

Convergence of Corporate Governance Principles Slovenia and European Union

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Abstract. Article shows, how the non-binding principles of corporate governance follow and support the state regulations and realize the convergence of the corporate governance in the European Union. It analyses the nature of soft law in the Republic of Slovenia and the history of the development of corporate governance principles in comparison with the development of this field in the European Union. Some recent researches are presented, which show the applicability of the “comply and explain” principle in Slovenian practice and the convergence of the approach on the level of the State and European Union.

Keywords: corporate governance, convergence, code

1. Introduction

The intellectual challenge of corporate governance is finding the right mix of instruments, answering whether and to what degree mandatory of fallback law is needed and if it is needed, what the role of the European Union should be. (Hopt 2010, 8)

Formal legislation, a series of unformal guidelines, recommendations, codes and standards of corporate governance try to determine good governance and prevent potentially self-interested managers from engaging in activities detrimental to the welfare of shareholders and stakeholders. (ECGI Research, 2015)

Article uses the historical method and shows the creation and the development of the soft law on the field of the corporate governance in the Republic of Slovenia (SI) as a civil law country. Soft law has been supplementing the laws in SI since 2004. It is providing a basic orientation, how to enforce the state regulations in practice. Article is structured so, that the introduction is followed by the explanation of the concept of the good corporate governance and the nature of the soft law, within the SI as a traditionally civil law country. Further chapters analyze the supplementing role of the CG codes, by showing the historical development of the CG Codes in SI and their orientation towards the European Union (EU) regulations and Organization for the Economic Cooperation and Development (OECD) principles of good corporate governance. The application of the “comply and/or explain” principles in practice is showed by presenting some resent researches on this field in SI. The development of the approach and its applicability in practice is summarized in the conclusion of the existence of the convergence of the Slovenian corporate governance principles with the EU regulation on the field of corporate governance.

2 The concept of a good corporate governance and convergence

The notion of values – as being good or bad - could be created by the understanding and executing the system of rules in practice. We therefore understand good corporate governance system: as a system of rules that on the level of the company (corporation) supports the execution of the defined corporation goals with optimal expenses.

The development of good and effective corporate governance system cannot be based only on written rules and standards. Effective corporate governance is demonstrated by actual implementation of the rules in practice which execute the objectives of the corporation. It is necessary to address the detected errors or anomalies and improve the system with a view to make it good and effective, (Djokic, 2011b)

However, adopting a specific corporate governance regulation is that it forces companies to commit credibly to a higher quality of governance (Becht et al. 2005). Even if companies initially design efficient governance rules, they may break or alter them at a later stage. Investors anticipate this and are willing to provide firms with funds at lower costs only when companies find ways to commit credibly to good governance.

Convergence of governance practice in European countries is encouraged by the European Commission (EC) and its recommendations (Aguilera and Cuervo-Cazurra, 2009; EC, 2014). Cromme (2005) found that governance guidelines at the European level are highly aligned with the country codes. (Duh, Djokic 2017b)

3 Legal nature of the codes

Provisions of the codes are not binding. Corporate code can be generally defined as a set (collection) of non-binding principles and standards of good practice, issued by a corporate body and connected with internal management of corporations. (CCS 2002, 1).

According to Anglo-American legislation terminology, the codes are defined as “soft-law”. If the nature of the code provisions would be placed into continental perception of sources of law, the provisions could be described as the usage or business custom. A definition of the code provisions as business custom would not be accurate since the code provisions also comprise recommendations and present different ways how to perform of correct decision making process in practice. The code norms are often instructional and have not been necessarily exercised in practice yet. Accordingly, their legal nature is above all ethical and moral. (Djokić, 2011b)

4 CG Codes as supporters of convergence

4.1 EU orientation

On the level of the European Union (EU), a comparative analysis of the codes of corporate governance had been prepared in 2002. (CCS, 2002). The comparative analysis dealt with the codes of corporate governance of the following States: Belgium, Denmark, Finland, France, Greece, Italy, Germany, Netherlands, Portugal, Sweden, Spain and Great Britain. It also involved the codes that were adopted internationally, including OECD principles of corporate governance from 1999.

The European Commission (EC) found out that it does not need to develop a common EU Code. The best practices that are included in the domestic codes of EU member states should develop in compliance with recognitions of business and capital investment in the areas in which the companies work. (EU Action Plan, 2003)

EU has estimated that the most considerable differences in the practice of corporate governance among the Member States arise from diverse regulations of company law and securities and

investment law, and not from the recommendations that are provided in the codes. In contrast to legal regulation, the codes from different States share the same point of view about what good CG practice actually is and how to execute it. (CCS, 6, 7)

This, general orientation of the EU from the beginning of the 21st century, has been realized in the following years by using the method of disclosure and transparency on the CG field, enforcing several changes of the accountancy, audit and reporting directives. The principle of “comply and explain” and methods of the disclosure and transparency have been used to harmonize the regulations and direct states to the the process of the harmonization.

The key element of the “comply and/or explain” principle is disclosure. It takes into account the fact that each company has its own, specific business practice that arises out of and suits the company’s structure, activities and other particularities that companies face in achieving their goals. This principle allows companies to deviate from the CG Code’s recommendations (except from provisions that refer to the temporary legislation); therefore not all of the CG Code’s recommendations are binding for companies. What is obligatory, however, is that they disclose which provisions they do not comply with and explain why. It does not suffice to simply list the provisions the company does not comply with; investors need useful, accurate and complete information on reasons for non-compliance. Such a disclosure must be true, complete and non-misleading, whereby non-compliance cannot be considered as a negative fact in itself, but must be accompanied by a value judgement. (EU Study 2009, pg. 50)

Some of the recent directives on the field is Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings requires companies to include a corporate governance statement in their management report if their transferable securities are admitted to trading on a regulated market of any Member State within the meaning of Article 4(1)(14) of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments (Directive 2013/34/EU)

The ‘comply and/or explain’ principle laid down in Article 20 of Directive 2013/34/EU is a key feature of European corporate governance. According to this principle, companies that depart from the relevant corporate governance code are required to explain in their corporate governance statement which parts of the code they depart from and the reasons for doing so. Non-compliance with a “best practices recommendations” is the one that provides an insight of the practical execution of the corporate governance. The EC Recommendation 2014 tends to instruct the member states, how to express the “non - compliance” and harmonize the approach. (EC 2014)

4.2 History and development of the Codes in Slovenia

SI introduced its first CG Code in the year 2004.

The first Slovenian code of governance of public companies came into force in March 2004. It was adopted by the Ljubljana Stock Exchange, the Managers’ Association of Slovenia and the Slovenian Directors’ Association. (CG Code, 2004)

The changes and supplements of the Code from 2004 were adopted by the same signatories on December 14 2005. (CG Code, 2005)

The next changes of the 2005 Slovenian CG Code have again been brought by the same signatories and were adopted on May 5 2007. (CG Code, 2007).

On December 8, 2009 a new code was enforced (CG Code, 2009).

The CG Code 2017 has been draft and signed on October 2016 by Slovenian Director's Association and Ljubljana Stock Exchange, with effect on January 1, 2017. (CG Code 2017)

The World Bank's 2004 Report on the Observance of Standards and Codes (ROSC) on Corporate Governance, which benchmarks Slovenia's observance of corporate governance against the Organization for Economic Co-operation and Development (OECD) Principles, states about the 2004 Slovenian CG Code that the corporate governance framework in Slovenia is "strong relative to the OECD Principles, and adheres to high levels of transparency of ownership." Slovenia's legislation complied with European Union (EU) Directives, and its corporate governance legal and regulatory framework was comparable to that of many EU member states. (ROSC.2004, pg. 16)

The CG Code 2004 did not pay sufficient regard to specifics of the Slovenian financial market and ownerships structure of Slovenian corporations. Slovenia has faced the post privatization era, where the process of consolidation of control was in progress, either with takeovers or by other types of concentration. Due to the method of privatization the state and two para state funds had significant influence in practically all listed Slovenian companies. Consequently, the amendments of the 2004 Slovenian CG Code regulated the role of the funds.

The CG Code 2005 also stipulated the representation of minority shareholders. According to the European Bank for Reconstruction and Development's (EBRD) 2006 report on Commercial Laws of Slovenia, amendments to the Corporate Governance Code in 2005 were expected to enhance the independence requirements of the supervisory board. (EBRD 2006, 26). The Code Amendments therefore implemented the above recommendations regarding the maximum number of companies in which a single person can act as member of supervisory or management body. The amendments also assumed the disclosure rules as they had already been enacted by the LJSE Rules. (EU Study 2009, 349)

The purpose of the CG Code 2007 has been to define in more detail the governance and management principles of public companies (pc), as well as recommend the same governance principles to the companies, which haven't gone public, but have the form of Joint Stock Company.

The CG Code 2007 leaned heavily on the principle 'comply and/or explain' in all the areas of potential conflicts of interest. It has stipulated that "Principle "Comply and/or Explain" allows companies to deviate from the Code's recommendations (except from provisions referring to temporary legislation)".

Therefore not all of the CG Code 2007 recommendations were binding for companies. The Preamble of the CG Code gave a detailed outline of the Code's chapters and provisions, pointing out those that referred to the relevant legislation regulating corporate governance of the joint stock companies and contained the word "must". Companies were required to observe them and should not deviate from them. The Code's provisions containing the word "should" had the nature of recommendations and were not legally binding. Companies had to "disclose any deviations from such provisions once a year in their declaration on compliance with the Code, to inform investors of any deviations from such provisions and give appropriate reasons for them." Provisions expressed with the words "it is recommended that / it may be done thus" have outlined future development of corporate governance in the company and disclosure of non-compliance with them is not required (CG Code 2007, Preamble). The CG Code 2009 used different approach to the CG issues. The same signatories as of the previous code established, the companies as well as the public have become increasingly familiar with the

provisions of the previous CG Code 2007. They were phrased with the modal »must« (shall, is obliged to, shall not, etc). All provisions of the amended CG Code 2009 have the nature of recommendations, which were not legally binding. This code stated that companies have to summarize the description of their corporate governance system in the Corporate Governance Statement determined in the Slovenian Companies Act (ZGD-1, 2006) The public companies should however inform investors of any deviations from the Code and reasons for them.) The CG Code 2009 also introduced the understanding of the Corporate Governance Policy.

The CG Code 2017 has been draft and signed on October 2016 by Slovenian Director's Association and Ljubljana Stock Exchange, with effect on January 1, 2017. Changes have been introduced merely on the field of the Corporate Governance Policy, management and supervisory board (independence and loyalty of the members), as well as regarding the chapter about the transparency of operations.

4.3 “Comply and/or Explain” Researches in Slovenia

Several researches, concerning the execution of the principle of “comply and/or Explain” in practice, have been executed by the studies from 2007 and 2010 funded and performed by the Slovenian Directors' Association. (SDA Research 2007, 2010)

Additionally, several researches have been provided, analysing the practical application of the principles of the disclosure and transparency in the Slovenian public companies, after the year 2010. They show the development of transparency on the field of the disclosure of the information in the annual reports and CG Statements in Slovenia. The fields of disclosure and transparency have been scrutinized from a different point of view. Different analyses pointed out the deficiencies and provide advises about the improvements that need to be implemented. (Djokic 2011a,2011b,2012, Stevanović 2013, Djokic, Duh 2017a, Duh, Djokic 2017b).

The past researches illustrate that the application of the disclosure principle has been gradually improving by providing more precise data to the shareholders and/or investors on the field of remunerations, as well as other corporate information. The adherence by Slovenian companies to corporate governance principles have been increasing. Companies have been revealing more precisely their attitude to the corporate governance conflicts of interest issues and other corporate information. Two recent researches, which have been executed by the Ljubljana Stock Exchange, provide better overview on the disclosures, missing in the CG Statements and Reports of the public companies.

The LJSE Analysis, 2012, which analyzed 10 listed public companies in the prime quotation disclosed deviations especially from the following principles of the Slovenian CG Code (2009): - definition of goals in the company's statute; - use of information technology to inform and implement sessions of a supervisory board; - the principle regarding payments of the supervisory board members; - appointment of an audit committee and a personnel committee; - disclosure of benefits given to the members of a management board and a supervisory board.

The results of analysis revealed also that the number of specific, high quality explanations on deviations describing besides deviations also alternative solutions, has increased – in 2010 there were 27% of such specific explanations and 44% in 2011.

In November 2015, the Ljubljana Stock Exchange together with the Slovenian Director's Association published another report on analysis of disclosures of compliances with the Slovenian CG Code (2009) for the period 2011–2014. The sample of this analysis (LJSE Analysis, 2015) consisted of companies that were listed on the Ljubljana Stock Exchange and include besides prime market companies also other companies listed on the Ljubljana Stock Exchange. This sample was therefore

bigger. There have been scrutinized 58 companies for 2011 and 2013, 57 companies for 2012, and 60 companies for 2014. Due to the different structure of both samples, the comparisons of the results of both analysis are only possible in limited ways.

The major sources of data were companies' annual reports, especially the CG Statements, which are the compulsory part of the annual reports. The objects of the analysis were disclosures of (non)compliances with the Slovenian CG Code (2009) that have been applied for several years in Slovenian companies. Not any other code has had longer tradition in governance practice in Slovenia.

The results showed that the number of companies following the governance principles of the Slovenian CG Code (2009) has increased from 63.8% in 2011 to 71.7% in 2014. The number of companies that do not use the Slovenian CG Code (2009) has decreased – there were 36.2% of such companies in 2011 and 28.3% of companies in 2014 (LJSE Analysis, 2015). Only one of the company adopted other publicly accessed corporate governance codes than CG Code 2009, even though the law enables such a solution.

The results show also that three companies disclosed compliance with all code's recommendations in 2011, two companies in 2012, three companies in 2013 and four companies in 2014. It is revealed that companies disclosed deviations from 84 principles in 2011, from 78 principles in 2012, from 85 principles in 2013, and from 89 principles in 2014. In all the observed years, only 22 principles (19.6%) were identified as those that all companies in the sample complied with (LJSE Analysis, 2015). This number is lower than the one revealed in the previous analysis. However, the comparison is limited since the sample from 2012 analysis consisted only of prime market companies that are expected to follow as much as possible the governance principles of the selected code.

The results of analysis also revealed that the number of specific, high quality explanations of deviations describing besides deviations also alternative solutions, has increased – in 2011 there were 23.5% of such specific explanations and 27.8% in 2014 (LJSE Analysis, 2015).

Even though this positive trend indicates that more companies were aware of the importance of good disclosure practices, the situation still needs to be improved. The analysis from 2012 showed in this respect statistically better picture, however, as previously mentioned the sample should be taken into consideration when making conclusions based on the results of analysis. (Duh, Djokic 2017b)

The analysis revealed that half of the most frequent deviations were deviations from the principles on transparency (last chapter of the code). The reported deviations were on the rules and communication strategy of a company, restrictions of trading with the company's shares, public announcements and reports in a foreign language, and disclosure of remuneration of each member of the management board and the supervisory board (LJSE Analysis, 2015).

The LJSE Analysis 2015 revealed the most frequent deviations from the following principles of the Slovenian CG Code: - Publication of an annual report in English language - 40% of companies disclosed this deviation; however, the share of specific, high quality explanations of this deviation was high (41.7%); - Definition of goals in the company's statute - 35% of companies disclosed this deviation; however, the share of specific, high quality explanations of this deviation was low (9.5%); - Preparation and publication of the Corporate Governance Policy - 31.7% of companies disclosed this deviation; however, the share of specific, high quality explanations of this deviation was very low (5.3%); - The principle regarding the work of supervisory board in compliance with the code (a statement on the independence of supervisory board members) - 30% of companies disclosed this deviation; however, the share of specific, high quality explanations of this deviation was low (11.2%); - The principle on appointing special committees of a supervisory board – 28.4% of companies

disclosed this deviation; however, the share of specific, high quality explanations of this deviation is higher (17.6%) than it is the case for other the most frequent deviations with the exception of the first one.

This year we have enlarged the results of the SEECGAN Research Slovenia 2015 (Djokić et al, 2015) with the case study research. We analyzed different questions (criteria) of the disclosure principle, as well as the execution of the particular recommendations of the Slovenian CG Code 2009 in practice of the sampled public companies.

The analyses of the six cases of the companies (2 from prime-P, 2 from standard-S and 2 from entry-E quotation) scrutinized also the execution of the Recommendation 23 of the Slovenian Code 2009, which states: “The company makes a detailed account of its governance practice in the Corporate Governance Statement, which it draws up pursuant to the Companies Act. The Corporate Governance Statement is made part of the company's annual report and is also an independent document posted on the company's website.”

The analysis of all six cases shows that four companies describe their corporate governance practice in the CG Statement that is published both on the website and as a part of the annual report (companies P1, P2, S1, E1) thereby following not only the CG code’s recommendations but as well as the EC recommendation.

According to this EC recommendation, companies should publish their corporate governance statement on their websites and include reference to the website in their management report (EC, 2014, Section II, paragraph 6). The company S2 publishes the document entitled the CG Statement on its website. However, this document only provides references to valid legal framework and does not include any description of the company’s governance practice. The company disclose more information on its governance practice in the CG Statement that is published as a part of the annual report. The company E2 does not publish the CG Statement on its website. This company do no report on the deviation from this recommendation. Its governance practice is described in the CG Statement in the annual report. (Duh, Djokić, 2017b)

5 Consequences of the SI Code harmonization with the EU approach

The Codes could be of a big help in providing better practices of corporate governance in a particular company. If the management bodies are prepared to use their recommendations properly, the Codes could be an orientation on how to execute particular job or an operation. Practical behavior and factual performance of the duties of a particular management body of a company is significant. The development of good and effective corporate governance cannot be based on written rules and standards alone. Effective corporate governance is demonstrated by the implementation of the rules in practice and through promoting the objectives of the corporation.

The “comply and/or explain” approach is effective only in the case of high level of transparency with credible and comprehensive disclosures. These are consisted of explanations that describe deviations, as well as alternative solutions and reasons for them. The use of the soft law and obligatory provisions (“ius cogens”) enacted by laws should work simultaneously in the process of the harmonisation. The codes could serve as promoters of the harmonisation, but with clear understandings of the “non-compliance” and transparency. Soft law with CG Codes is very important source of the corporate governance. The CG Codes refer to the recommended practice of the operations of the joint stock companies’ bodies. (EU Study 2009, pg.358)

The review of the historical development of the EU approach regarding principles of good corporate governance and the development of the CG Codes in SI, showed that ethical principles and norms of the Slovenian CG Codes, which are non-binding, created a suitable legal basis for the development and better implementation of CG in Slovenian public companies. Slovenian legal tradition and the culture of CG could not be compared to the tradition of the other EU member states, such as Great Britain, Germany or France. Since the first Companies Act was adopted in Slovenia in 1993, the principles of CG of the Joint Stock companies or Limited Liability Companies as suitable legal forms for capital investment have only been used for the last 25 years.

The Slovenian CG Codes do not constitute a part of the company law. Its signatories are professional organisations and Ljubljana Stock Exchange. However, Companies Act (ZGD-1-UPB3) refers to the “comply-or-explain” approach regarding the corporate governance codes. The legislation determines only the minimum standard. Therefore the soft law, including the CG Code, is very important source of the corporate governance in SI.

In CG Code 2009 is estimated that the “comply and/or explain” principle has become an overall used principle and a requisite element of the corporate governance statements in the frame of companies’ business report. This principle allows companies to deviate from the Code’s recommendations and thus enables them to develop their own business practices.

It is also expected that listed companies, especially prime market and standard market companies, should largely abide by the Code's recommendations. (CG Code 2009, 2)

Such a development shows that regardless to the non-binding legal nature of the European Commission Recommendation, the Slovenian CG Codes follow the EU recommendations. Namely, the Codes guidelines are harmonised with the major EU approach and the principles are structured in a way that they influence the practice of the preparation of the annual reports. Companies from year to year reveal more relevant information to the shareholders of the listed companies, which consequently helps to create good practice in the field of corporate governance.

6 Conclusion

OECD and EU generally determine that CG codes influence the increase of economic effects by: i) stimulating global efficacy and competitiveness of business sphere in the EU; ii) influencing the rights of shareholders and third parties, ensuring them better legal security; iii) contributing to greater trust among European investors and increasing their awareness and responsibility; iv) encouraging harmonization of the systems of corporate governance. (EU Green Paper, 2011)

Slovenian CG Codes generally enable better execution of the particular provision of the Company Law concerning corporate governance. This could be explained by revealing the disclosures in the annual reports of the public companies in SI; the development of the institute of the corporate governance statement for the listed companies; formation of the “comply and/or explain” principles in the CG Codes in SI and the gradual improvement of the disclosures and explanations in the public companies annual and business reports. The analysis of the development and content of the Slovenian CG Codes show that the codes helped improving the information, provided to the shareholders and therefore constituting the information right of the stakeholders and investors.

Historical development reveals the convergence of the regulative approach, when comparing EU and SI. The improvements of disclosures are expected and will be based also in the future on the “comply and/or-explain” principle. This principle allows the companies to deviate from the recommendations

of the selected code and thus enables them to develop their own business practices. The non-compliance with respective provisions of the code recommendations has to be explained. These practices should according to the deviations pointed out by the researches mentioned in the article become explained more substantially to be able to show the corporate governance practice and costs to investors.

The research findings on governance codes adoption (LJSE Analysis, 2012, 2015) indicate that the “comply or explain” mandatory disclosure requirement for listed companies have an important impact on the improvement on governance practice in Slovenian listed companies. They represent a way of regularly monitoring of the practical use of the code. The constant analysis of the Code compliances provide an important insight in corporate governance practice, its compliance with codes recommendations and alternative solutions of the governance systems. This kind of surveillance could considerably increase the understanding of the code’s governance principles among companies. Besides that, such findings also reveal the improvements, which are necessary in governance practices and suggest those areas where measures should be undertaken to change unsatisfactory practice.

Both LJSE Analysis (2012, 2015) revealed that the number of specific, high quality explanations of deviations has increased. This positive trend indicates that companies have become aware of the importance of good disclosure practices. Nevertheless, improvements are needed. We estimate it is still not enough explanations of reasons and alternative solutions at all or only for some of the disclosed deviations. Namely, appropriate disclosure of noncompliance with the code recommendations and of the reasons for these is very important for the stakeholders and investors.

On the basis of the EC 2014 implementation in SI, we expect to find out more substantial explanation of the non - compliance with the codes within the public companies reports in the future. The future researches, will judge the regularity of these statements and going to explain further convergence steps between the Slovenia principles and EU approach.

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