

CONCEPTS AND MODELS OF CORPORATE GOVERNANCE: THE CASE OF UKRAINE

The success of the various countries can often be linked to the type of privatization that was followed to take businesses from state-owned enterprises to joint stock companies to public companies (*Djankov S., G. Pohl, 1996*), (*Carlin W., M. Landesmann, 1997*).

In general there are three types of privatization process: the first one is a mass privatization model, state-owned assets being distributed free of charge to the general public through vouchers that can be traded for ownership shares in state-owned firms (*Earle J., A. Telegdy, 1998*). This model is sometimes referred to as the voucher privatization method and was used in the Czech Republic and Russia (*Barberis N., M. Boycko, A. Shleifer, N. Tsukanova, 1996*). The second model allowed management and employees buying company assets. This method was the method adopted in Poland. The third model, and arguably the one which produced the most successful result, involved selling majority control to an outside investor (*La Porta, Rafael, Florencio Lopez-de-Silanes, Andrei Shleifer and Robert W. Vishny, 2000*). This third model was followed in Hungary and also in Estonia. As *Christine Mallin (2004)* suggests that the method of privatization has tended to have more of an immediate impact on the development of corporate governance than the legal framework in these countries.

From this perspective, Ukraine is a unique country to research. All three methods of privatization were used in Ukraine step by step. The first was the method which allowed management and employees to buy company shares (1992-1995). The second was the voucher privatization (1995-1999). The third method was that of selling shares to outside investors (1999-recently). Let us consider how corporate governance changed during each method of privatization.

Privatization methods and corporate governance concepts

Corporate governance practices in Ukraine underwent many changes during the process of privatization that took place during the last ten

years. The process of privatization can be divided into several stages, two of which were over by 1999.

At the same time the process of deregulation of major industries of Ukrainian economy was initiated. This concerned metallurgy, chemical industry and others. The state wanted to give the levers of governance into the hands of private (individual or institutional) owners.

In the first stage, privatization in Ukraine was very liberal. By a liberal feature of privatization is meant that those companies that wanted to be privatized were privatized. So, the first stage was given over to the will and intentions of Ukrainian companies. To support efforts of participants of management and employees in privatizing companies, the state authorities introduced the law "On Enterprises". According to this law, some important characteristics of corporate governance system were introduced.

First, the dual board structure was imposed. The same board structure is applied in most European countries. Thus, all joint-stock companies with more than 50 shareholders should establish the supervisory and management boards. The supervisory board is responsible for monitoring executives, advising executives and representing the interests of shareholders to various groups of stakeholders. The management board is responsible for executing decisions made by shareholders at the annual general meeting, and supervisory board. Second, the continental model of supervisory board was introduced. According to this model, used in continental Europe, the supervisory board performs rather a function of a controller, than a function of a strategist. Thus, shareholders of the companies in Ukraine wanted supervisory boards rather to control the activity of the management board than to develop strategy for the company.

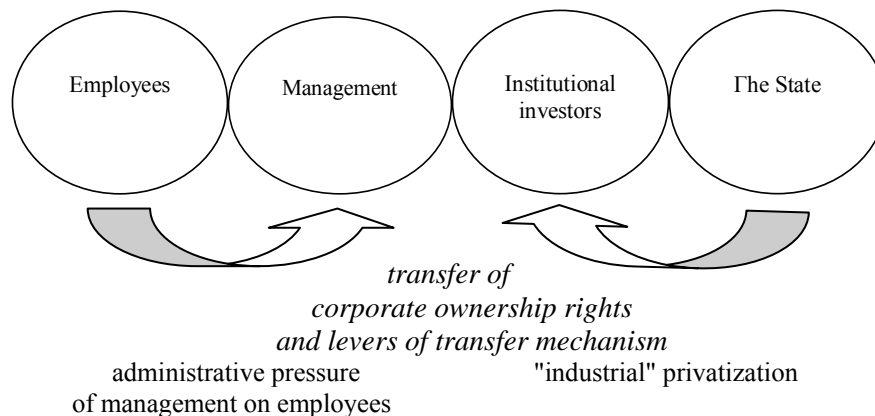
Third, regarding the ownership structure model, the first stage of privatization initiated development of the insider model, popular in Europe. According to this model, the only owners of the companies are the management and employees. They are inside the company.

Fourth, the market regulators wanted Ukrainian open joint-stock companies to follow the monistic concept of corporate governance. According to this concept, the company behaves in the interests the shareholders. Shareholders consider the companies they own only as instruments to create wealth. Interests of stakeholders such as financial institutions, banks, and government agencies are secondary.

In the first stage of privatization, the State wanted employees of Ukrainian companies to decide whether to privatize their companies or not. Regrettably, lack of effective audit firms, capable of estimating companies' values (par value, book and market values) greatly distorted actual "investment" value of companies, and many of them were bought by employees and management at very low cost. At the same time, the

and 69 percent in 2001. But the share of employees had dropped down from 62 percent to 54 percent. At the same time the share of institutional shareholders increased from 10 percent in 1998 to 19 percent in 2001. The shares of the state and small individual outside shareholders had decreased.

As a result, two mechanisms of transferring ownership rights were developed in the third stage of privatization. The first method is administrative pressure used by management of companies to deprive employees of the shares they own and sell the shares to management. The second is the privatization itself, i.e. share auctions, used by the state to sell shares to institutional shareholders.



Source: *Kostyuk (2003)*

Fig.1.3. *A mechanism of concentration of corporate ownership structure in Ukraine during 1999-2001*

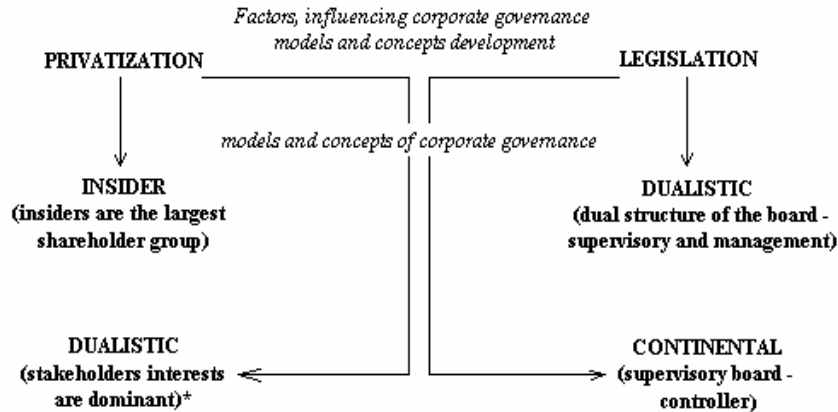
As *Kostyuk (2003)* concluded that an increase of the role of institutional shareholders in corporate governance in Ukraine during the third stage of privatization had led to the transformation of models and concepts of corporate governance.

Privatization process, corporate law and governance

Regrettably, the process of privatization was not reinforced by appropriate changes in legislation. The draft of the law "On Joint-Stock Companies" is still in parliament under consideration. The draft was written three years ago. Parliamentarians are not quick to approve the law because they are concerned about the lobbying interests of large institutional and individual shareholders. According to the draft, the

law would effectively protect the interests of minority shareholders, especially employees and minority individual outsiders.

The Code of Best Practices, developed by the IFC in Ukraine and introduced to the general public in June 2003, is still more a paper document than a contributor to the development of the best corporate governance practices. The Ukrainian parliament, stock exchanges, the State Commission on Securities and Stock Market, Ukrainian joint stock companies have not utilized the Code in whole or in part to develop statements and other documents in the field of corporate governance.



* stakeholders are considered as shareholders and asset management firms)

Fig. 1.4. *Models and concepts of corporate governance, developed at the third staged of privatization - industrial method*

The stock market, as an external mechanism of corporate governance, is still not made much use of by Ukrainian joint stock companies. There are about 35,000 joint stock companies in Ukraine, but only about 2,000 of them have listed their shares at the stock exchanges. As a result, the book value of companies is lower than market value, i.e. companies are undervalued. This is an excellent opportunity for large institutional investors to dominate at the stock market and use opaque procedures to buy the rest of the state property. This is an excellent ground for growing a speculative motive of investors. Thus, the market of Ukraine needs more transparency and knowledge on functioning the mechanisms of corporate governance, especially internal, to establish a good base for developing good corporate governance.