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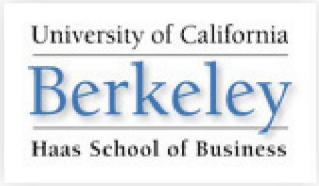

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I. Corporate Governance in Macedonia – micro and macro analysis

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Abstract:

The corporate governance issue in Macedonian companies has been brought forward during the recent few years. The main reason is the fact that the privatization process completion of socially-owned and partly state-owned enterprises has put emphasis to the challenge to reasonably regulate relationships established within companies on one hand, and relationships between companies and larger society on the other. All market economies, including those with longest tradition, have faced this kind of challenge so far.

Corporate governance becomes an increasingly important issue for the Macedonian economy. It is being taken with greater consideration by the companies, regulators and government. The strong wave of privatization programs from mid-90' have resulted in an altered business environment, and new legal and institutional frameworks have been established. Indeed, corporate governance contributes to sustainable economic development by enhancing the performance of companies and increasing their access to external sources of capital.

In this paper we will make attempt to analyze the predominant factors that create prolific corporate governance environment in two terms; a) micro level and macro level.

JEL Classifications: G30, G32, G38; L33; O11; P31

Keywords: governance, corporate governance, management strategy, transition, Southeast Europe, Macedonia

Acknowledgements: I would like to thank Prof. Nicola Bellini for the continuous support, as well as, the PhD Program in Management and MAIN Lab of Scuola Superiore Sant'Anna, Pisa, Italy

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Introduction

This paper is concerned with corporate governance and enterprise restructuring through a measure of management's capabilities to act in the best interest of shareholders, as well as, the mechanisms that trigger managerial behavior needed to augment the wealth of the enterprise i.e. the stewardship and enterprise dimensions. The specific characteristics of the economies in transition give research ground for different models analyzing the effects of governance and organizational capabilities for restructuring. The economy of Macedonia has been characterized by high level of changes in the ownership structure and business environment turbulence. There are studies that specifically analyze the changes in the ownership structure and business environment turbulence, which will be used in this article (Hoskisson, Eden, Lau, & Wright, 2000; Uhlenbruck & Castro, 1998).

The already established transition economic theory gives evidence that the privatization of formerly state-owned companies is not fallowed with performance improvements as default guarantee (Megginson & Netter, 2001). Further, the literature suggests that it is needed replacement of the management and introduction of several governance mechanisms, if wanted grater performance of newly privatized enterprises (Cuervo & Villalonga, 2000). Indeed, the studies analyzing governance and enterprise restructuring in transition economies suggest that evolving corporate governance is crucial for the outcome of firm restructuring (Djankov & Murrell, 2002; Filatotchev, Buck, & Zhukov, 2000). Thus, it is evident that different methods of privatization (management-employee buyouts, gave-aways, tying to strategic foreign investors, etc.) require different governance.

Due to the nature of the transition process these markets have different settings and attributes when compared to developed national economies (Hoskisson, Johnson, Yiu, & Wan, 2006). The learning process of the corporate governance in post-communist economies is characterized by the need of developing the monitoring systems, as well as, tuning managers to respect and satisfy the needs of the shareholders (Filatotchev, Hoskisson, Buck, & Wright, 1996), which is creating new 'rules of the game'(North, 1990; North, 1994). Hence, the weight of transformation and enterprise restructuring falls on the quality of managers and their capabilities to learn the new rules of the game (Lyles & Salk, 1996; Steensma & Lyles, 2000).

The research hypotheses are:

1st Hypothesis i.e. Micro Level: domestic versus foreign owners, companies are driven by foreign owners;
2nd Hypothesis i.e. Macro Level: governance and enterprise restructuring is influenced by gross domestic product and foreign direct investments dynamics.

Theoretical and literature framework

1. The transition economy literature

The planned economies' management based on the principles of theoretical ground of the political ideology at that time when national economies were characterized by state-owned property inducing acute inefficiencies of firms, thus also on overall macro level (Kornai, 1992). This resulted with incapability to increase efficiency of the firms and make their products competitive in regional and international business environment (Sachs, Warner, Åslund, & Fischer, 1995). The process of privatization was imposed as to introduce sociopolitical change and improve macroeconomic benefits, as well as, 'restart' the state-owned companies by imposing market managerial mechanisms (Megginson & Netter, 2001) .

There has been variation of different modes of privatization that were imposed while restructuring from planned to functional market economies, and there is sufficient literature bases that suggest different mode of privatization lead to different governance outcomes (EBRD, 1994-2009; Estrin & Wright, 1999; Wright, Hoskisson, Busenitz, & Dial, 2000)

2. Problems of governance in transition economies

There are studies that link enterprise restructuring with governance features, such as board attributes and ownership structure (for example, (Bergh, 1995; Bethel & Liebeskind, 1993; Djankov & Murrell, 2002; Johnson, Hoskisson, & Hitt, 1993). The specificities of each separate country contribute to explanations of enterprise restructuring, such as development of market

institutions, government involvement, ownership patterns, industry structures and enforcement of business laws (Chang & Hong, 2000; La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1998; North, 1994). During the restructuring phase important hybrid organizational forms took place i.e. so-called 'recombinant properties', which represent recombination of property, thus distorting the boundary between public and private ownership (Peng & Heath, 1996; Spicer, McDermott, & Kogut, 2000; Stark, 1996). The variations in enterprise restructuring outcomes could be caused by managerial opportunisms which are not controlled by the owners; hence this is likely to be a consequence of board composition, legal enforcement (the lack of it) and weak capital market (Filatotchev et al., 2000; Wright, Buck, & Filatotchev). Thus, the governance problems most often are caused by inadequate monitoring of managers or because they have acquired too much ownership due bending the transition process (Morck, Shleifer, & Vishny; Newman, 2000; Whitley & Czaban, 1998) .

3. Apprenticing and competences

One of the most important problems that transition economies are faced with is the lack of capital and new ways of acquiring finances, moreover because the capital markets are not well developed and there is no sufficient protection to foreign and minority investors (EBRD, 1994-2009). Consequently, the enterprise restructuring in all its organizational characteristics turns around learning and fortification of market competencies (Lyles & Salk, 1996; Uhlenbruck, Meyer, & Hitt, 2003).

The 'ability to change' as a function of firm's resources is essential to enterprise restructuring (Barker Iii & Duhaime, 1997), especially in an environment where they have very limited absorptive capacity i.e. the ability 'to recognize the value of new information, assimilate it, and apply it to commercial ends' (Cohen & Levinthal, 1990). This is quite vital as it provides firms with strategic flexibility to assume good positions in constantly changing and turbulent transition environment (Puffer, McCarthy, & Peterson, 2001).

Indeed, the absorptive capacity and the ability to adopt and further build competitive capacities depends on prior knowledge, which in transition economies is estimated to be significantly low (Newman, 2000)

4. Governance and upgrade of competences

The constrains that inflict enterprise restructuring are usually lack of effective governance mechanisms, as well as, managerial inability to adopt to changes (Mahoney, 1995). However, it is evident that managerial abilities may get better due time, but these improvements are usually lagging behind the pace of change in the business environment. Thus, effective corporate governance can influence managers to improve and increase the overall strategic flexibility of the firm towards undertaking the necessary restructuring (Hitt, Ireland, & Hoskisson, 2009; Hoskisson, Johnson, & Moesel, 1994; Johnson, 1996).

In the analytical framework used by Filatotchev, Wright, Hoskisson et al. there are two basic dimensions of governance modes: insider and outsider governance modes (Filatotchev, Wright, Uhlenbruck, Tihanyi, & Hoskisson, 2003).

The insider governance mode is characterized by governance mechanisms imposed by dominant ownership management and employees and outsider governance mode is associated to dominance of ownership from investors outside of the firm (mainly foreign investors)(Hitt et al., 2009; Hoskisson et al., 2000; Puffer et al., 2001). The other two dimensions are low or high absorptive capacity that indicate the capability of the firm to upgrade its competences due time and competitive pressures (Filatotchev et al., 2003) :

Figure I.1 Corporate governance and learning capacity

	Insider governance	Outsider governance
Learning—low absorptive capacity	**Quadrant 1: Stuck privatization** *Organizational characteristics:* • Managerial incentives reduced in absence of purchase • Low managerial turnover • Resistance to outside board members • Entrenchment of traditional networks • Low learning and weak governance *Strategic outcomes:* • Likelihood of low corporate restructuring effectiveness	**Quadrant 2: Privatization to domestic institutions** *Organizational characteristics:* • Managerial incentives but poor wealth diversification lead to low risk behavior • Monitoring by outside investors • Limited access to outside networks • Important role of bank-led financial-industrial groups producing financial reallocation but also private appropriation • Ambiguous efficiency of governance, may be traded off for low learning *Strategic outcomes:* • Likelihood of moderate corporate restructuring effectiveness
Learning—high absorptive capacity	**Quadrant 3: Privatization buy-outs** *Organizational characteristics:* • Managerial incentives • Passive monitoring by financiers • Limited access to outside networks • High learning is traded off for weak governance *Strategic outcomes:* • Likelihood of moderate corporate restructuring effectiveness	**Quadrant 4: Privatization to foreign investors** *Organizational characteristics:* • Effective boards • Managerial turnover • Break-out from traditional networks • High learning complements high efficiency governance *Strategic outcomes:* • Likelihood of high corporate restructuring effectiveness

Analytical Framework

1. Sample selection and Data

The first assumption will be analyzed on the bases of a survey on shareholders in Macedonia, with an emphasis on their rights (the level of acknowledgement of their rights, the level and manner of practicing of their rights, their involvement in the company's decision making), conducted by USAID/Business Environment Activity (BEA)[1] .

Since there has been a major development of the capital market in Macedonia, increase of the knowledge of investors and the broader public, this survey is a more comprehensive research and provides a more general picture of the shareholders' structure, with an emphasis on (the level of) incorporation of good Corporate Governance practices in the companies, especially the Joint Stock Companies. The principal players are the shareholders, management and the board of directors.

The second estimation is based on data provided by the data bases of the European Bank for Reconstruction and Development (EBRD) Transition report series (EBRD, 1994-2009), the World Bank Database[2] and the National Bank of the Republic of Macedonia[3] and Macedonian Stock Exchange[4]. The indicator of GDP is measuring growth in real GDP (in per cent) for the time period of 1989 to 2009 (with exceptions for the years where data was not available, which is minor) and the indicator of FDI's is measuring foreign direct investment as net inflows recorded in the balance of payments.

[1] USAID/Business Environment Activity (BEA). Available at :[http://www.bea.org.mk/]
[2] World Bank Database, Available at: [http://data.worldbank.org/]
[3] National Bank of the Republic of Macedonia. Available at: [http://www.nbrm.gov.mk/]
[4] Macedonian Stock Exchange. Available at: [http://www.mse.org.mk/]

2. Model and Econometrics

a) First hypothesis analytical framework

The first hypothesis is that companies are driven by foreign owners which puts domestic versus foreign owners, and it is tightly connected with the second hypothesis. In order to get good results and more complete research, this first hypothesis is analyzed qualitatively. Thus, the approach taken is concerned with the micro level of Macedonian economy i.e. examination on the origin of dominant owners and the impact each category has to directing the firm structure therefore giving favorable outcomes.

b) Second hypothesis analytical framework

The econometric model (Freedman, 2005) that is used for the second hypothesis is a regression model where we have estimated the fallowing equation:

$$\gamma i = \beta_o + \beta_1 x_{1i} + ... + \beta_p x_{pi} + \varepsilon_i \quad \textbf{(1)}$$

$$i = 1,...n \quad \textbf{(2)}$$

Thus, applied to our research this model has the fallowing shape:

$$GOV_{i,t} = \beta_o + \beta_1 GDP_{i,t} + \beta_2 FDI_{i,t} + \varepsilon_{i,t} \textbf{(4)}$$

- where the ***dependent variable***, $GOV_{i,t}$, shows governance and enterprise restructuring;
- the ***independent variables***, are as follows :
    1. $GDP_{i,t}$ gross domestic product;
    2. $FDI_{i,t}$ foreign direct investments;
- β is a p-dimensional ***parameter vector*** ;

ε is the ***error term*** or *noise.*

Results and Effects

1. Results on the first hypothesis i.e. Micro Level

The numbers taken from the IFC's Corporate Governance Manual for Macedonian companies and the survey of USAID/Business Environment Activity (BEA)[5] are valid until 2008 and were retrieved from the Central Depositary[6]. The number of Joint Stock Companies at that time was 577, with total number of shareholders 174 870. Thus, largest type of holders is the domestic individuals (95.64%), followed by domestic legal entities (2.43%). The foreign individuals form a group of 1.43% and the smallest is the group of foreign legal entities with 0.45% of shares in the Macedonian joint stock companies (IFC, 2008).

On the other hand, if we observe the number of shares that are owned by various types of owners we get completely different picture, which confirms the first hypothesis in this study. Hence, *more than half* (56.68%) of the shares in the Macedonian joint stock companies are owned by the foreign legal entities. This group is followed by domestic legal entities which own 34.23% of all shares in the country, and at the end there are domestic and foreign individual owners who hold in total less than 10% of the shares in the Macedonian joint stock companies (IFC, 2008).

These values are well portrayed in the figures below, where it is found evidence for the first hypothesis i.e. most of the valuable and important Macedonian joint stock companies, that in essence form the Macedonian economy, are indeed driven by foreign owners.

The fact that *more than half* of the shares in the Macedonian joint stock companies are owned by foreign legal entities is connected to the movements in foreign direct investment and thus to the second hypothesis. Furthermore, it is evidence of dispersion of shareholding by domestic owners against concentration of control of foreign entities. This also shows that most of the enterprise restructuring, learning and apprenticing of new capacities and capabilities, hence improving corporate governance and governance of the economy in general, comes from foreign input.

[5] USAID/Business Environment Activity (BEA). Available at :[http://www.bea.org.mk/]
[6] Central Depositary [http://www.cdhv.org.mk/]

Figure I.2 Percentage of shares by type of holder

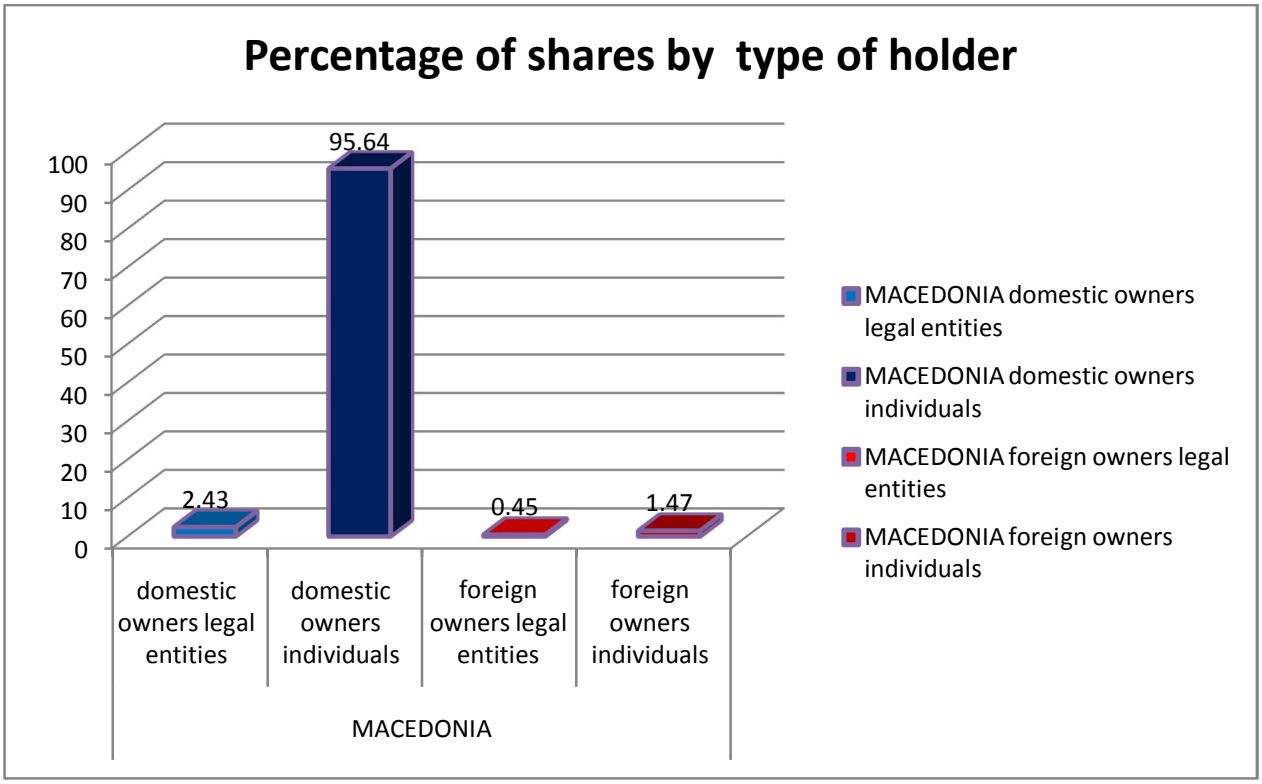
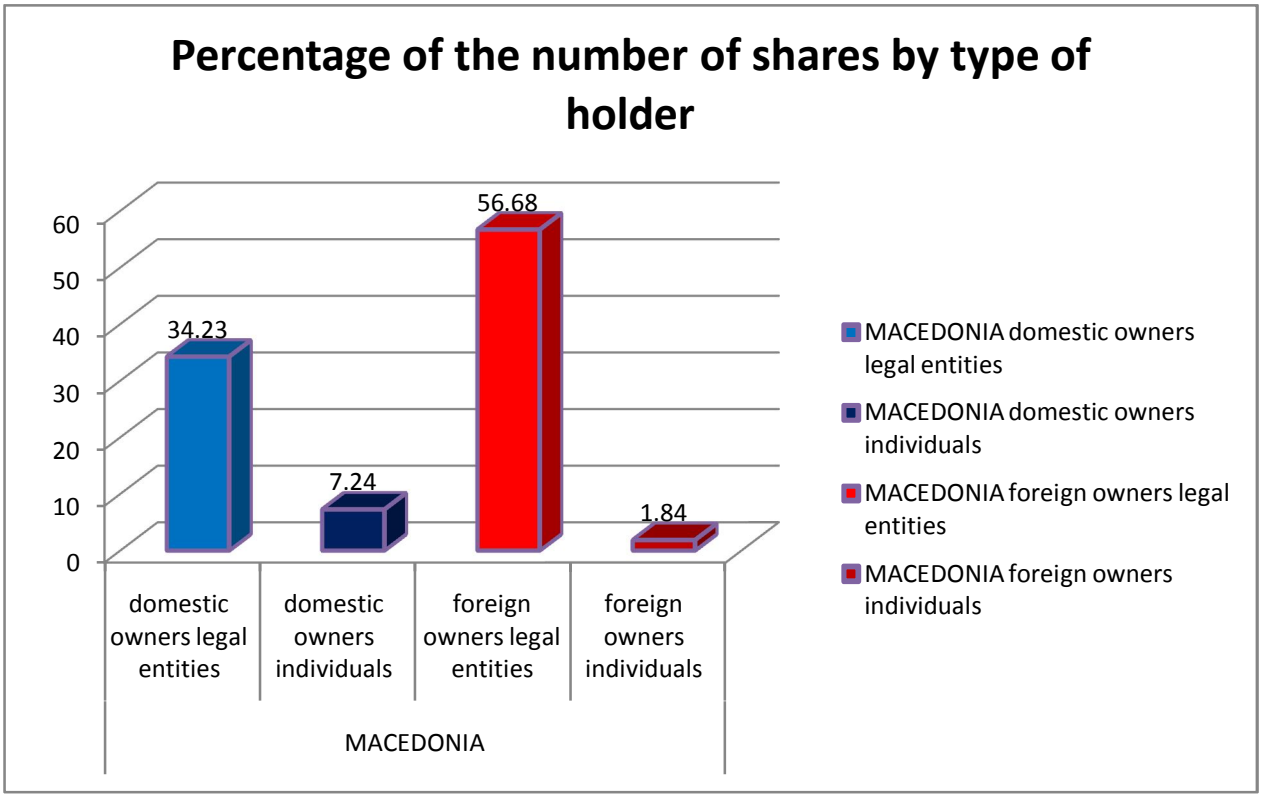


Figure I.3 Percentage of the number of shares by type of holder



2. Results on the second hypothesis i.e. Macro Level

The results on the second hypothesis are shown in the tables below. The second hypothesis assumes that governance and enterprise restructuring is influenced by gross domestic product and foreign direct investments dynamics. Further, the study produced correlation matrix and OLS regression analysis results.

Figure I.4 Correlation Matrix on GOV for GDP and FDI – Macedonia

	GOV	GDP	FDI
GOV	1		
GDP	0.8327	1	
FDI	0.6936	0.4835	1

Figure I.5 OLS on GOV for GDP and FDI – Macedonia

OLS	***Dependent Variable*** **Governance and enterprise restructuring**
Independent Variable	**Macedonia**
GDP	0.0741883
	[0.0140246]***
FDI	0.0010187
	[0.0003291]***
Constant	1.859174
	[0.0845265]***
Observations	63
R-squared	0.8039
Adjusted R-squared	0.7808
Time period	1989-2009
Standard errors are in parentheses.	
Significance Level:	*** p < 0.01 ** p < 0.05 * p < 0.1

The OLS analysis is rather basic and it has the purpose to indicate and support the first hypothesis. The results of the OLS regression explaining the link between GOV and GDP, FDI are given in the figures describe the relationships and movements between these variables.

The GDP results are significant for both GDP and FDI ($p < 0.01$). It is clear from the figures that governance and enterprise restructuring is positively influenced by gross domestic product and especially foreign direct investments dynamics.

However, it must be said that deeper econometric analysis might bring different light to the way separate segments of these variables contribute to governance and enterprise restructuring. Hence, the business aspect of analysis introduced to this paper gives rather satisfactory picture of the positive impact that foreign investments give to the business environment, as well as, their dominance in ownership shareholding which eventually impacts the process of learning, capabilities building and apprenticing from foreign boards and investors.

Figure I.6 GDP in GOV – Macedonia

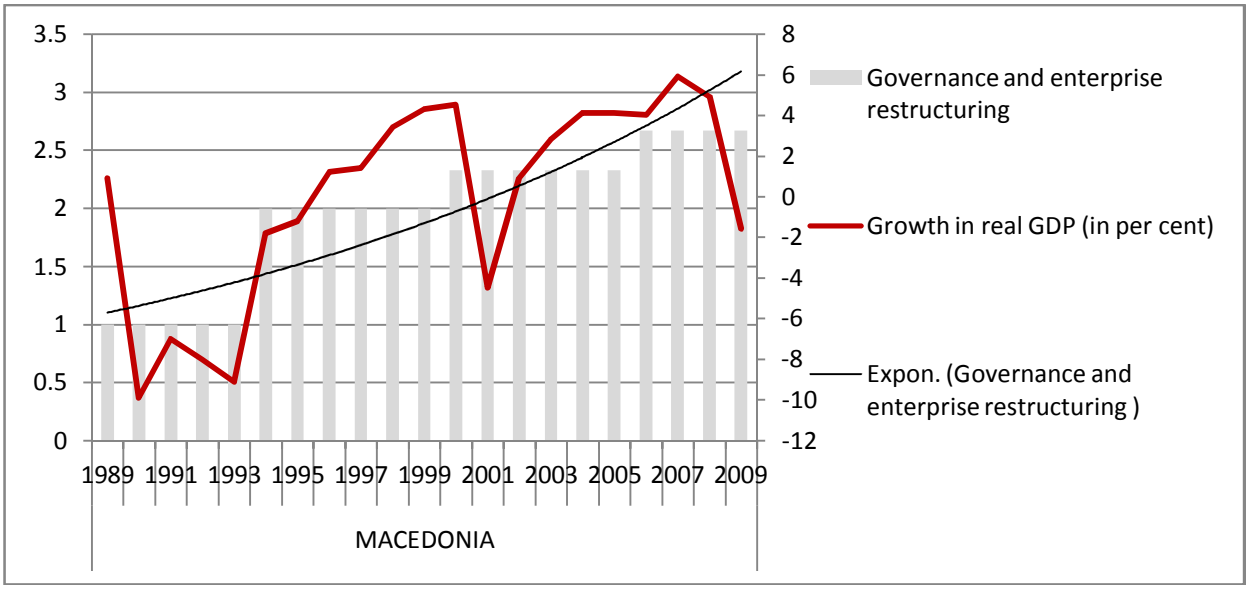
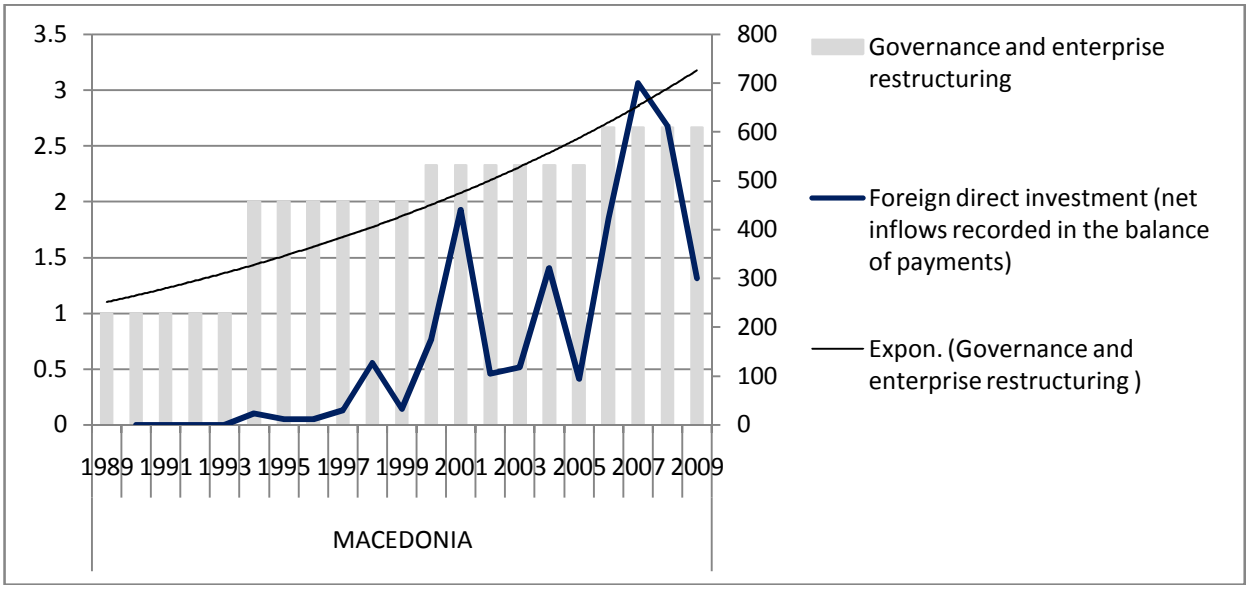


Figure I.7 FDI in GOV – Macedonia



Discussion

The first analysis gave results that more than half of the shares in the Macedonian joint stock companies are controlled by the foreign legal entities. The analysis of the second hypothesis showed to be significant for foreign direct investments. Hence, it can be said that the ownership structure is connected to the movements in foreign direct investment and thus to the second hypothesis. This also confirms the premise that domestic ownership is dispersed and the control is given to foreign entities, where the influx of new capacities and capabilities pushed by foreign ownership increases the learning and apprenticing process of the firm.

The basic examination of foreign direct investment variable, gross domestic product variable and governance and enterprise restructuring variable indicates that governance and enterprise restructuring is positively influenced by gross domestic product and especially foreign direct investments dynamics.

The format of study and the business aspect of the research give acceptable results of the impact that foreign investment to the business environment, as well as, the dominance of ownership shareholding which eventually impacts the process of learning, capabilities building and apprenticing from foreign boards and investors.

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