CORPORATE GOVERNANCE INITIATIVE

Market economy calls for certain changes in the management of recent state owned enterprises. The managers of companies privatized during the first round of mass privatization had to define new governance models coping with the change in ownership structure and protecting shareholder rights. One of the core targets laid down in the economic policy of the government is to improve enterprise management in the process of restructuring, accountability, transparency and control systems. The lack of information and ongoing privatization combined with restructuring requirements became the driving forces behind the Center for the Study of Democracy's decision to institute a long-term program to promote core principles of corporate governance in Bulgaria.

Corporate Governance Initiative

This is a coalition of Bulgarian non-governmental organizations established in beginning of 1999 by Association of Industrial Capital, Association of Voluntary Pension Funds, Center for Economic Development, Center for the Study of Democracy, Investors' Union, and Securities Holders Association. The main objective of the CGI is to facilitate the adoption of relevant corporate governance standards and procedures that would ensure accountability, transparency and control in the economy.

The initiative includes three main focus areas:

- Assist the elaboration of a comprehensive set of practical recommendations and policy instruments that would facilitate the adoption of modern corporate governance principles through diagnostics of needs and analysis of existing corporate governance structures.

- To facilitate the practical implementation of modern corporate governance principles by developing a Policy Recommendation Paper and adopting a policy agenda through a consensus building process based on a Policy Workshop and a Policy Forum.

- To promote public awareness of corporate governance principles and their practical importance for the effective operation of companies and for ensuring accountability, transparency and protection of shareholders' rights through public education, advocacy and dissemination.

Policy Recommendation Paper

The PRP is designed to present a consistent set of policy and legislative measures (action agenda) that would help develop the institutional and market infrastructure of corporate governance. It seeks to identify factors that contribute to corporate governance models inefficiency and objectives of policy on corporate governance system development.

The Policy Recommendation Paper is elaborated by a Task Force and includes the following action lines:

- Equal Treatment of Shareholders and Protection of Shareholders' Rights
- Disclosure of Information
- Board Responsibilities
- Capital Market and Corporate Governance
- Residual State Shareholdings

Main structures

The **Policy Workshop** (at an expert/deputy ministerial level) and the Policy Forum (at a representative institutional level) are the main elements of the Corporate Governance Initiative process. They will assist the development and adoption of the Policy Recommendation Paper. The main objective of the Policy Workshop, conducted on July 2, 1999, was to discuss and review the draft version and incorporate the comments and suggestions of all concerned institutions. As a result of the work after the Policy Workshop, the revised final version will be presented for approval/endorsement to the Policy Forum.

The **Policy Forum** is the supreme body in the Corporate Governance Initiative structure. It is constituted of about fifty Members invited to participate by the Steering Committee. Members are prominent public and business personalities with established integrity and reputation as well as representatives of the public and private institutions. Its meetings ensure that the work carried out under the initiative by various institutions reflects a consensus of the main concerned public and private institutions. It also provides visibility to the initiative effort thus enhancing its impact.

The **Steering Committee** provides the coordination of CGI activities and outputs. It meets regularly, approximately every four-to-six weeks and has a major role in the run-up to the Policy Forum meeting. The Committee prepares the meeting agenda through advance consultations with the Forum members. The Steering Committee is formed by the representatives of the CGI founding organizations together with representatives of Bulgarian Stock Exchange-Sofia, Council of Ministers, Ministry of Industry, Securities and Exchange Commission and business community.

For the purpose of providing permanent support to the work of the Steering Committee, a CGI **Secretariat** is being set up at the Center for the Study of

Democracy. The CGI Secretariat provides the day-to-day operational management, logistical support and reporting for the CGI activities.

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CORPORATE GOVERNANCE AND CONTROL IN BULGARIA

Summary Report

At present, a few countries in the world can afford to ignore the problems related to corporate governance and control, still more if they are aiming to attract foreign investment. This is quite true for the transitional economies as well. The good corporate governance and control guarantees a benefit for shareholders, restrict the abuses and corruption, and, finally, it is a guarantee for economic growth and social progress.

The positive point is that Bulgaria is also a part of the global process of theoretical discussions and practical initiatives to apply the best world standards in the field. Until recently, “corporate governance and control” were an abstract and incomprehensible concept not only for the mass of individual shareholders who acquired ownership through mass privatization, but also for the representatives of state institutions and private business. As of today, the importance of the problem particularly for an economy whose restructuring is an urgent need is realized on the highest governmental level. During the last years, meetings and discussions, education seminars and sociological surveys were organized and the first more serious editions on the issue were published in Bulgaria, all of them supported by the active efforts of the professional community and media. A proof for Bulgaria’s striving for searching an answer to the global problems in the field of corporate governance and control is the inclusion of the issue in the program of this year’s Investment Forum for South-East Europe (18^{th}-20^{th} October, 1999, Sofia).

This report is aiming at presenting the state and specific problems of corporate governance and control in Bulgaria. It has been elaborated as part of the project “Corporate Governance Initiative in Bulgaria” with the financial support of the Center for International Private Enterprise, an affiliate of the U.S. Chamber of Commerce. The project is mainly targeted at facilitating the introduction of contemporary standards of corporate governance and procedures that are to guarantee responsibility and accountability, transparency in the economy and control mechanisms within companies.

The report has been drawn on the basis of data from sociological surveys (carried out by Vitosha Research Agency for the Center for Economic Development) as well as publications of international organizations and specialized editions. The conclusions for Bulgaria presented in the report are based on the information from a qualitative sociological survey on the corporate governance problems. The survey was carried out in late January 1999 using the discussions-in-focus-groups method. Participating in the discussions were representatives of branch ministries, the Privatization Agency, Center for Mass Privatization, Securities and Stock Exchanges Commission, Bulgarian Stock Exchange - Sofia, managers of enterprises and investment companies, investment intermediaries, investors’ organizations, individual shareholders, journalists.

The basic empirical data presented in the report are a result of a quantitative sociological survey carried out in the autumn of 1998. The sample covers 52 enterprises with more than 100 employees, a value of assets owned exceeding Levs 20 million (as of December 31st, 1995) and privatized prior to the end of 1996.

The report presents an analysis of the core problem areas of corporate governance in Bulgaria during a period when the predominant number of enterprises and approximately half of the assets were privatized. Apart from diversifying the forms of ownership, the privatization of state-owned enterprises also denotes a necessity in new mechanisms for control over managers and coordination of owners' interests. The ambition is to identify the specific peculiarities of corporate governance and control for transitional economies on the example of Bulgaria, that are supposed to require adequate measures for overcoming the specific problems.

1. Obscurity of the concept and terminological difficulties

The discussions in the focus groups confirmed the hypothesis that a commonly accepted understanding of the contents and scope of corporate governance has not yet been shaped and approved. Differences were ascertained in the interpretation of the "corporate governance" concept even on experts' level. A typical illustration of absence of a commonly accepted understanding of corporate governance is its repeated mixing with the strategic and operational management. In a number of cases, the concept's scope includes also elements such as personnel (human resources) management, realization of production, financial management, etc. The related difficulties are manifested also in the "terminological insufficiency" ensuing from the use of a single concept "governance" that is given different meanings. For the wide public presented in the discussions by individual shareholders and media representatives, the problems of corporate governance are solely brought forward in a practical aspect, without searching for their conceptual basis.

At present, corporate governance in Bulgaria is most often interpreted as governance of relationships and coordination of interests between owners (principal) and managers of corporations (agent). A specific details is the addition that corporate governance also concerns the relationships between various categories of shareholders having specific interests and, most often, unequal possibilities for exerting influence on joint-stock companies. The scope of corporate governance also includes the issues of management structure, rights and responsibilities of managing bodies of joint-stock companies as well as the inside relationships within the managing bodies (e.g. between inside and outside directors).

Standing out, as a specific element of corporate governance in the transition process in Bulgaria, is the role of the state in the process of corporate governance both as being responsible for creating the common legal and regulatory and economic conditions whereon corporate governance is being implemented, and a specific subject of these relationships. In practice, the contents of the concept "corporate governance" in Bulgaria do not usually include the relationships with the stakeholders, i.e. customers, suppliers, the local communities. A connection between corporate governance and the role of banks within it is made very rarely.

2. Ongoing restructuring of corporate ownership

Most of the Bulgarian enterprises are relatively small and most often they prefer the model of the limited liability company rather than the joint-stock company. Today, most of the joint-stock companies in Bulgaria are a product of their mass transformation with a view of their upcoming privatization, and not of the natural development of market mechanisms. This is the heart of the most serious challenge to them during the transitional period. They have to establish and strengthen their corporate structure and introduce efficient mechanisms of corporate control within a short time.

A considerable number of enterprises privatized under the mass privatization scheme, and former privatization funds have already been granted a status of public companies. The new model of corporate ownership with various schemes of interaction of capital (private and state) as well as the status of a public company are the ground for development of corporate governance and control in Bulgaria. The development of corporations and formation of public companies in particular in Bulgaria is not always subordinated to the economic necessity but is subject to administrative and legal measures. This is a serious obstacle to the establishment of principles of corporate governance and control.

At present, the joint stock companies do not yet have serious economic motivation to apply the principles of corporate control, nor a created corporate culture. This forms the idea of “artificiality”, “compulsive nature” and “inefficiency” of the legal and regulatory rules within the experts’ community.

The ongoing changes in the ownership structure are also exerting negative effect (in the sense of indefiniteness) on corporate governance in the Bulgarian firms. Unlike many ex socialist countries, Bulgaria does not suffer from the deformations in the ownership structure occurring often in the said countries, i.e. excessive dispersion of ownership resulting from mass privatization and considerable shareholders participation of investors being inside to the firm (employees and managers).

According to data from the quantitative sociological survey, the most significant category of owners in the Bulgarian enterprises after the privatization are the local legal entities (23%) and privatization funds (19%). Follow the present employees and managers of the company and ex personnel (24%) and foreign investors (10%). The state is still an owner of 18% of the enterprises under survey.

A characteristic feature of the ownership structure is the high degree of ownership concentration. In 60% of the companies, a strategic investor owning over 50% of stock is present. In 32% of the companies under survey, this investor owns over two thirds of the ownership, that guarantees an entire control of the investor over the management. In the remaining 21% of the companies, the biggest investor cannot influence the management since the former owns less than one third of the stock. At the same time, not more than three among the biggest investors are holding the controlling stock interest in 87% of the joint stock companies.

As a result of privatization and transformations in the ownership in the Bulgarian companies surveyed, four basic models of ownership structure are formed. The first and most often occurred (55% of the companies) is the one with predominant participation of the outside local investors in the ownership, where in 25% of the companies these are privatization funds, and in 30%, other Bulgarian legal entities. The second model is the one with predominant participation of employees and managers in 21% of the enterprises surveyed. The third model is with predominant participation of outside foreign investors (12%), and the fourth model is the one where none of the subject of ownership has more significant participation (12%).

In 64% of the enterprises in the sample under survey, a one-tier system of management is applied, and a two-tier system is applied in the remaining 36%. As a whole, the staff of the managing bodies of companies corresponds to their ownership structure. Yet, persons being related in one way or another with the state very often represent the companies. It is expected that the restructuring of ownership in the line of its concentration (especially in the former privatization funds) and final withdrawal of the state from its role of an owner will be completed in the near future.

From a point of view of the ownership structure, the prospects for applying the contemporary corporate governance and control in the Bulgarian reality can be estimated as good. No serious difficulties are to be expected in coordinating the interests and standpoints for development of business of various groups of owners. A much more serious problem is how to overcome the short-term thinking and behavior of owners and managers by means of corporate governance mechanisms.

3.Realization and protection of shareholders' rights

As a result of the mass privatization program, some 3.5 million Bulgarian citizens became owners of financial instruments during the period 1996-1997. (The total number of adult citizens is some 6.5 million). Some 3 million citizens are owners of shares of 81 privatization funds, and some half a million citizens are owners of shares of 1,050 companies proposed in the program.

These individual shareholders whose number is enormous on the strength of mass privatization are usually not quite aware of their rights and responsibilities and have not sufficient experience in their exercising. The realization of their rights is impeded by deficiency of financial resource and unwillingness of the management to work for the shareholders' benefit. The motivation and interests of individual shareholders are too weak.

Under these circumstances in Bulgaria, the individual shareholders seem to be passive in most cases. At present, their role is considered to be peripheral and economically subordinate. Still, they are not thought of as a source of financial resource but are rather perceived as a problem and not a possibility. Regardless of the skeptical attitude towards the individual shareholders at present, the expectations are for continuous increase of their significance as a source for accumulating a financial resource in the future. Their activity as a participant in corporate governance is to be manifested. Unlike the USA and Western Europe, these shareholders in the Central and East-European countries will probably be more active because of their ambition to “make up for the missed time” and the smaller average size of enterprises within the region.

The issue of the most adequate way of protecting the interests of minority shareholders has not yet been solved within the Bulgarian environment. There has not been sufficient practice on the realization and protection of the rights of minority shareholders. On the one hand, the legislation regulates the shareholders’ rights to exert influence on the management and prevent serious violations on the part of the managers. This will be achieved to a maximum extent by the forthcoming adoption of the Law on Securities by the National Assembly. Discussed were also proposals for legal regulations allowing voting via mail, cumulative voting, etc. At the same time, there are still numerous organizational and bureaucratic obstacles to the entire realization of the rights of minority shareholders - participation in the general meeting of shareholders, representation in the managing bodies, receiving dividends and so on. One cannot sufficiently rely on the judicial system since it intervenes slowly and not always professionally in settling disputes related to corporate governance and control. In such an environment, it is difficult to protect the shareholders’ rights and provide, at the same time, the required degree of freedom of managers under an underdeveloped institutional basis that has to clearly define the relationships between owners and managers.

This is the situation where an acceptable balance between the interests of shareholders and managers has to be found. Besides the legal regulations, numerous other measures aiming to convert the individual shareholders into “active” owners will be of high significance. They include education and support by NGOs, public awareness campaigns with the participation of all interested parties, disclosure of positive examples through media, etc.

4. Composition and behavior of managing bodies

Another issue of importance for corporate governance and control, having specific dimensions related to the transitional period, is the following: who are the members of company’s managing bodies and what is their role for restructuring and determining the trends of company’s development? This is the point where one should also trace out whether the requirements for representativeness and team-operation in governance, transparency and responsibility in the work of managing bodies are adhered.

In Bulgaria, these aspects of corporate governance and control have not yet been entirely perceived and are realized in insufficient degree in practice. There is no empirical information for determining what is the role of company’s insiders and outsiders and whether there is a balance between them in the managing bodies. The issue of the motivation of operational management to work for company's interest and all shareholders has been investigated insufficiently as well.

Like the other former socialist countries, the structure and personnel composition of corporate governance bodies in Bulgaria were not formed completely. Data from the sociological survey is pointing out that representatives of the former owner, i.e. of the state, are members of the corresponding boards in more than a half of the companies. They are present even in 20% of the companies with a foreign investor. On the one hand, this fact is an evidence for the ambition of the state to continue influencing the privatized enterprises, and on the other one, it evidences that, in the best case, in most of the enterprises the inertia of the past and dependence on the state authorities has not yet been overcome. In the worst case this might be a manifestation of some form of corruption.

The next big group of members of the supervisory boards/boards of directors are the owners - company's insiders. They are present in 44% of the companies and mostly in those with predominant ownership of employees and managers. In 36% of the companies, there are also representatives of Bulgarian legal entities (without privatization funds), and in 22% of the companies, there are representatives of privatization funds. A summary of these data from a point of view of the dominating positions of any of the groups will give the following result: in 66% of the companies under survey, the boards are dominated by outside representatives not related to the state; in 24%, by inside representatives (employees and managers), and in 10%, by outside representatives related to the state.

This aspect of corporate governance in Bulgaria should also concern the problems of relationships between the owners and representative managing bodies appointed by the former and the executive bodies of management - first of all, the executive directors. The role and function of these main subjects whose relationships are regulated by corporate governance have not yet been defined and differentiated clearly in Bulgaria. This is the ground where conflicts arise and the existing practice deviates from the principles of corporate governance.

The executive directors have not yet been adjusted to subordinate the governance of joint-stock companies to the owner's interests. Usually, they do not perceive their obligations to work for the interest of the company and its shareholders, but led by the heritage of the past, they are acting as sole owners or serving the interests of some of major shareholders. This model of governance is assessed as a rather steady one, thus impeding the establishment of principles of corporate governance. Sometimes, the executive managers succeed in affecting strongly some of the shareholders (e.g. workers and employees) under a threat of dismissal, and even some of company's outsiders by allowing them no access to information being of importance for the company.

The present situation is, to a great extent, a consequence of the continuous absence of efficient control on managers due to the delayed privatization, permanent instability of the management teams, presence of a common environment and mechanisms motivating a kind of managers' behavior that favors them for the account of the companies managed by them. In Bulgaria, there are still no satisfactory regulations on the problem related to the "conflict of interests" and such occurrences are not subject to sanctions. A serious problem is also the objective lack of knowledge and experience for work in a market environment. The attempts to bind the managers' remuneration to the achieved economic results (e.g. by payment of a bonus to the executive directors as percentage of the realized profit) are not always effective. Pressed is the view that the lawful economic incentives do not have the motivating force of the personal interest that is often formed out of the framework of the legal economic practice.

In conclusion, it should be noted that also in Bulgaria the most part of the former executive managers of companies, who preserved their positions after the privatization as well, will continue to be opponents to the restructuring and establishment of a new type of relationships with the owners. Besides, the privatization funds in Bulgaria changed 3-7% of the managers of enterprises upon the completion of the first round of mass privatization. (In comparison with the Czech Republic, this percentage is within the limits of 80-90%.)

The gradual introduction of the corporate governance standards in Bulgaria will also contribute to the creation of a new type of managers - having knowledge on the market economy and with the proper respect and skill for working with the shareholders and stakeholders. Also, we are speaking of managers being acquainted with, and using the capital markets, who will contribute to the observance of rules of accountability and transparency. The use of methods such as disclosure of information about the remuneration of managing bodies and executive directors, structuring of auxiliary bodies such as a remuneration committee, an appointment committee, and an internal audit section will significantly improve the corporate governance practice. There is also a necessity of brisking up the efforts for education and enhancement of the advanced vocational training of the members of companies' managing bodies and executive managers.

5. Corporate governance and capital market

In Bulgaria, the interconnection between the application of principles of corporate governance and development of capital markets is perceived increasingly. The approval of professional standards of corporate governance is a prerequisite and a significant stimulus for development of capital market. These are of a particular importance for maintaining the investors' trust and guaranteeing the market liquidity. The feedback (capital market - corporate governance) is also making its way. The capital market is an extremely important control mechanism that evaluates the corporations and selects those of them that are governed skillfully and are running efficiently.

At the same time, there are numerous factors impeding the potential possibilities for implementation of this kind of interaction. The predominant experts' assessment is that at present the capital market in the country is still in an embryonic state and stagnation. It is existing mostly as a secondary market and does in practice serve mostly the reallocation of ownership. The expectations are pointing out that without development of the capital market that could allow raising of financial resources under favorable conditions, the capital market in Bulgaria will play an insignificant role.

There is no confidence among the investors that the resources provided by them will be governed efficiently. On the one hand, this is related to the inefficient application of principles of corporate governance, and on the other one, to the limited and inaccurate, in many cases, information being submitted on the state of public companies.

Most part of joint-stock companies that are granted a statute of “public companies” are not interested and willing to maintain this statute. To them, this is related with administrative pressure and supposes considerable expenditure without getting economic benefit in return.

Even in cases where an interest in issuing stock and bonds is manifested, the state in the person of the Securities and Stock Exchanges Commission is often imposing a restrictive policy. At experts’ opinion, a striving for “overregulation” is demonstrated, that appears to be an additional obstacle to the development of the primary market.

A demotivating factor for investing in stock is also their low liquidity. This does not allow to actuate the control function of capital market as well since the shareholders do not know for certain that they are in a position to impose sanctions on eventually inefficient governance of joint-stock companies.

During the post-privatization period in Bulgaria, the capital market will further increase its active role for restructuring of enterprises (property rights and control rights). It is to be implemented exclusively on a market basis by the managers who are feeling threatened by the owners, as well as by takeover. The efficiently operating capital market may play an important role for disciplining the managers and finding an objective market evaluation of their activity’s results.

Through the capital market, the mass privatization participants who are not willing to remain owners, should have the possibility to relieve from their shareholdings under fair conditions, thus consolidating additionally the ownership and improving the corporate governance. Restructuring of strategic and institutional investors’ portfolios will continue as well. The developed and liquid capital market in Bulgaria will forward the companies’ stock to the most efficient structure of ownership and concentrate the ownership among the most efficient investors.

6. Transparency and disclosure of information

The establishment of statutory rules and a mechanism for granting a free, fast and inexpensive access to information about the state of joint-stock companies is a key condition for realization of the remaining principles of corporate governance as well.

All participants in the focus-groups discussions are sharing the view that transparency and access to information as of today are extremely restricted. Violated is even the statutory requirement for publishing the annual balance sheets of joint-stock companies. Managers of enterprises declare that they are providing information about the companies’ state and activity quite reluctantly and only when required to do so within their statutory obligations.

It is paradoxical that a large volume of information being one and the same in most cases, is gathered by various institutions. At the same time, the subsequent access to it appears to be extremely difficult that makes the efforts for its gathering rather senseless.

The public companies which, by definition, have to guarantee maximum transparency about their activity, do not realize in practice this basic principle of corporate governance.

The main reason for this state is to be searched in the joint-stock companies' lack of motivation to provide information. First, absent is the important motive that providing information to the wide public will make possible to attract a financial resource. Providing information to the wide public has not been motivated by a real economic interest but rather by a statutory and administrative pressure. Second, there are fears that the information might be used against the organization's interests. Third, expressed are opinions that the enterprises are not interested in providing a comprehensive and reliable information, that is manifested, in some cases, in the differences between data submitted by tax administration, on the one hand, and the National Institute of Statistics, on the other one.

Transparency on the state of public companies cannot be obtained through administrative pressure even when required by law. The stipulated sanctions when are not supported by economic motivation fail to be efficient.

During the last months, a noticeable progress was achieved along these lines in Bulgaria. The Securities and Stock Exchanges Commission is working actively for providing a fast and inexpensive access to information about the public companies. The most suitable way to do so is the electronic form of the unified register. Information has to be received operatively and in a form allowing for making an analysis and summaries.

Particularly important is also the necessity in providing adequate information to the small individual shareholders. The availability of comprehensive and reliable information about the state of companies whose shares they are holding, is the most reliable mechanism for protecting their interests. The confidence in the joint-stock company and expectations for receiving a yield exceeding the average rate of interest appear to be the main motives for the investor. From this point of view, the reliable information about the existing risk and expected yield on share purchase are a paramount element of the information searched for.

7. The role of former privatization funds in corporate governance in Bulgaria

The program for the first round of mass privatization in Bulgaria envisaged the participation of privatization funds in their capacity of institutional participants. To this end, 81 privatization funds were registered and licensed then by the Securities and Stock Exchanges Commission. The specific conditions for their establishment, their characteristics and regulation of their activity are of a great importance in the long run for the development of companies in which the participants hold shares as a result of mass privatization. Their influence on corporate governance and perspectives for companies' restructuring is mostly dependent on the relative share of their ownership in privatized enterprises and their own long-term strategy. The already former privatization funds themselves are also an interesting example for application and development of corporate governance mechanisms.

As a result of the program for the first round of mass privatization, about 3 million citizens are holding shares in 81 privatization funds, whose total face value is about Levs 60 billion. The privatization funds themselves are owners of diversified portfolios of shares of totally 1,050 companies. Upon completion of the program, the most part of former privatization funds were transformed into industrial holding companies, and their single representatives, in investment companies.

Unlike other countries in Central and Eastern Europe, Bulgaria is short of sufficient empirical information from specialized surveys dealing with the behavior of privatization funds during the post-privatization period, as well as surveys tracing through the problems of corporate governance in the funds themselves.

The influence of privatization funds on the development of corporate governance in Bulgaria is going to be manifested in full strength and evaluated within a few years. But even now one can assert that they are meeting, to a great extent, the requirements for providing a high concentration of capital and ownership, efficient control over operational management and professional management oriented to purely economic aims.

The aims they set themselves and their behavior during the post-privatization period are pointing out that they are acting rather as a strategic than a typically institutional investor. The insufficient experience and training of the members of managing bodies of their subsidiary companies appeared to be a serious problem for former privatization funds. This brings forth the urgent need of additional training and skills enhancement. The significance of the purely market mechanisms for employing adequate personnel with proper experts' knowledge and managerial skills will become stronger as well. There are also difficulties in the relationships with the executive directors who are taking away the most managerial functions. It is still hard to overcome the weak personal interest and lack of understanding of shareholding relationships on the part of workers and employees who have received minimum blocks of free shares through mass privatization.

Serious problems related to corporate governance are also emerging in the cases when certain privatization funds are controlled by managers of the main companies in their portfolios, i.e. inside shareholders are controlling the enterprises. The outside shareholders (the holders of shares in the privatization fund) are a very incompact group to exert significant influence. There are also omissions in the regulatory enactments, the regulation and infrastructure of capital market, that make possible the abuses and violations of the rights of shareholders of former privatization funds.

8. Specific role of the state in corporate governance

At present, numerous enterprises are still experiencing an extremely unpleasant precedent of partnership between the state and private shareholders. In many cases, the state is still a majority shareholder but its shareholding exceeds insignificantly that of the remaining shareholders, and finalizing of privatization procedures is at hand. In even more cases, the state is a minority shareholder, i.e. the state is getting for the first time into a situation where it is just one of the shareholders, and not the owner.

Under this situation, the state representatives are demonstrating several types of behavior. They are either disinterested in the enterprise and do not participate in its governance at all, or the state- appointed representatives are easily talking at a common ground with private shareholders to the prejudice of the state in its capacity of a shareholder. Finally, they often abuse of their capacity of state administration representatives and interfere beyond their authority of a shareholder. All of these cases bring forth conflicts whose settlement has to be sought for in the strict observance of corporate governance principles.

During the process of transition until the state retires in practice from the enterprises or in cases where the state will maintain for a while a noticeable or majority participation in large-scale enterprises of service sector infrastructures, it is very important to specify the essence of corporate governance through adequate forms of training and continuous dialogue with state authorities. Probably, it is not still late to elaborate and approve the adequate regulatory enactments on state participation in corporate governance, that will be in conformity with the transformed structure of ownership.

The state intervention in the functioning of private economic entities creates a situation favoring undesirable informal commitments of companies with civil servants and often unnecessary politicizing of decisions being economic in essence. This will be overcome by the completion of the privatization process in broad outlines and establishment of a common public policy on the issue of state shareholding.

As the analysis points out, in Bulgaria there are still missing approved rules and practice to exercise efficient corporate governance and control. For the present, the regulatory framework and entire institutional environment have not found a system that can provide efficient governance of ownership to the benefit of all shareholders. The efforts of the Corporate Governance Initiative to prepare and discuss, as broadly as possible, the Policy Recommendation Paper - Policy for Corporate Governance Development in Joint-Stock Companies in Bulgaria, are an attempt to foster these processes in Bulgaria.

POLICY FOR CORPORATE GOVERNANCE DEVELOPMENT IN JOINT-STOCK COMPANIES IN BULGARIA

Policy Recommendation Paper

Introduction

The Policy Paper is aimed to assist the efforts of state institutions and market participants to analyze and improve the economic and legal conditions for development of corporate governance in Bulgaria. It proposes guidelines and specific recommendations for investors, joint-stock companies, stock exchange and all other organizations concerned with corporate governance.

Corporate governance is an attribute inherent in market economies with developed capital markets. This is governance implemented on behalf of shareholders through governing, supervisory and operational managing bodies elected by shareholders with a view of guaranteeing profits of shareholders' investment. In the present situation it is taken as a guarantee for efficient functioning of publicly held companies and a measure for the competitiveness of the national economic system. The strategic purpose and role of corporate governance determine the special attention paid to it by the state. From a national and international point of view, conditions are created by the legislative, executive and judicial power for implementing the principles and objectives of corporate governance.

Corporate governance is manifested in relationships between shareholders, governing and supervisory bodies and operational management, on the one hand, and interaction with economic, social and political environment, on the other one. It relies upon the principles of equal treatment of shareholders regardless of the amount of their ownership, upon representative nature and teamwork of management. It follows the requirements for transparency and responsibility of boards. It rests on the balance of interaction between inside and outside directors. Independence and impartiality provided by outside directors guarantee operational management and behavior of inside directors oriented to satisfying shareholders' requirements and expectations. Corporate governance introduces conditions and mechanisms both for the efficient utilization of stock capital in the company and efficient functioning of national economies. The unanimous opinion is that the Asian crisis was caused by inefficient corporate governance as well. Its social dimension is an indisputable fact.

The structural reform of the Bulgarian economy and stock ownership presented in publicly held and close companies require the gradual approval of corporate governance. The democratic nature and equal treatment of business entities at the time of transition towards market economy are inconceivable without a proper managerial scheme. At the same time, corporate governance should be perceived as an element of Bulgarian economy attractiveness to the foreign strategic and portfolio investor. Transparency of economic activity, efficient use of stock ownership and guaranteeing of profit for the shareholders as well as rational structure of governance are only part of the requirements and expectations of this individual or institutional investor towards the economy. Reintegration of the national economic system into the world economic structures calls for adequate corporate governance. The international significance of corporate governance is also supported by the attention paid by OECD and the International Organization of Securities Commissions (IOSCO) to the approval of its format.

The very significance and possibilities of corporate governance are the factors mandating the undertaking of measures to foster its approval. Under the conditions of today in Bulgaria it could be developed successfully through combined and one-way efforts of the state and business as well as of associations of interested parties. The Policy Paper is materializing these efforts. It is based on the achievements in economic practice and regulatory mechanisms within the country. The specific guidelines are compared to the corporate governance format in the countries with developed market economies and capital markets. The plan is targeted at corporate governance that will be approved gradually in the public companies. The specific place and role of state ownership and the existence of mixed, state and private ownership necessitate the undertaking of specific action lines.

The Policy Paper contains formulations of recommendations for both legislative and information and educational amendments. The interdisciplinary nature of corporate governance and understanding of necessity of systematic and not only one-sided measures related to its gradual introduction into the Bulgarian publicly held companies are determining the approach followed up.

Action Line 1.

Guaranteeing Equal Treatment of All Shareholders

The issue of the balance of interests of majority and minority shareholders is of a very delicate nature since “staggers” to the two extremes are continuously observed. On the one hand, the majority shareholder takes much greater responsibilities so it is in order to be granted more rights. On the other hand, there are a number of occasions where he imposes actions to the company, protecting his/her own interests only but not the interests of the remaining shareholders, and even, not the interests of the company itself.

Background

The Bulgarian legislation does not stipulate in details the principle of equal treatment of shareholders in individual companies. The Comercial Law contains provisions targeted at guaranteeing equal treatment of all shareholders, which, however, are not sufficiently clear and specific. A typical example is the protection of shareholders’ property rights both immediately upon the incorporation of the company and on increase of its capital. Art. 72, para 2 of the Comercial Law stipulates that by the time of incorporating a company the rights in the form of a non-monetary contribution into the capital shall be assessed by three experts appointed by the court of company's registration.

Objectives

Prevent the evasion of regulations concerning the assessment of non-monetary contributions by concluding deals with related parties at a time following the incorporation, and protecting the shareholders' property rights.

Recommendations

It is reasonable to introduce into the Comercial Law a regulation stipulating the so-called "re-incorporation" of company, based on the model of Directive No. 1 of the European Community in the field of company law. Such a regulation should rule that in the cases where a joint-stock company acquires, within two years from its incorporation, rights at a price exceeding 10 per cent of the capital, from a person who subscribed shares upon company's incorporation, assigned rights shall be governed by Art. 72, para 2 of the Comercial Law, and acquisition is to be approved by the general meeting of shareholders.

The Comercial Law should also provide for a boards' obligation to convene a general meeting of shareholders, in case the losses exceed ¼ of capital, not later than three months from ascertaining the losses.

The issue of buying back ownership shares by the company should be improved and regulated in details.

Amendments in the Comercial Law concerning the capital increase should be effected as well. It is inadmissible for the managing body to increase the capital without being empowered to this purpose by the general meeting as well as to take decisions for increasing the capital before the company registered capital is entirely subscribed. It is also mandatory to enter amendments in the Comercial Law stipulating that in the case of capital increase by the Managing Board, the Board of Directors respectively, where the bylaws allow this, it is obligatory to enforce the regulations concerning the right of each shareholder to acquire a portion of the new shares, that corresponds to his/her share in the capital prior to the increase. It should be provided for that the Managing Board, the Board of Directors respectively, may exclude or limit this shareholders' right only in case it is empowered by the bylaws or a resolution of the general meeting taken by the relevant majority of votes. In this case only the capital increase should be effected provided that the shares are to be purchased by certain persons at a certain price or against a non-monetary contribution.

These recommendations concern all joint-stock companies, both publicly held and close ones, as far as the principle of equal treatment should be enforced for any joint-stock company regardless of the structure and method of raising its capital.

Action Line 2.

Protection of Minority Shareholders' Rights

Ensuring the regulatory and practical possibilities for the free exercise of shareholders' rights will bring forth the improvement of social and economic relations in this sphere and establishment of efficiently operating practices for turning the shareholders into active agents for system monitoring, control, sanctioning and evaluation of corporate governance. The shareholders shall, by directly exercising their rights and indirectly by "voting by their feet", turn into a natural mobilizing environment for efficient corporate governance.

Action Line 2.1
Protection of Minority Shareholders' Rights to Convene a General Meeting and Determine Its Agenda

Background

At present, a general meeting of a joint-stock company may be convened by a request of shareholders holding at least 10 per cent of capital (Art. 223, para 1 of the Comercial Law). This regulation provides for equal treatment of all joint-stock companies regardless of whether publicly held or not. Particularly for the publicly held companies this gives an advantage to the major shareholders and impedes the possibility for minority shareholders to protect their rights. This regulation would impede the possibility for protection of rights not only of individual shareholders but also of institutional shareholders, such as investment companies, pension and insurance companies which, in principle, are portfolio investors and possess comparatively small holdings.

Objectives

Guarantee the possibility for minority shareholders to participate in taking decisions being significant for the company and, control its governance.

Recommendations

Discuss the expediency of introducing proper legislative amendments regulating the possibility for shareholders holding a minor share of capital in publicly held companies to convene a general meeting and determine its agenda. It is possible to specify a 5 per cent share, as in Germany and Austria, or even a smaller percentage in the case of very big companies with many shareholders.

Contribute to the adoption of the legal possibility proposed into the draft of a Law on Securities, for persons holding 5 per cent and more of a publicly held company capital to raise company's claims before the court against third parties in case of inaction of boards, as well as of the proposed permission for such persons to raise a claim before the district court for indemnification of substantial damages caused deliberately to the company by action or inaction of members of the boards.

Action Line 2.2.
Protection of Shareholders' Right to Self-Organization

Background

In accordance with Regulation 19 dt. August 12,1996 issued by the Minister of Finance and BNB for the Central Securities Depository, each investor is granted access to the Central Depository registry concerning information only related to the securities held by himself/herself. At the same time, no regulation obliges the management of a publicly held company to submit information about the list of its shareholders. In view of that one or several shareholders of a publicly held company, willing to discuss with the remaining shareholders on problems of company business or governance have no possibility to do this in practice, since they are not in a position to organize a meeting with the remaining shareholders. Most often, this is not a problem for the majority shareholders since they are usually represented in the boards. This is, however, a real impediment for the minority shareholders' possibility to have influence on the processes running at the company.

Objectives

Create a wide range of prerequisites and possibilities for the shareholders to self-organize when necessary. Thus, they will be able to protect their rights themselves, to have more information and control to a greater extent the company governance.

Recommendations

Foster and support educational measures among the shareholders with a view of their awareness concerning the possibilities for self-organization, incl. by making use of mass communication media services. The gradual approval of the role and significance of institutional investors (e.g. the pension funds) will bring forth a higher degree of good organization among minority shareholders.

Action Line 2.3
Expanding the Minority Shareholders' Possibility to Nominate Their Representatives in the Boards of Publicly Held Companies

Background

The present regulatory enactments concerning the voting rights allow for a shareholder holding 50 per cent of capital (or even less) to dominate in fact over the election of the boards by the joint-stock company General Meeting. Thus, such a majority shareholder may pass through a type of governance that is for his/her benefit and that might do harm to the other shareholders.

Objectives

Strengthening the influence of minority shareholders on the election of public company boards. This will provide a better protection of their rights and avoid the eventual possibilities for abuses by the majority shareholders for the account of minority shareholders.

Recommendations

Adopt amendments in the legislation, e.g. in the draft of a Law on Securities, regulating the possibility for cumulative voting when electing the public company boards.

Action Line 2.4
Obligatory Offer for Buyout by Majority Shareholders

Background

Where a shareholder buys out a significant share of capital of a public company, he will have the possibility to dominate over the remaining shareholders. Thus, he/she might eventually make benefits for himself/herself in prejudice of the remaining shareholders. Therefore, it is necessary for a shareholder (or a group of related shareholders) acquiring a critically great share of capital (e.g. over 66% or over 75%) of a publicly held company, to be obligated to make an offer for buying out the remaining shares. The share of capital should be determined depending on economic arguments for expediency.

Objectives

Provide for a possibility for shareholders who do not agree with the majority shareholder and do not approve his/her policy for development of the company to liquidate their investment under fair market conditions. Thus, the minority shareholders will have the exit right where the control on the company passes effectively into the hands of a single shareholder or a group of related shareholders. This will provide for a better protection of minority shareholders.

Recommendations

Streamline the adoption of the legislative amendments regulating the obligation of a shareholder who has acquired a share of a public company capital over a specified limit, to duly announce the fact and make an official offer to the remaining shareholders for buying out their shares at a price corresponding to the usual market conditions. Such amendments would be in conformity with the present practice of the EU member countries.

On the other hand, it is desirable to streamline the adoption of a regulation stipulating the “closing” of a public company. Thus, Art. 149 of the draft of the Law on Securities provides for a person who has acquired, either directly or through related persons, over 95 per cent of the votes cast at the publicly held company general meeting, to be entitled to publish a tender offer to the remaining shareholders to acquire their shares against reimbursement. The expediency of decreasing this percentage to 75%, for example, might be discussed with a view of relieving the ownership consolidation process.

Action Line 2.5.
Protection of Minority Shareholders from Dilution of Value of Their Shares

Background

The eventual increase of capital at an issue price which does not correspond to the value of shares might cause damage to minority shareholders through dilution of value of their shareholding. The effective Law on Securities, Stock Exchanges and Investment Companies (Art. 83, c) makes a provision for preventing this possibility by ruling a determined qualified majority for taking decisions for increase of public company capital. This majority equals ¾ of the capital represented, and it is required that the meeting has to be attended by at least ¾ of the capital, or at least ½ of the capital if the meeting is held under the provisions of Art. 227 of the Comercial Law. The quorum requirements are impeding to some extent the possibility for dilution of value of minority shares but do not eliminate it entirely. With the present-day prevailing ownership structure in the Bulgarian publicly held companies and the established practice of convening and holding general meetings, a single or several majority shareholders could make the required quorum comparatively easy.

Objectives

Protection of minority shareholders from dilution of value of their shares. This will ensure better protection of minority shareholders rights, the risk of their investment will be reduced and the confidence in capital market will be increased.

Recommendations

Streamline the adoption of legislative amendments in the sense that the public company shareholders' right to participate pro rata in capital increase cannot be waived (Art. 112 of the draft of the Law on Securities). When taking a decision for capital increase, all shareholders should be duly notified and given a possibility to redeem their rights. Thus, a legal prerequisite is established for preventing unfair actions by majority shareholders.

Further, it is necessary to make a provision in the Comercial Law that in cases where shares of various classes are present, the shareholders' right to participate pro rata in the capital increase is valid for the shareholders of the corresponding class. The remaining shareholders should exercise their privilege after the shareholders of the class of the newly issued shares.

Besides, it is reasonable to, with a view of preventing the possibility for dilution of value of existing shareholders' shares, pass a regulation into the Comercial Law stipulating that it is necessary to pay the difference between the nominal and issue value of the new shares in order to enter the capital increase into the commercial register.

This proposal should concern both the publicly held companies and closed companies.

Action Line 2.6
Providing for Real Possibilities for Shareholders to Attend General Meetings

Background

The effective regulatory enactments do not explicitly regulate the place and time of holding general meetings of shareholders. The result is that they are appointed by the boards. This creates a possibility for the boards to appoint a place and time of holding the general meetings, which impede the attendance of part of shareholders. As a result of such actions the boards may manipulate the resolutions of general meetings. This hypothesis is not valid just in theory. There are occurrences of general meetings held at places where public transportation even is not available.

Objectives

Provide for holding the general meetings of publicly held companies at places of real access for all shareholders. This is to ensure in practice the right of all shareholders to attend the general meetings, make proposals and cast their votes on the agenda resolutions.

Recommendations

The legislative amendments provided for in the draft of the Law on Securities (Art. 115, para 1), regulating the holding of shareholders' general meetings of publicly held company will allow to avoid the irregularities as ascertained above.

Action Line 2.7.
Strengthening the Responsibility of the Audit before Shareholders

Background

The issue of the role and responsibility of the auditors of a publicly held company before its shareholders is both significant and not regulated at the same time. The auditors' reports are the most important source of independent and specific information, and, hence, of evaluation of the company's state. The shareholders elect the auditors with a view of obtaining an independent expertise. At the same time, the responsibility of auditors before the shareholders concerning the audits performed and evaluations presented as well as the guarantees that they are performing their liabilities in due diligence, are insufficiently well regulated. This might result in incomplete or inaccurate information for the shareholders and lead to weak control of shareholders on the boards. Thus, conditions for abuses might be generated. Weak points are ascertained in the performance of individual auditors.

Objectives

Provide for accurate, complete and independent information for the shareholders through the auditing procedure. Thus, corporate governance will be improved as a result of strengthening the shareholders' control on the boards. Transparency of company's activity is the other measure for qualitative and impartial audit.

Recommendations

Creation of adequate regulatory enactments allowing the shareholders to obtain guarantees for performance of auditors' liabilities in due diligence and allowing the shareholders to practically pursue their rights in cases where the auditors are consciously or unconsciously misleading the shareholders. Extending the shareholders' possibilities to control the process of appointing an auditor. With this regard, it should be recommended to structure internal auditors' committees. In their capacity of a group giving assistance to the supervisory boards and boards of directors of the publicly held company, they will boost the shareholders' participation in corporate governance.

Strengthen the role of professional associations in the sphere of audit, and reevaluate, if necessary, the national auditors' standards related to quality and their comparability to international practice.

Action Line 2.8.
Establishing an Institution for Intermediation and Nonjudicial Settlement of Disputes

Background

Transformation of legal and by-law rules into an efficient regulator of relationships depends on the good knowledge and exercise by all interested parties. The unequal treatment of various participants in capital market relative to investment culture and possibilities for making use of qualified legal assistance raises a number of problems related to consummation of rights of different groups of shareholders, stipulated by law:

- minority shareholders are lacking sufficient funds to bring actions before the court and a possibility to make use of qualified legal remedy;
- another real danger is the eventual abuse of rights by professional institutional minority investors that will impede the public company governance.

Objectives

Assist the transformation of legal rules regulating the relations of capital market in well functioning practices. Provide for a possibility for the shareholders through efficient consummation of their rights to perform their role of a corrective agent of corporate governance and control.

Recommendations

Establish an institution for intermediation and nonjudicial settlement of disputes with representatives of all interested parties that should ensure confidentiality, free access, speed, quality and economies of the process.

Action Line 3.

Disclosure of Information and Transparency

The institutional and legal framework of corporate governance and control should guarantee the timely and accurate disclosure of information concerning the ownership structure, governance principles, financial status and operational results from the joint-stock company activity. These issues are significant for the possibility for the shareholders to exercise their rights and taking correct investment decisions, for attracting capital and maintaining the confidence in the capital market.

Action Line 3.1.
Disclosure of Information and Transparency

Background

The effective Comercial Law stipulates that the resolutions of the general meeting of shareholders for amendment and addition of the bylaws should be entered into the commercial register and published with a view of giving rise to a legal act. On the other hand, there is no requirement for deposition of updated bylaws containing all approved amendments and additions into the commercial register after any proper amendment of the bylaws. The Comercial Law provides for specified rules for the balance sheets of companies related to the approval and publication of the annual report in the State Gazette.

Objectives

Guaranteeing and adhering to the principle of transparency not only in the sphere of publicly held companies and securities market but for the common or “close” companies in the sense of the Comercial Law.

Recommendations

Transparency is obtained through adequate regulations for the commercial register functioning and announcing of data by entering into the commercial register. The judicial practice in the country is oriented to the requirement to deposit the updated bylaws into the commercial register after any proper amendment of the company’s bylaws, but this should be ruled on a regulatory level as well. This provides for transparency of the company’s fundamental document, thus eliminating the necessity for the interested persons to achieve alone its actual contents and compare the previous versions with the regulations for amendment and addition adopted by a resolution of the general meeting of shareholders.

With a view of providing for wider transparency, it is reasonable to enter a regulation into the Comercial Law for mandatory submission in the commercial register, upon incorporation of a joint-stock company, of the Memorandum of Association and a list of persons who subscribed shares upon the incorporation, certified by the company’s managing body.

It is necessary to make an amendment in the Comercial Law, requiring that the report certified by a chartered public accountant should be also deposited into the commercial register at the company's registered office. Thus, the report will be accessible to any interested person.

The recommendations concern both the publicly held and "nonpublic", close companies.

Action Line 3.2.
Providing for Observance of Legal Requirements for Disclosure of Information by Publicly Held Companies

Background

The Law on Securities, Stock Exchanges and Investment Companies (Chapter seven) and particularly the draft of the Law on Securities contain formal requirements for disclosure of information by publicly held companies before the Securities and Exchanges Commission and the stock exchange. It is provided that information shall be disclosed in the form of annual reports, six-months reports and reports to be presented in shorter terms in case the Securities and Stock Exchange Commission requires so. In spite of that most of the publicly held companies do not observe these requirements in practice. The necessity and significance of disclosure of information and its timely disseminating to shareholders, potential investors, etc. are still not perceived to a full extent.

The effective legislation does not regulate sufficiently clear and explicitly the scope of information included in the reports' contents. Apart from accounting and financial data, the reports should contain information about the current commercial activity and related risks, about the major shareholders in the company, the members of the managing body, their remuneration, their shareholding in the company capital, the availability of interconnection with other companies running similar activity, etc.

Objectives

Observance of legal requirements for disclosure of information. As a result of that the shareholders and potential investors in the publicly held companies will be granted guaranteed access to credible information about the companies' state. Access will be independent on companies' boards.

Recommendations

With a view of improving the disclosure of information mechanisms, proceed to timely adoption of the bill on securities, stipulating in section 4 the order and method of disclosure of information by publicly held companies, incl. ad hoc information concerning price-level sensitive changes in the company activity. Along these lines, it is recommended to undertake steps for systematizing and publishing an order with detailed conditions for disclosure of ad hoc information with a purpose of preventing the possibilities for price manipulation.

Undertaking specific steps by the Securities and Stock Exchanges Commission, aiming at regular performance of legal obligations for disclosure of information on the part of publicly held companies. These steps should comprise two activities. On the one hand, the administrative means and sanctions for nonsubmission of information according to the requirements or submission after the terms set. At the same time, it is necessary to continue the information and training activity among the boards of publicly held companies about the role and significance of disclosure of information.

The Securities and Stock Exchanges Commission needs to proceed with the steps undertaken in facilitating the access to information by extending its operation with representatives of publicly held companies or with investment intermediaries authorized by the companies.

Of significance is the issue of the responsibility of members of the managing body where the reports contain misinformation, incomplete or misleading information and cause harm to investors and shareholders. Such losses are extremely difficult to be ascertained and proved.

Nongovernmental organizations should cooperate with the state institutions and market participants in undertaking systematic actions for clarifying among publicly held companies and investors the necessity, potential advantages and benefits related to disclosure of information.

Action Line 3.3.
Providing for Access to Information Disclosed

Background

Disclosure of information is exerting disciplining effect on corporate governance provided that the information disclosed is available to investors in a fast, easy and inexpensive way. At present, access to the available information at the Securities and Stock Exchanges Commission and the Bulgarian Stock Exchange, Sofia does not fully meet these requirements. Access is rendered difficult due to a number of reasons:

- information is not unified;
- the most part of information is not submitted on electronic media;
- there are still technical difficulties in using the information because of its incomplete electronic processing;
- the shareholders themselves and the potential investors are not aware of the institutionalized capabilities for access to public information;
- as a whole, the wide public is not informed about the free access to public information.

This has a negative impact on professional institutional investors and has a particularly unfavorable impact on nonprofessional, small investors.

Objectives

Providing for a fast, easy and inexpensive access to information disclosed. This is the only way to make the disclosure of information play its significant role as one of the mechanisms for control on the management and optimum allocation of capital market resources.

Recommendations

The information disclosed should be stored and accessible on electronic media in standard form allowing its processing by standard software products. The Securities and Stock Exchanges Commission should expand the activity of its documentation center and submit the available information on media being suitable for both professional investors and small investors. The Commission should proceed with its efforts for rendering a wide access to the available public information, incl. via Internet. This will guarantee the possibility for the institutional and small investors to follow and be aware of the activity of individual companies. The improved conditions for transparency realization will have a reverse disciplining effect on the companies themselves.

Foster publicly held companies and the major ones, in particular, through proper information and elucidation measures, to maintain in Internet standardized and updated information about their financial results, general meeting resolutions, reports on management, auditors' reports, etc. Thus, the shareholders, potential investors and regulating authorities will have a maximum fast access to public information. The present-day advancement of communications technologies makes a similar approach feasible, convenient and inexpensive both for publicly held companies and information users.

It is reasonable to regulate the information that is considered to be "public". It is very important that the Securities and Stock Exchanges Commission has clear criteria about the information - which of the information gathered by or submitted to it is public; otherwise, the establishment and maintenance of public registers would not be feasible. Analogous liabilities should be put forward to the Bulgarian Stock Exchange, the Central Depository and self-regulating organizations. A compromise version is to recommend a legal obligation for the concerned institutions and organizations to adopt their in-house criteria for transparency of information possessed by them, and render it to the general public. These institutions and organizations should be legally bound to, immediately or within specified short terms, submit the public information possessed by them (either gathered or obtained through the obligatory accountability) to all parties interested.

Undertake information and elucidation measures for using the information by nonprofessional investors with a view of taking adequate decisions by the latter.

Action Line 4.
Responsibilities and Motivation of Boards

The boards of joint-stock companies should be responsible and properly motivated to take the most important strategic decisions in the interest of the company and its shareholders as well as to follow the performance of operational management liabilities.

The practice experienced two examples of bad governance. In the first case, managers manifest behavior of sole owners, and in the other one, the director is closely tied with one of the shareholders only.

Action Line 4.1.
Differentiating and Specifying the Responsibilities of Boards

Background

In case the responsibility is not of a punishable nature, i.e. it is within the framework of the Comercial Law, it should be treated from a point of view of the efficient business management and protection of investors' interests. This aspect of responsibility is underdeveloped in the effective Comercial Law. In accordance with Art. 240, para 2 of the Comercial Law the board members are jointly responsible for damages caused to the company. Besides, it is required that the board members should be obliged to submit a guarantee for their activity amounting to a sum specified by the general meeting, but not less that their 3-month gross remuneration. In practice, this guarantee is a small sum that could not reimburse the eventual damages caused by bad governance. It is necessarily to adopt detailed regulations on managers' responsibility with regard to the efficient business management in the interest of all shareholders.

The Bulgarian legal framework does not regulate in details the fundamental rights and responsibilities of boards (one-tier and two-tier system) with regard to the management of publicly held companies. Corporate governance in the person of Board of Directors or Supervisory and Managing Board is implemented not in its well known Western models. Often the experience and errors are the factors passing through the public companies governance. Lacking are explicit rules and criteria to the individuals participating in corporate governance. There are no explicit regulations with regard to the balance inherent to corporate governance: inside-outside directors. The Bulgarian practice is not familiar with the inside auxiliary groups: committees on remuneration, election, finance, etc. Lacking are well-chosen incentives that are dependent on management contribution to implementation of the target "shareholder's value". The announcement of inside and outside directors' remunerations is belittled.

Objectives

Issue regulations for explicit and specific responsibilities of publicly held companies' management with regard to efficient business management in interest of all shareholders. Thus, the responsibility of members of boards will acquire practical measures, and the degree of shareholders' control on boards will increase, that will bring forth more efficient governance.

Recommendations

Amendment in the Comercial Law regulating specific competence, rights and responsibilities of members of public companies' boards as well as sanctions to be imposed upon their nonobservance. These responsibilities should be mandatory for any member of boards (either representing the company or not) and include at least:

- an obligation to declare an eventual conflict of interests before the other members of boards;
- an obligation not to vote on decisions for deals where conflict of interest might exist;
- an obligation to manage the business with a view of minimizing the loss-of-investors risks.

Streamline the adoption of the bill on securities, that sets forth certain requirements towards the members of boards with regard to disclosure of shareholding and trade with inside information.

Action Line 4.2.
Implementing the Responsibility of Boards

Background

The legal liability of boards is implemented through mechanisms of their liability towards the company and penalties that should be imposed by court upon nonobservance of requirements for announcing certain circumstances to be entered into the commercial register. Provided is administrative liability for the public companies' boards upon nonobservance of certain regulatory requirements, that is realized as a rule by the Securities and Stock Exchanges Commission by means of penalty and compulsory measures.

Objectives

Create an environment of higher requirements to the members of the joint-stock companies' boards and efficient implementation of their legal liability.

Recommendations

Amend the legal framework of possibilities for implementing the boards' liability on the part of the companies. It is necessary to make a clear distinction of legal powers among the individual boards - chief executive officer, Board of Directors, Supervisory Board, General Meeting of Shareholders.

The entire change in the business climate will affect the managers behavior as well. However, the possibilities for pressure on managers on the part of shareholders should not be pushed too far, and the lack of sufficiently trained staff and some shareholders' aptitude for abuses with the rights granted to them should not be neglected. Initially, the decisions should be sought through education and information activity related to the allocation of liabilities in a company.

Action Line 4.3.
Creating Conditions for Better Motivation of Boards and Remuneration Policy

Background

In a number of publicly held companies, a lack of binding of direct results of company's performance with the management remunerations is ascertained. Data evidences of another manifestation of this "unbinding": a number of members of Boards of Directors, Managing and Supervisory Boards do not hold stock in the companies managed by them. There are a number of evidences of unpopularity of the concept "shareholder's value" being inherent to corporate governance. The amount of management remuneration is not disclosed as well. Restricted are the possibilities for control on the part of shareholders.

Objectives

Create an up-to-date system of remuneration of public companies' management, guaranteeing efficient resource utilization being also to shareholders' benefit. Generate conditions for public disclosure and control on remunerations of members of Boards of Directors, Managing and Supervisory Boards.

Recommendations

The associations of interested parties should undertake information and education measures for shareholders' rights to exercise control on directors' remunerations and requirements for public disclosure of their remunerations. Approve the practice of creating remuneration committees at the public company boards.

Action Line 4.4.
Personal Requirements to Boards

Background

The contemporary world practice of corporate governance comprises a system of principal requirements to the qualification, experience and skills of members of public company boards. They are materialized in codes of corporate governance, adopted on national and international level. The established standards are also recommended by the professional associations. The shareholders and managerial market (corporate control market) exercise on the observance of these standards. The Bulgarian business practice suffers from deficiency with regard to the personal requirements to boards. This leads inevitably to diminishing the effect from the boards activity. The shareholders do not have at their disposal clear and exact criteria for evaluating the contribution of individual managers.

Objectives

The increase of corporate governance quality requires high qualification level of the members of company management bodies. Approval of clearly and exactly formulated requirements on the part of shareholders and professional associations towards knowledge, experience and skills of inside and outside directors is part of the line for establishing up-to-date corporate governance. This will allow to restrict the possibilities for incompetent and subjective actions of the public company managers.

Recommendations

The associations of concerned parties as well as the public authorities should foster the formulation of a system of requirements to public company boards. They should be disclosed to shareholders and potential investors through information and elucidation undertakings. Conducting qualification initiatives for company directors. Give an incentive for undertaking an initiative for elaboration and establishment of a corporate governance code including the personal requirements to public company boards.

Action Line 5.

Significance of Judicial System and Improvement of Judicial Practice

The role of judicial system with regard to joint-stock company functioning is mainly displayed on the occasion of entries of circumstances into the commercial register.

Background

A common emerging problem for transitional economies is the lack of an adequate judicial infrastructure for sufficiently efficient settlement of complicated business disputes. The problems of corporate governance make no exception. Entries into court registers, protection of shareholders' rights, management responsibilities are only part of the issues that experience rather contradictory judicial practice.

Objectives

Clear regulation of circumstances subject to entry and exact formulation of the grounds for executing an entry.

Recommendations

The abovemade proposals with regard to the prerequisites for incorporation and entering the joint-stock company incorporation, for increase of its capital, for evaluation of nonmonetary contributions as well as for deposition of documents into the commercial register are related to the issue of precisely outlining the scope of control exercised by the judicial system, and hence, for clarifying its role.

Elaboration by the Ministry of Justice of an ad hoc program of work with the courts on problems related to corporate governance. This plan should focus on problems being of court competence in this field, propose possible solutions of these problems, unify opinions and approaches, consider cases that have really occurred in practice.

Action Line 6.

Significance of Capital Market

Regardless of the type of corporate governance (either market or bank-controlled) the influence and interaction with the capital market is a significant element of corporate governance problems. Capital market is a source of financial resource and important disciplining factor for publicly held companies and, more generally, for corporate governance.

Present is a feedback whose manifestation will be realized in the Bulgarian practice from now on. Good corporate governance and control contributes to the development of capital market and its liquidity.

Action Line 6.1.
Creating Possibilities for Stock Buyout by Potential Investors

Background

Capital market should be one of the important outside mechanisms for efficient corporate governance. It may perform this function if a takeover of a company, i.e. buyout of considerable share holdings with subsequent change of management, is effected through its operation. A similar threat is in force in case of realistic possibilities for its realization. The present framework of tender offer for stock buyout and substitution has proved to be very clumsy and bureaucratic and could not find practical application.

Objectives

Providing a possibility for potential investors to place a tender offer to shareholders of a publicly held company for buying out their shares. This would bring forth a real possibility for substituting inefficient management with a more efficient one upon change of the ownership structure.

Recommendations

Amendments and additions should be made in the existing legal framework, especially in the field of stock tender offer. Adequate mechanisms should be introduced for guaranteeing the real adherence to the requirement laid down in the Law on Securities, Stock Exchanges and Investment Companies, stating that where a person wishes to acquire above 25% (perhaps, it should be amended to 33%) of a public company stock through a series of deals for small shareholding acquisition, such a person should submit a tender offer to all shareholders for buying out their shares at an equal and fair price within a specified period. Thus, the importance of forms for protection of shareholders will be perceived, which will contribute to the entire improvement of shareholders' and investors' capability to make use of the existing mechanisms of corporate governance.

Action Line 6.2.
Establishing a Regulatory Framework for Capital Market - Corporate Governance Interaction

Background

The significance of capital market for improving the corporate governance style is also manifested through deep concern about investors' interest. The effective enforcement of the lawful forms of investors' protection granted also by means of investment intermediaries requirements, will contribute to the entire improvement of shareholders' and investors' capability to make use of the existing mechanisms of corporate governance.

Objectives

Guarantee by law the possibility for interaction and introduction of contemporary corporate governance standards into the Bulgarian practice.

Recommendations

Streamline the adoption of the bill on securities.

Action Line 6.3.
Elucidating the Significance of Capital Market for Efficient Functioning of Publicly Held Companies

Background

The main problems are mostly related to the necessity of carrying out elucidating activity among the companies with regard to benefits from wider transparency relating to capital market trade.

Objectives

Boost the efforts for information dissemination and other levers (education, discussions) among shareholders and public company boards.

Recommendations

Achieve a wider scope and better coordination of proper activities that are implemented by the Securities and Stock Exchanges Commission, the Bulgarian Stock Exchange, Sofia, the Bulgarian Association of Licensed Investment Intermediaries, other nongovernmental organizations and foreign donors.

Action Line 7.

Management of Residual Share of State Ownership and Conduct of State in its Capacity of a Shareholder

The problems of management and control of the stock companies after the privatization process is completed in the main concern the state participation as well. The future role of state will depend on the volume of the residual state share and its strategic intentions about its management, determined on the basis of economic efficiency and rationality. One of the core objectives of transition is to re-formulate the role of state in economy (regulator instead of owner).

Action Line 7.1.
Liquidating State Participation to a Maximum Extent

Background

The dual capacity of the state as a regulator of economy and shareholder in private companies at the same time is inevitably generating internal conflicts and often leads to useless politicizing of purely economic problems. This might result and does often result in low efficiency and decisions determined by noneconomic factors.

Participation of public servants in company governing bodies will be diminished but their presence for the time being tends to exert a dominating and, sometimes, unsuitable influence on managers.

Objectives

Relieve the state, as soon as possible and at a maximum extent, from its participation as a shareholder in state ownership that is subject to privatization. This is particularly valid for companies where the ownership is mixed and the state participates in the capital jointly with private shareholders.

Recommendations

Implement such a privatization program that will make the state relieve from its participation as a shareholder, especially for companies where it participates jointly with other private shareholders. Limit the role of the state as an owner even in the industries of natural monopolies. Given the present stage of privatization process development and comparatively weak investment interest, the eventual low revenues from such a program should not be used an a counter-argument for its implementation.

Action Line 7.2.
Clear Regulation of State Policy With Regard to State Participation in Stock Companies

Background

Regardless of the implementation of a large-scale privatization program, a certain state participation in stock companies will inevitably remain. However, the present-day state policy with regard to its participation as a shareholder is not clearly regulated. The existing regulatory framework is out-of-date and does not include the substantial changes that have occurred in the structure of the state enterprise ownership. The various ministries being state ownership principals are not at one with each other and do not take consistent action. This leads to subjective attitude and subjective actions towards the problems related to enterprise governance. Important decisions, such as election of boards, amendments in bylaws, management of long-term assets, are often left to a purely subjective evaluation which deteriorates the corporate governance quality and makes harm to the other shareholders.

Objectives

Formulation and consistent implementation of a common state policy with regard to the conduct of state as a shareholder.

Recommendations

Elaboration and adoption of a regulatory document (e.g. Decree of the Council of Ministers or amendments in Decree No. 7 of the Council of Ministers, whose regulations should extend their application to enterprises of less that 100 per cent state ownership), that should clearly outline the policy of state in its capacity of a shareholder. The rules for economic management of state shares in enterprises should be reasonably balanced between the interests of the state as an owner and the interests of enterprise managers. Take into account the role of private shareholders and differentiate the conduct of state depending on whether it is a majority or minority shareholder.

The state should preserve its role of an owner in strategic enterprises, incl. a holder of the so-called “gold share”, that would enable it to cast a veto on each resolution of the boards. This mechanism is much more flexible as a control instrument than the long-term preservation of state majority participation. It is also preferred because of the possibility for exact and clear definition of the mechanism scope and duration.

Action Line 7.3.
Equal Treatment of State in Its Capacity of a Shareholder

Background

With a view of its particular status, the state is capable of enforcing interpretations and changing regulatory enactments, thus being in a dominating position towards the other shareholders which violates the fundamental principle of shareholding, i.e. the equal treatment of shareholders. One example is the interpretation of company liabilities to its shareholders. This is the case of dividend payment. If a company suffers difficulties with regard to its liquidity, thus delaying the dividend payment, the state (in the person of tax administration) interprets the dividend due to it as state takings. Such an interpretation guarantees a priority of the dividend being due to the state over the dividend being due to the other shareholders. The result is that the burden of eventual difficulties of the enterprise will be borne by certain shareholders (private) for the account of other shareholders (the state).

Objectives

Provide for such a regulatory framework and its interpretation that would allow to treat the state in its capacity of a shareholder (and not of a regulator) without preferences, on an equal level with the other shareholders with all ensuing rights and liabilities.

Recommendations

Comprehensive review, amendments and additions in the regulatory framework.

Action Line 7.4.
Providing for Fresh Resources for Restructuring the Companies

Background

The present way of state ownership management does not allow the state to invest in the enterprises. At the same time, the nowadays need of restructuring the real sector is very acute, and it will inevitably be existing in the future. Given the limited access to credit granting, the capital increase is in practice the only possible means of raising fresh resources. However, it meets with resistance on the part of the state due to the drop of state participation share. As a rule, such decisions are taken with great difficulties and serious administrative obstacles on the part of related ministries.

Objectives

Facilitate the possibility for inflow of fresh resources to the companies.

Recommendations

In conducting a streamlined privatization program, the state should perceive the companies' capital increase as a sufficiently good alternative to privatization of the residual state share.

Action Line 7.5.
Activating the Participation of State Authorities Representatives in Enterprise Restructuring and Introducing the Principles of Contemporary Corporate Governance

Background

At the present stage of the structural reform in Bulgaria and with a view of the specific nature of post-privatization state of enterprises (especially those with mixed ownership), a certain tendency is observed towards underestimation of the significance of good corporate governance for active restructuring of privatized enterprises on the part of branch ministries representatives.

Objectives

Maintain the strategic interest of the state to gradually introduce the internationally recognized standards of corporate governance in Bulgaria.

Recommendations

Increase the requirements and provide for incentives for state authorities representatives to harmonize the Bulgarian practice with the best world achievements.

Action Line 8.

Nonregulatory Mechanisms for Improving Corporate Governance

Background

The problems of corporate governance cannot be solved only on the basis of improving the regulatory framework. Even in countries with highly developed corporate governance and highly developed capital markets supported by well elaborated legislation and long-time practice, some of the problems of corporate governance are solved not by law. This is effected by means of social rules - professional, moral, ethical, etc., which, along with the regulatory framework, create the common environment for conduct of shareholders, creditors and managers of a company and other interested persons.

Objectives

Improve corporate governance by energetic action of nongovernmental organizations and professional associations of shareholders and managers.

Recommendations

Organizations supporting the present initiative (among them are the Union of Investors, the Association of Securities Holders, the Association of Industrial Capital, the Bulgarian Stock Exchange, Sofia, the Securities and Stock Exchanges Commission, etc.) should, either jointly or separately, carry out proper campaigns among their members on elucidating the problems of corporate governance and methods of their solution. Such campaigns might include publishing and dissemination of proper materials, organizing of series of seminars, etc.

Elaboration and adoption by business associations of “codes of conduct”, rules and procedures related to corporate governance.

Dissemination of information on successful practical initiatives on a joint-stock company level.