the European Commission pointed out that Slovenia has the greatest state involvement in the national economy in comparison to another member state in the European Union. As shown by Figure 3, the share of companies with a state shares that is larger than 50% (according to the book value in the share of

GDP), is the highest in the EU. If we look at the companies with the state-owned assets in equity amounting from 10% to 50%, Slovenia is ranked second. In terms of the share of employees employed by the state in total employment, Slovenia is ranked as the third-highest (see Figure 4).

Figure 4. Employment in state-owned enterprises in the European Union (as % of the total employment)



Source: Country Report Slovenia 2015, European Commission.

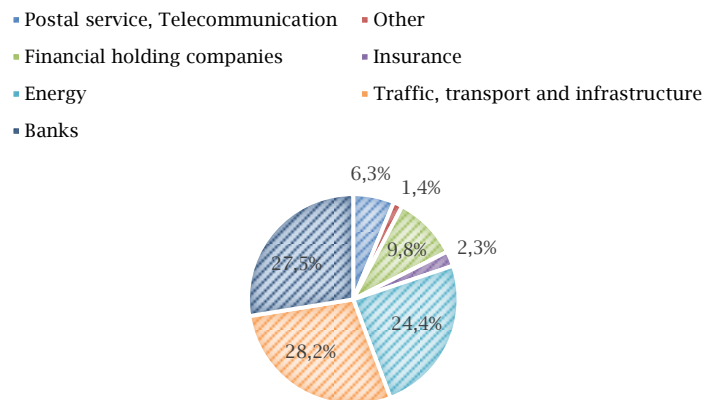
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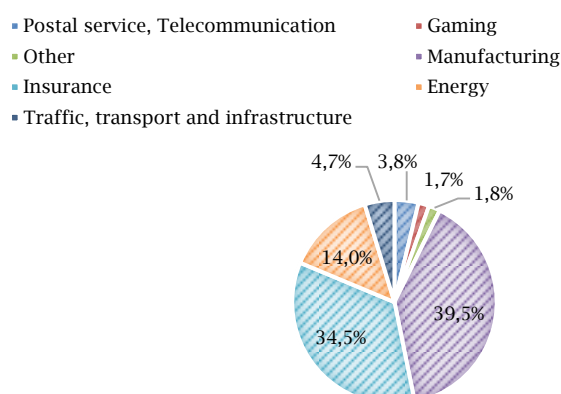
As revealed by Figure 5, Slovenian state is mainly involved - through direct holdings - in three sectors: transport and infrastructure, energy and financial sector (mainly banks), that comprise almost 80% of the state's total equity holdings. On the other side, the indirect holdings of the state that 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 the 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 5. Equity holdings in the Republic of Slovenia's direct ownership (book value as of 31 Dec. 2015)



Source: Slovenian Sovereign Holding.

Figure 6. Equity holdings in the SSH's direct ownership (book value as of 31 Dec. 2015)

Source: Slovenian Sovereign Holding.

4. THE MARKET FOR CORPORATE CONTROLS (M&A)

After the political change, between 2004 and 2008, the 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 dubious methods to obtain 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 under a different name). The weak performance of the regulator (Securities Market Agency) was additionally deteriorated by the postponement of the takeovers regulation to non-listed companies, having a huge impact on the regulators.

After the financial collapse in 2008, there has been progress when it comes to applying remedies by the regulator. Legislators and regulators have taken important steps related to the misconduct 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 was able to use its powers to withhold voting rights as one of the measures for violating the binding bid provisions of the legislation. This was also supplemented by increased 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 20 years of having corporate governance in Slovenia. Cases, where criminal prosecution and/or claims for compensation were undertaken, were very rare. It is yet to be seen whether increased regulatory actions and claims for compensations (damages), regular and extraordinary audits and revision processes in the corporations, would lead to better practices in corporate governance in Slovenia.

5. BOARD OF DIRECTORS' PRACTICES

Board of directors, as the highest authority in the firm, has a significant impact on firm performance (Kiel & Nicholson, 2005; Westphal & Bednar, 2005). What makes a board effective as a governance mechanism is one of the key issues concerning corporate governance (Nicholson & Kiel, 2004; De la Rosa, 2006; Schmidt & 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 & Kiel, 2004; Pye & Pettigrew, 2005; Aguilera, 2005).

So in order to be an efficient board of directors need 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 direction (by providing strategic guidance) and control (monitoring of the management such as employment, compensation, replacement of senior managers, etc.), reporting to shareholders, ensuring compliance with the law (Nicholson & 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 the 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 to 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 made 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 in charge of 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 in an individual case. The courts accept the business judgment rule as a theoretical guideline for assessing a board member's liability.

The principal obligation 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 management board is the required *pari-passu* approach to creditors' claims in situations of pre-insolvency financial distress.

Other specific responsibilities 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.

6. DIRECTORS' REMUNERATION PRACTICES

Before transition, firms in Slovenia were "socially owned" as they were governed jointly by managers, employees and political organizations (Gregorič et al., 2010). This impacted also the remuneration system, the salaries of top managers and other staff salaries were determined in a common wage pool at the state level.

During the early transition period between 1987 and 1993 witnessed first market reforms and wage liberalization causing adjustment in the salaries of management board members (Orazem & Vodopivec, 1997). The following year in 1994, the Association of Slovenian Executives proposed executive pay to a 5:1 vis-a-vis the pay of the average employee (Gregorič et 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 et al., 2010). Some of the performance criteria included net earnings, growth of exports and employment, return

on equity (ROE) or on assets (ROA), market value and value-added per employee. Bonuses were also paid out 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 wave of privatization happened after the break of Yugoslavia, bringing for the first time «proper» owners to former socially-owned firms (Gregorič et al, 2010). Now, almost 30 years after Slovenian independence, new regulation and guideline² 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 establishing 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 existing policies and ethical standards in order to facilitate the company's sustainable development.

The fixed part of remuneration allows for the firm to withhold payment of the variable part if the management board members did not perform. Once the variable part of the remuneration is paid, the payment of the part exceeding the total fixed remuneration during the past year is postponed to another year. If the variable part of the remuneration is given in share, the shares are paid out 3 years later.

Severance payments are only allowed if members of the management board are early dismissed due to no-fault reasons or due to

² 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).

consensual termination of employment for anticipated reasons such as illness. Moreover, they cannot be higher than 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 of 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 a government of the Republic of Slovenia and Municipalities will decrease after the enforcement of the respective regulation.

7. SHAREHOLDER'S RIGHTS PROTECTION

As a legacy from 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, the 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 exercise their rights, vote and engage in joint 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 the 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 the 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. And even though there were recent changes in corporate governance

framework with regards the relations with shareholders, equal treatment of shareholders still remains a challenge.

8. CORPORATE GOVERNANCE AND FIRM PERFORMANCE

As for the first decade after privatization, Damijan, Gregoric and Prasnikar (2004) found that the method of privatization did matter for post-privatization performance of Slovenian firms in the period 1998-2002. They find that when dominant, insider owners and domestic non-financial companies enhance the 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 the post-privatization performance of Slovenian firms. Using the data for 1994-2001, they arrived at two important findings. First, mass privatization agents that received shares mostly at no cost, are found to be more efficient owners at the beginning provided that they operate in a transparent and regulated economic and legal environment. Then, firms sold to foreign or domestic strategic owners by the government are more efficient than firms sold by mass privatization agents. Though, the supremacy of the government in selling firms to efficient owners is not established in 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 are particularly poor in regard to 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 the 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 somewhat surprisingly that private firms (domestic private and foreign-owned) are more involved in corrupt activities. Their results also reveal that foreign-owned firms that are involved in corrupt practices are likely to benefit. 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 decreases and their negative impact on firm performance is smaller indicating an improvement in the stability of the business environment and law enforcement after the EU entry.

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 improve the prosperity and interests of society. From a social responsibility perspective, the internal and external environment represents different stakeholders firm need to be responsible for (Daft & Marcis, 2001, p.118). Efficient corporate governance makes sure that long-term firm's strategic objectives and plans are established, and the appropriate management is set 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 the firm's primary tasks. The third level takes into account interaction between a 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 a relatively small number of firms apply it practically, mostly just in words. An obligatory law on corporate social responsibility is nonexistent, although a large percentage of the Slovene economy is state-owned, where corporate social responsibility is promoted through the choice of supervisory board members or boards of directors on a personal level.

10. CONCLUSIONS

This paper 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 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 central ownership agency (Slovenian Sovereign Holding) to harmonise all government ownership actions, in adopting the State Assets Management Strategy and 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 the private sector, compliance with corporate governance code increased over the years and the number of firms that declare full compliance is higher each year. But, 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.

In this paper, we undertook the review on the corporate governance regulatory and institutional framework as well as the associated performance of firms based on the ownership. However, the study would largely benefit from empirically analyzing the efficiency gains of ownership changes and changes in the governance of SOEs. Moreover, the research could focus on how the incentives in particular and managerial behavior after the ownership changes improved the performance and provide for industrial competitiveness.

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