



VILNIAUS GEDIMINO TECHNIKOS UNIVERSITETAS

VERSLO VADYBOS FAKULTETAS

ĮMONIŲ EKONOMIKOS IR VADYBOS KATEDRA

Aleksandras Kučinskis

**RESEARCH ON THE INTERRELATIONSHIP BETWEEN
CORPORATE GOVERNANCE AND OWNERSHIP STRUCTURE:
CASE OF LITHUANIA**

**BENDROVIŲ VALDYMO IR NUOSAVYBĖS STRUKTŪROS
TARPUSAVIO RYŠIO TYRIMAS:
LIETUVOS ĮMONIŲ PAVYZDYS**

Baigiamasis magistro darbas

Verslo vadybos studijų programa, valstybinis kodas 62403S121

Tarptautinio verslo specializacija

Vadybos ir administravimo mokslo kryptis

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Pavadinimas: **Bendrovių valdymo ir nuosavybės struktūros tarpusavio ryšio tyrimas:
Lietuvos įmonių pavyzdys**

Autorius **Aleksandras Kučinskis**

Vadovas **prof. dr. Manuela Tvaronavičienė**

Kalba

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Anotacija

Baigiamajame magistro darbe tiriamas bendrovių valdymo ir nuosavybės struktūros tarpusavio ryšys, apžvelgiama dabartinė nuosavybės struktūros ir bendrovių valdymo situacija Lietuvoje bei kitose pasirinktose valstybėse. Pirmoje darbo dalyje analizuojami nuosavybės struktūros ir bendrovių valdymo teoriniai pagrindai, egzistuojantys bendrovių valdymo modeliai bei nuosavybės koncentracijos reiškinys. Praktinėje darbo dalyje buvo atlikti du tyrimai: bendrovių valdymo ir nuosavybės struktūros Lietuvos bendrovėse analitinis tyrimas bei Lietuvos ir pasirinktų šalių nuosavybės struktūros palyginamoji analizė. Šioje darbo dalyje pateikti pagrindiniai Lietuvos bendrovių valdymo praktiniai aspektai, nuosavybės struktūros vystymosi tendencijos, akcininkų teisės ir pareigos, bendrovių valdymo teisinė aplinka, įskaitant bendrovių valdymo kodeksą bei viešai skelbiamos informacijos reikalavimus, bendrovių socialinės atsakomybės reikšmė šiuolaikinių bendrovių valdyme. Išnagrinėjus teorinius ir praktinius bendrovių valdymo ir nuosavybės struktūros aspektus, pateiktos svarbiausios baigiamojo darbo išvados ir siūlymai. Darbo apimtis – 117 p. teksto be priedų, 32 iliustracijos, 12 lentelių, 67 literatūros šaltiniai. Atskirai pridedami darbo priedai.

Prasminiai žodžiai: nuosavybės struktūra, bendrovių valdymas, nuosavybės koncentracija, bendrovių valdymo modeliai, Lietuvos įmonės

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Final master thesis of business management study program

Title: **Research on the interrelationship between Corporate Governance and Ownership Structure: Case of Lithuania**

Author **Aleksandras Kučinskis** Academic supervisor **prof. dr. Manuela Tvaronavičienė**

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Annotation

This final master thesis investigates relationship between corporate governance and ownership structure, presents actual corporate governance and ownership situation in Lithuania and other chosen countries. The first part of the paper presents the theoretical background for corporate governance and ownership structure, available corporate governance models, ownership concentration and other significant aspects. In the practical part two researches are performed: analytical research on situation of corporate governance and ownership structure in Lithuanian companies and comparative analysis of Lithuania with the chosen countries. Development tendencies of ownership structure, responsibilities and rights of the shareholders, corporate governance legal framework, including corporate governance code and information disclosure requirements, significance of corporate social responsibility for the modern corporate governance and other practical aspects of Lithuania are analyzed here. At the end of the work, all essential conclusions of the analyzed issues and future research recommendations are presented. Paper consists of: 117 pages of text without appendixes, 32 pictures, 12 tables, 67 reference sources. Appendixes are included.

Keywords: ownership structure, corporate governance, ownership concentration, corporate governance models, Lithuanian enterprises

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INTRODUCTION

Corporate governance, a phrase that not long ago meant little to all but a handful of scholars and shareholders, has now become a mainstream concern — a staple of discussion in corporate boardrooms, academic meetings, and policy circles around the world. Two events are responsible for the heightened interest in corporate governance. During the wave of financial crises in 1998 in Russia, Asia, and Brazil, the behavior of the corporate sector affected entire economies, and deficiencies in corporate governance endangered the stability of the global financial system. Just three years later confidence in the corporate sector was sapped by corporate governance scandals in the United States (Enron and WorldCom) and Europe (Marconi in the United Kingdom, Royal Ahold in the Netherlands) that triggered some of the largest insolvencies in history. In the aftermath, not only has the phrase corporate governance become nearly a household term, but economists, the corporate world, and policymakers everywhere began to recognize the potential macroeconomic consequences of weak corporate governance systems. The scandals and crises, however, are just manifestations of a number of structural reasons why corporate governance has become more important for economic development and well-being (Becht, Bolton, and Röell, 2005). The private, market-based investment process is now much more important for most economies than it used to be, and that process is underpinned by better corporate governance.¹

The importance of interrelationship between corporate governance and ownership structure is evident in the fact that corporate governance and the ownership structure of companies is currently characterized by change processes as the economies of the world become more and more globally integrated. Ownership structure has the major importance in corporate governance because it affects activity and operational efficiency of the economic entity. Thus, proper and efficient corporate governance also depends on the ownership, its structure, activities, rights and preferences of shareholders etc.

This work aims to trace the most significant dimensions through which ownership structure and corporate governance operates in economic entities and countries, with the strong emphasis on the practical research of the recent ownership structure and corporate governance background and peculiarities in Lithuania, compare it with common practice in other countries. To carry this out, we will draw the theoretical background by review the extensive literature on the subject and try to identify areas of the high importance and relevance to our analyzed topic. Afterwards, purposeful and concentrated practical analysis on the corporate governance and ownership structure in Lithuania will be performed, based on developed survey and systematic analysis of the available information and statistical data.

¹ Marco Becht, Patrick Bolton and Ailsa Röell. “Corporate Governance and Control” *ECGI Working Paper Series in Finance* 2005. Available at: http://ssrn.com/abstract_id=343461; (2008-03-09);

Objects of the work are ownership structure and corporate governance, their main systems and principles, development background and peculiarities in Lithuania and other chosen countries.

Therefore, this whole work is devoted to **the main problem** of ownership structure influence on corporate governance and their significance for “healthy”, operational efficient and well-developing business units in the world economy.

Main goal of this work is to reveal essential objects of the interrelationship between the ownership structure patterns and modern corporate governance systems and principles, and they influence on operation of the economic entities.

To reach the settled goal of the work **such objectives are raised:**

- ☒ Theoretically overview: ownership structure and corporate governance, including definition, history, development backgrounds, conditional aspects, available models etc.
- ☒ Develop and analyze the survey on ownership structure and corporate governance in Lithuania, which would be helpful for estimation of current situation in the country.
- ☒ Estimate the actual background and peculiarities of ownership structure and corporate governance in Lithuania.
- ☒ Overview and generally analyze the background of ownership structure and corporate governance in other chosen countries, compare it with Lithuania.
- ☒ Summarize received results of the analysis; compare it to the actual situation, present appropriate conclusions and recommendations for future researches.
- ☒ Commonly, become well acquainted with ownership structure and corporate governance practice, existing problems and draw possible future development trends.

The work is structured as follows:

Theoretical part starts with a definition, history and actuality of corporate governance, as that determines the scope of analyzed issues. It reviews how corporate governance can and has been defined. It describes why more attention is being paid to corporate governance in particular, and to protection of private property rights, more generally. Next, the work explores generalized three models of corporate governance that are met around the world. Then, history and background on the ownership patterns, including ownership concentration and legal protection tools, are provided.

Afterwards, theory proceeds to the practice and we empirically analyze issues of corporate governance and ownership structure in Lithuania. This part starts with short overview of the economical situation in Lithuania, as the country where the whole analysis of the paper is performed/ Further, survey on ownership structure and some corporate governance common issues

in Lithuania is developed. Actual stand of corporate governance and ownership structure patterns in Lithuania including major remarks on the corporate efficiency are presented in the next chapters of this part of the master thesis.

Beyond, we move to the third part of the work, which overviews the corporate governance and ownership patterns in chosen countries, mainly in Europe. Furthermore, European countries' patterns of corporate governance and common averages of the share ownership, including comparison with already discovered situation of Lithuania, are introduced and developed here. This part of the work is concluded with juxtaposition of the main data analyzed throughout the whole empirical part of the thesis. The paper is finalized with summarized conclusions and recommendations identifying some main policies and research issues that demands further studies. As it is required, the references and appendixes used within the thesis are presented in the very end of the paper.

Applied methods of analysis:

- ☒ Systematic analysis of the scientific and statistical material.
- ☒ Analysis of the relative researches and previously developed surveys.
- ☒ Graphical data presentation and its analysis.
- ☒ Logical analytical research of the available information.
- ☒ Comparative analysis of the received data.
- ☒ Summarizing of analyzed issues and presentation of appropriate conclusions.

1. THEORHETICAL ASPECTS OF CORPORATE GOVERNANCE AND OWNERSHIP STRUCTURE

1.1. Introduction to Corporate Governance

Definitions of corporate governance vary widely. They tend to fall into two categories. The first set of definitions concerns itself with a set of behavioral patterns: that is, the actual behavior of corporations, in terms of such measures as performance, efficiency, growth, financial structure, and treatment of shareholders and other stakeholders. The second set concerns itself with the normative framework: that is, the rules under which firms are operating—with the rules coming from such sources as the legal system, the judicial system, financial markets, and factor (labor) markets.

For studies of single countries or firms within a country, the first type of definition is the most logical choice. It considers such matters as how boards of directors operate, the role of executive compensation in determining firm performance, the relationship between labor policies and firm performance, and the role of multiple shareholders. For comparative studies, the second type of definition is the more logical one. It investigates how differences in the normative framework affect the behavioral patterns of firms, investors, and others.

In a comparative review, the question arises how broadly to define the framework for corporate governance. Under a narrow definition, the focus would be only on the rules in capital markets governing equity investments in publicly listed firms. This would include listing requirements, insider dealing arrangements, disclosure and accounting rules, and protections of minority shareholder rights.

Under a definition more specific to the provision of finance, the focus would be on how outside investors protect themselves against expropriation by the insiders. This would include minority right protections and the strength of creditor rights, as reflected in collateral and bankruptcy laws. It could also include such issues as the composition and the rights of the executive directors and the ability to pursue class-action suits. This definition is close to the one advanced by economists Andrei Shleifer and Robert Vishny in their seminal 1997 review: “*Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment*” (1997, p. 737)². This definition can be expanded to define corporate governance as being concerned with the resolution of collective action problems among dispersed investors and the reconciliation of conflicts of interest between various corporate claimholders.

² Shleifer, Andrei, and Robert Vishny. “A Survey of Corporate Governance.” *Journal of Finance* 1997. 52 (2): 737–83. Available at: EBSCOhost Web. Business Source Premier. (2008-03-09)

A somewhat broader definition would be to define corporate governance as a set of mechanisms through which firms operate when ownership is separated from management. This is close to the definition used by Sir Adrian Cadbury, head of the Committee on the Financial Aspects of Corporate Governance in the United Kingdom: “*Corporate governance is the system by which companies are directed and controlled*” (Cadbury Committee, 1992, introduction)³.

An even broader definition is to define a governance system as “*the complex set of constraints that shape the ex post bargaining over the quasi rents generated by the firm*” (Zingales, 1998, p. 499)⁴. This definition focuses on the division of claims and can be somewhat expanded to define corporate governance as the complex set of constraints that determine the quasi-rents (profits) generated by the firm in the course of relationships and shape the ex post bargaining over them. This definition refers to both the determination of value-added by firms and the allocation of it among stakeholders that have relationships with the firm. It can be read to refer to a set of rules, as well as to institutions.

Corresponding to this broad definition, the objective of a good corporate governance framework would be to maximize the contribution of firms to the overall economy—that is, including all stakeholders. Under this definition, corporate governance would include the relationship between shareholders, creditors, and corporations; between financial markets, institutions, and corporations; and between employees and corporations. Corporate governance would also encompass the issue of corporate social responsibility, including such aspects as the dealings of the firm with respect to culture and the environment.

When analyzing corporate governance in a cross-country perspective, the question arises whether the framework extends to rules or institutions. Here, two views have been advanced. One is the view that the framework is determined by rules, and related to that, to markets and outsiders. This has been considered a view prevailing in or applying to Anglo-Saxon countries. In much of the rest of the world, institutions—specifically banks and insiders—are thought to determine the actual corporate governance framework.

In reality, both institutions and rules matter, and the distinction, while often used, can be misleading. Moreover, both institutions and rules evolve over time. Institutions do not arise in a vacuum and are affected by the rules in the country or the world. Similarly, laws and rules are affected by the country’s institutional setup. In the end, both institutions and rules are endogenous to other factors and conditions in the country. Among these, ownership structures and the role of the state matter for the evolution of institutions and rules through the political economy process.

³ “Cadbury Committee” (Committee on the Financial Aspects of Corporate Governance). “The Report of the Committee on the Financial Aspects of Corporate Governance.” 2000. London.

⁴ Zingales, Luigi. “The Value of the Voting Right: A Study of the Milan Stock Exchange Experience.” *Review of Financial Studies* 1994, No. 7 (Spring): 125–148.

Shleifer and Vishny (1997, p. 738) take a dynamic perspective by stating: “*Corporate governance mechanisms are economic and legal institutions that can be altered through political process.*” This dynamic aspect is very relevant in a cross-country review, but has received much less attention from researchers to date.

When considering both institutions and rules, it is easy to become bewildered by the scope of institutions and rules that can be thought to matter. An easier way to ask the question of what corporate governance means is to take the functional approach. This approach recognizes that financial services come in many forms, but that if the services are unbundled, most, if not all, key elements are similar (Bodie and Merton 1995)⁵. This line of analysis of the functions—rather than the specific products provided by financial institutions, and markets—has distinguished six types of functions: pooling resources and subdividing shares; transferring resources across time and space; managing risk; generating and providing information; dealing with incentive problems; and resolving competing claims on the wealth generated by the corporation. One can define corporate governance as the range of institutions and policies that are involved in these functions as they relate to corporations. Both markets and institutions will, for example, affect the way the corporate governance function of generating and providing high-quality and transparent information is performed.

Therefore, to summarize, we can state, that corporate governance is the set of processes, customs, policies, laws and institutions affecting the way a company is directed, administrated or controlled. Corporate governance also includes the relationship among the many players involved and the goals for which the company is governed. The principal players are the owners and management. Other stakeholders include employees, suppliers, customers, banks and other lenders, regulators, the environment and community at large.

1.1.1. Historical origins: a brief sketch

In the 19th century, state corporation law enhanced the rights of corporate boards to govern without unanimous consent of shareholders in exchange for statutory benefits like appraisal rights, in order to make corporate governance more efficient. Since that time, and because most large publicly traded corporations in America are incorporated under corporate administration friendly Delaware law, and because America's wealth has been increasingly securitized into various corporate entities and institutions, the rights of individual owners and shareholders have become increasingly derivative and dissipated. The concerns of shareholders over administration pay and stock losses periodically has led to more frequent calls for Corporate Governance reforms.

⁵ Bodie, Zvi, and Robert Merton. “A Conceptual Framework of Analyzing the Financial Environment.” *The Global Financial System: A Functional Perspective*. 1995. Boston: Harvard Business School Press.

In the 20th century in the immediate aftermath of the Wall Street Crash of 1929 legal scholars such as Adolf Augustus Berle, Edwin Dodd, and Gardiner C. Means pondered on the changing role of the modern corporation in society. Berle and Means' monograph "The Modern Corporation and Private Property" (1932, Macmillan)⁶ continues to have a profound influence on the conception of corporate governance in scholarly debates today.

From the Chicago school of economics, Ronald Coase's "Nature of the Firm" (1937)⁷ introduced the notion of transaction costs into the understanding of why firms are founded and how they continue to behave. Fifty years later, Eugene Fama and Michael Jensen's "The Separation of Ownership and Control"⁸ firmly established agency theory as a way of understanding corporate governance: the firm is seen as a series of contracts.

American expansion after World War II through the emergence of multinational corporations saw the establishment of the managerial class. Accordingly, the following Harvard Business School management professors published influential monographs studying their prominence: Myles Mace (entrepreneurship), Alfred D. Chandler, Jr. (business history), Jay Lorsch (organizational behavior) and Elizabeth MacIver (organizational behavior). According to Lorsch and MacIver "many large corporations have dominant control over business affairs without sufficient accountability or monitoring by their board of directors."

Current preoccupation with corporate governance can be pinpointed at two events: The East Asian Crisis of 1997 saw the economies of Thailand, Indonesia, South Korea, Malaysia and The Philippines severely affected by the exit of foreign capital after property assets collapsed. The lack of corporate governance mechanisms in these countries highlighted the weaknesses of the institutions in their economies. The second event was the American corporate crises of 2001-2002 which saw the collapse of two big corporations: Enron and WorldCom, and the ensuing scandals and collapses in other corporations such as Arthur Andersen, Global Crossing and Tyco.

1.1.3. How representative is corporate government?

The institutional arrangements surrounding corporate elections and the role and fiduciary duties of the board have been the central themes in the corporate governance literature from its inception. The dilemma of how to balance limits on managerial discretion and small investor protection is ever present. Should one limit the power of corporate plutocrats (large shareholders or voting trusts) or should one tolerate concentrated voting power as a way of limiting managerial discretion?

⁶ Berle, A. A., and G. Means. *The Modern Corporation and Private Property*. 1932. New York: Macmillan.

⁷ Coase, Ronald C. "The Nature of the Firm." *Economica* 1937, No.4: 386–405.

⁸ Fama, E.F. and M.C. Jensen: "Agency Problems and Residual Claims" *Journal of Law and Economics* 1983, No. 26: 327–349. Available at: EBSCOhost Web. Business Source Premier. (2008-03-09);

The concern of early writers of corporate charters was the establishment of “corporate suffrage”, where each member (shareholder) had one vote. The aim was to establish “democracy” by eliminating special privileges of some members and by limiting the number of votes each shareholder could cast, irrespective of the number of shares held. However, just as “corporate democracy” was being established it was already being transformed into “plutocracy” by moving towards “one-share–one-vote” and thus allowing for concentrated ownership and control (Dunlavy, 1998)⁹.

In the USA this was followed by two distinct systems of “corporate feudalism”: first, to the voting trusts and holding companies originating in the “Gilded Age” and later to the managerial corporation. The “captains of industry” in the trusts and hierarchical groups controlled the majority of votes in vast corporate empires with relatively small(er) amounts of capital, allowing them to exert product market power and leaving ample room for self-dealing. In contrast, the later managerial corporations were controlled mainly by professional managers and most of their shareholders were too small and numerous to have a say. In these firms control was effectively separated from ownership.

Today corporate feudalism of the managerial variety in the USA and the “captain of industry” kind elsewhere is challenged by calls for more “shareholder democracy”, a global movement that finds its roots with the “corporate Jacksonians” of the 1960s in the USA (Becht, Bolton, and Röell, 2005).

As an alternative to shareholder activism some commentators in the 1960s proposed for the first time that hostile takeovers might be a more effective way of disciplining management. Thus, Rostow (1959, p. 47)¹⁰ argued, “the raider persuades the stockholders for once to act as if they really were stockholders, in the black-letter sense of the term, each with the voice of partial ownership and a partial owner’s responsibility for the election of directors”. Similarly, Manne (1964, p. 1445)¹¹ wrote, “vote selling [. . .] negatives many of the criticisms often leveled at the public corporation”. As we shall see, the abstract “market for corporate control” has remained a central theme in the corporate governance literature.

⁹ Dunlavy, C.A. “Corporate governance in late 19th century Europe and the U.S.: the case of shareholder voting rights”, *Comparative Corporate Governance. The State of the Art and Emerging Research* 1998. Oxford University Press, 5–40.

¹⁰ Rostow, E.V. “To whom and for what ends are corporate managements responsible?” *The Corporation in Modern Society* 1959. Harvard University Press, Cambridge. p.47.

¹¹ Manne, H.G. “Some theoretical aspects of share voting” *Columbia Law Review* 1964, No. 64. 1427–1445.

Whom should corporate government represent?

The debate on whether management should run the corporation solely in the interests of shareholders or whether it should take account of other constituencies is almost as old as the first writings on corporate governance. Berle (1932) held the view that corporate powers are powers in trust for shareholders and nobody else. But, Dodd (1932) argued that:

*“[business] is private property only in the qualified sense, and society may properly demand that it be carried on in such a way as to safeguard the interests of those who deal with it either as employees or consumers even if the proprietary rights of its owners are thereby curtailed”.*¹²

Berle (1932) disagreed on the grounds that responsibility to multiple parties would exacerbate the separation of ownership and control and make management even less accountable to shareholders.

There is nowadays a voluminous literature on corporate governance. On many key issues our understanding has improved enormously since the 1930s. Remarkably though, some of the main issues over which the early writers have been debating remain central today.

1.1.2. Why corporate governance is currently such a prominent issue?

Why has corporate governance become such a prominent topic in the past two decades or so and not before? We have identified, in no particular order, the following reasons: 1) the worldwide wave of privatization of the past two decades; 2) pension fund reform and the growth of private savings; 3) the takeover wave of the 1980s; 4) deregulation and the integration of capital markets; 5) the 1998 East Asia crisis, which has put the spotlight on corporate governance in emerging markets; vi) a series of recent USA scandals and corporate failures that built up but did not surface during the bull market of the late 1990s. (Becht, Bolton, and Röell, 2005)

The world-wide privatization wave

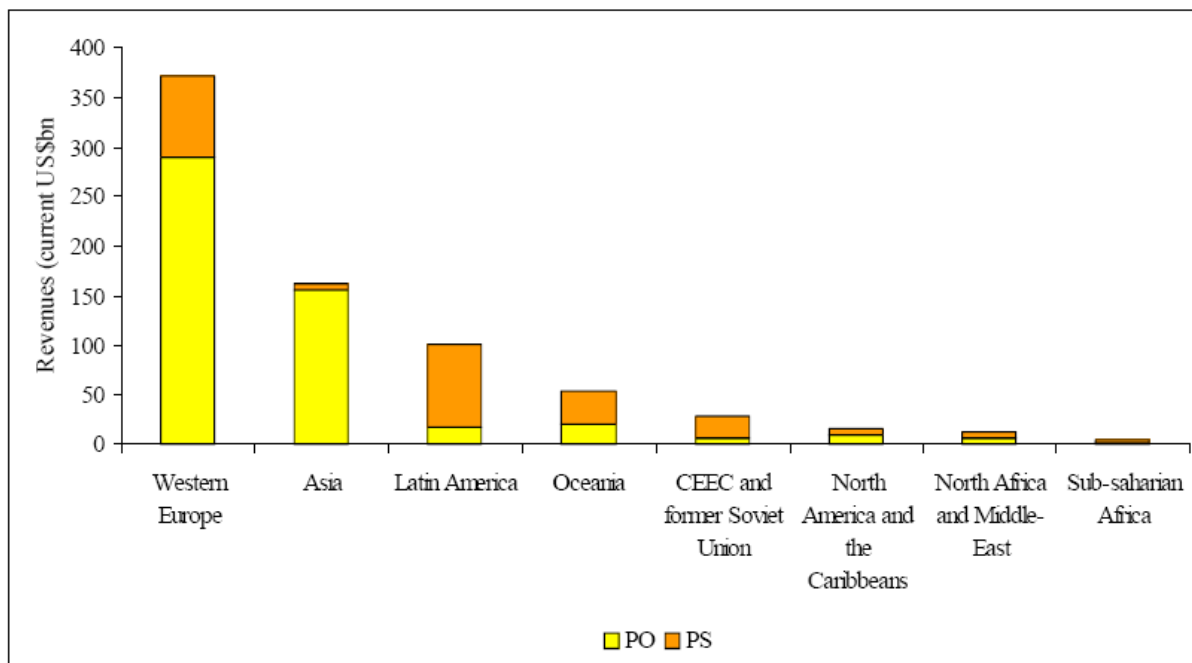
Privatization has been an important phenomenon in Latin America, Western Europe, Asia and (obviously) the former Soviet block, but not in the USA where state ownership of enterprises has always been very small. (see *Picture 1.1.*) On average, since 1990 OECD (Organization for Economic Cooperation and Development) privatization programs have generated proceeds equivalent to 2.7% of total GDP, and in some cases up to 27% of country GDP. The privatization wave started in the UK, which was responsible for 58% of OECD and 90% of European Community privatization proceeds in 1991. Since 1995 Australia, Italy, France, Japan and Spain alone have generated 60% of total privatization revenues.¹³

Inevitably, the privatization wave has raised the issue of how the newly privatized corporations should be owned and controlled. In some countries, most notably the UK, part of the

¹² Dodd, M. “For whom are corporate managers trustees?”, *Harvard Law Review* 1932, No.45. p.1145.

¹³ Bortolotti, B., M. Fantini and D. Siniscalco “Privatisation and institutions: a cross country analysis”, 2000. Available at: <http://ssrn.com/abstract=257773> (2008-03-09);

agenda behind the massive privatization program was to attempt to recreate a form of “shareholder democracy” (see Biais and Perotti, 2002)¹⁴. In other countries great care was given to ensure the transfer of control to large shareholders. The issues surrounding the choice of privatization method rekindled interest in governance issues; indeed Shinn (2001)¹⁵ finds that the state’s new role as a public shareholder in privatized corporations has been an important source of impetus for changes in corporate governance practices worldwide. In general, privatizations have boosted the role of stock markets as most OECD sales have been conducted via public offerings, and this has also focused attention on the protection of small shareholders.



Picture 1.1. Privatization Revenues by Region 1977-97

Source : Bortolotti, Fantini and Siniscalco (2000),
(Becht, Bolton, and Röell, 2005)

Note : PO – Public Offerings; PS – Private Sales

Pension funds and active investors

The growth in defined contribution pension plans has channeled an increasing fraction of household savings through mutual and pension funds and has created a constituency of investors that is large and powerful enough to be able to influence corporate governance.

These pension funds are playing an increasingly active role in global corporate governance. This has led to the emergence of a service industry that makes voting recommendations and exercises votes for clients. The largest providers now offer global services. Japanese institutional investors command 13.7% of total institutional investor assets in the OECD but just 8.3% of the

¹⁴ Biais, B., and E. Perotti “Machiavellian privatization”, American Economic Review. 2002, No.92: 240–258.

¹⁵ Shinn, J. “Private profit or public purpose? Shallow convergence on the shareholder model”, Ph.D. Dissertation, 2001, Princeton University.

equities. These investors are becoming more demanding and they are one of the forces behind the rapid transformation of the Japanese corporate governance system. As a percentage of GDP, the holdings of Italian and German institutional investors are small (39.9% and 49.9% in 1996) and well below the OECD average of 83.8%. The ongoing reform of the pension systems in both countries and changing savings patterns, however, are likely to change this picture in the near future (Becht, Bolton, Röell, 2005).

Mergers and takeovers

The hostile takeover wave in the USA in the 1980s and in Europe in the 1990s, together with the recent merger wave, has also fuelled the public debate on corporate governance. The successful \$199 billion cross-border hostile bid of Vodafone for Mannesmann in 2000 was the largest ever to take place in Europe. The recent hostile takeovers in Italy (Olivetti for Telecom Italia; Generali for INA) and in France (BNP Paribas; Elf Aquitaine for Total Fina) have spectacularly shaken up the sleepy corporate world of continental Europe. Interestingly, these deals involve newly privatized giants. It is also remarkable that they have not been opposed by the social democratic administrations in place at the time. Understandably, these high profile cases have moved takeover regulation of domestic and cross-border deals in the European Union to the top of the political agenda (Becht, Bolton, Röell, 2005).

Deregulation and capital market integration

Corporate governance rules have been promoted in part as a way of protecting and encouraging foreign investment in Eastern Europe, Asia and other emerging markets. The greater integration of world capital markets (in particular in the European Union following the introduction of the Euro) and the growth in equity capital throughout the 1990s have also been a significant factor in rekindling interest in corporate governance issues. Increasingly fast growing corporations in Europe have been raising capital from different sources by cross listing on multiple exchanges (Pagano, Röell and Zechner, 2002)¹⁶. In the process they have had to contend more with USA and UK pension funds. This has inevitably contributed to the spread of an ‘equity culture’ outside the USA and UK.

The 1998 Russia/East Asia/Brazil crisis

The East Asia crisis has highlighted the flimsy protections investors in emerging markets have and put the spotlight on the weak corporate governance practices in these markets. The crisis has also led to a reassessment of the Asian model of industrial organisation and finance around highly centralized and hierarchical industrial groups controlled by management and large investors.

¹⁶ Pagano, M., A. Röell and J. Zechner (2002), “The geography of equity listing: why do companies list abroad?”, *Journal of Finance* 57:2651–2694.

There has been a similar reassessment of mass insider privatization and its concomitant weak protection of small investors in Russia and other transition economies.

The crisis has led international policy makers to conclude that macro-management is not sufficient to prevent crises and their contagion in an integrated global economy. Thus, in South Korea, the International Monetary Fund has imposed detailed structural conditions that go far beyond the usual Fund policy. It is no coincidence that corporate governance reform in Russia, Asia and Brazil has been a top priority for the OECD, the World Bank and institutional investor activists.

Scandals and failures at major USA corporations

Series of scandals and corporate failures is surfacing in the United States, a market where the other factors we highlighted played a less important role. Many of these cases concern accounting irregularities that enabled firms to vastly overstate their earnings. Such scandals often emerge during economic downturns: as John Kenneth Galbraith once remarked, recessions catch what the auditors miss (Becht, Bolton, Röell, 2005).

1.2. Three Models of Corporate Governance

The corporate governance structure of enterprises in a given country is determined by several factors: the legal and regulatory framework outlining the rights and responsibilities of all parties involved in corporate governance; the de facto realities of the corporate environment in the country; and each corporation's articles of association. While corporate governance provisions may differ from corporation to corporation, many de facto and de jure factors affect corporations in a similar way. Therefore, it is possible to outline a "model" of corporate governance for a given country.

In each country, the corporate governance structure has certain characteristics or constituent elements, which distinguish it from structures in other countries. To date, researchers have identified three models of corporate governance in developed capital markets. These are the Anglo-US model, the Japanese model, and the German model.

We will analyze those models according one of the greatest scientists in the corporate governance and developed capital markets sphere – Professor Geoffrey Mazullo.¹⁷ He has completed number of various researches and analysis on the corporate governance topics across the Europe and other part of the world. Mazullo presented his summary of the corporate governance in various lectures, seminars and conferences across the world.

¹⁷ Mazullo G. Three Models of Corporate Governance in Developed Capital Markets. *Lectures on Corporate Governance*. 2004. Gdansk. Poland. Available at: <http://www.pfsprogram.org/file.php?id=Three+Models+of+Corporate+Governance+-+January+2007.pdf> (2008-03-09);

Each model identifies the following constituent elements:

- ☒ key players in the corporate environment;
- ☒ share ownership pattern in the given country;
- ☒ composition of the board of directors (or boards, in the German model);
- ☒ regulatory framework;
- ☒ disclosure requirements for publicly-listed stock corporations;
- ☒ interaction among key players;

The purpose of this part of work is to introduce each model, describe the constituent elements of each and demonstrate how each developed in response to country-specific factors and conditions.

Though, we should understand that it is not possible to simply select a model and apply it to a given country. Instead, the process is dynamic: the corporate governance structure in each country develops in response to country-specific factors and conditions.

1.2.1. The Anglo-US Model

The Anglo-US model is characterized by share ownership of individual, and increasingly institutional, investors not affiliated with the corporation (known as outside shareholders or “outsiders”); a well-developed legal framework defining the rights and responsibilities of three key players, namely management, directors and shareholders; and a comparatively uncomplicated procedure for interaction between shareholder and corporation as well as among shareholders during or outside the Annual General Meeting (AGM) (Mazullo, 2004). The Anglo-US model governs corporations in the UK, the US, Australia, Canada, New Zealand and several other countries.

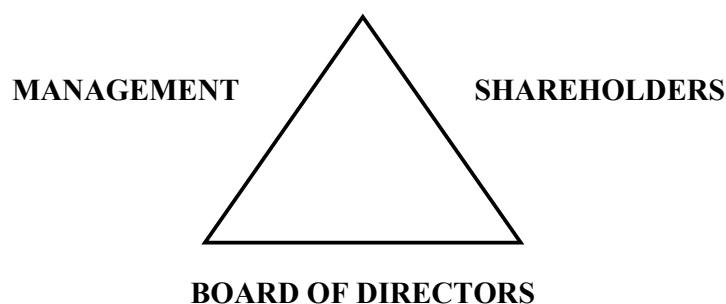
Equity financing is a common method of raising capital for corporations in the United Kingdom (UK) and the US. It is not surprising, therefore, that the US is the largest capital market in the world, and that the London Stock Exchange is the third largest stock exchange in the world (in terms of market capitalization) after the New York Stock Exchange (NYSE) and Tokyo.

There is a causal relationship between the importance of equity financing, the size of the capital market and the development of a corporate governance system. The US is both the world’s largest capital market and the home of the world’s most-developed system of proxy voting and shareholder activism by institutional investors. Institutional investors also play an important role in both the capital market and corporate governance in the UK.

Key Players in the Anglo-US Model

Players in the Anglo-US model include management, directors, shareholders (especially institutional investors), government agencies, stock exchanges, self-regulatory organizations and consulting firms which advise corporations and/or shareholders on corporate governance and proxy voting.

Of these, the three major players are management, directors and shareholders. They form what is commonly referred to as the "corporate governance triangle." The interests and interaction of these players may be diagrammed as in Picture 1.2.:



Picture 1.2. Corporate Governance triangle (Anglo-US Model).

Source: Mazullo (2004)

The Anglo-US model, developed within the context of the free market economy, assumes the separation of ownership and control in most publicly-held corporations. This important legal distinction serves a valuable business and social purpose: investors contribute capital and maintain ownership in the enterprise, while generally avoiding legal liability for the acts of the corporation.

Investors avoid legal liability by ceding to management control of the corporation, and paying management for acting as their agent by undertaking the affairs of the corporation. The cost of this separation of ownership and control is defined as “agency costs”.

The interests of shareholders and management may not always coincide. Laws governing corporations in countries using the Anglo-US model attempt to reconcile this conflict in several ways. Most importantly, they prescribe the election of a board of directors by shareholders and require that boards act as fiduciaries for shareholders’ interests by overseeing management on behalf of shareholders.

Share Ownership Pattern in the Anglo-US Model

In both the UK and the US, there has been a marked shift of stock ownership during the post-war period from individual shareholders to institutional shareholders. In 1990, institutional investors held approximately 61 percent of the shares of UK corporations, and individuals held approximately 21 percent. In 1990, institutions held 53.3 percent of the shares of US corporations (Mazullo, 2004).

The increase in ownership by institutions has resulted in their increasing influence. In turn, this has triggered regulatory changes designed to facilitate their interests and interaction in the corporate governance process.

Composition of the Board of Directors in the Anglo-US Model

The board of directors of most corporations that follow the Anglo-US model includes both “insiders” and “outsiders” (Jones, 2005)¹⁸. An “insider” is as a person who is either employed by the corporation (an executive, manager or employee) or who has significant personal or business relationships with corporate management. An “outsider” is a person or institution which has no direct relationship with the corporation or corporate management.

A synonym for insider is executive director; a synonym for outsider is non-executive director or independent director.

Traditionally, the same person has served as both chairman of the board of directors and chief executive officer (CEO) of the corporation. In many instances, this practice led to abuses, including: concentration of power in the hands of one person (for example, a board of directors firmly controlled by one person serving both as chairman of the board of directors and CEO); concentration of power in a small group of persons (for example, a board of directors composed solely of “insiders”; management and/or the board of directors’ attempts to retain power over a long period of time, without regard for the interests of other players (entrenchment); and the board of directors’ flagrant disregard for the interests of outside shareholders.

Beginning in the mid-1980s, several factors contributed to an increased interest in corporate governance in the UK and US. These included: the increase in institutional investment in both countries; greater governmental regulation in the US, including regulation requiring some institutional investors to vote at AGM’s; the takeover activity of the mid- to late-1980s; excessive executive compensation at many US companies and a growing sense of loss of competitiveness vis-a-vis German and Japanese competitors (Mazullo, 2004).

In response, individual and institutional investors began to inform themselves about trends, conduct research and organize themselves in order to represent their interests as shareholders. Their findings were interesting. For example, research conducted by diverse organizations indicated that in many cases a relationship exists between lack of effective oversight by the board of directors and poor corporate financial performance. In addition, corporate governance analysts noted that “outside” directors often suffered an informational disadvantage vis-a-vis “inside” directors and were therefore limited in their ability to provide effective oversight.

¹⁸ Jones Trefor, “Corporate Governance and Business Objectives” in *Business Economics and managerial decision making* book, 2005, John Wiley and Sons Publishing, 4-21.

Several factors influenced the trend towards an increasing percentage of “outsiders” on boards of directors of UK and US corporations. These include: the pattern of stock ownership, specifically the above-mentioned increase in institutional investment the growing importance of institutional investors and their voting behavior at AGMs; and recommendations of self-regulatory organizations such as the Committee on the Financial Aspects of Corporate Governance in the UK and shareholder organizations in the US.

Board composition and board representation remain important shareholder concerns of shareholders in the UK and US. Perhaps this is because other corporate governance issues, such as disclosure and mechanisms for communication between corporations and shareholders, have largely been resolved.

UK and US boards are generally smaller than boards in Japan and Germany. In 1993, a survey of the boards of the 100 largest US corporations conducted by the executive search firm Spencer Stuart found that boards were shrinking slightly; the average size was 13, compared with 15 in 1988 (Mazullo, 2004).

Regulatory Framework in the Anglo-US Model

In the UK and US, a wide range of laws and regulatory codes define relationships among management, directors and shareholders.

In the US, a federal agency, the Securities and Exchange Commission (SEC), regulates the securities industry, establishes disclosure requirements for corporations and regulates communication between corporations and shareholders as well as among shareholders.

Laws regulating pension funds also have an important impact on corporate governance. In 1988, the agency of the Department of Labor responsible for regulating private pension funds ruled that these funds have a “fiduciary responsibility” to exercise their stock ownership rights. This ruling had a huge impact on the behavior of private pension funds and other institutional investors: since then, institutional investors have taken a keen interest in all aspects of corporate governance, shareholders’ rights and voting at AGMs.

We should note that because US corporations are registered and “incorporated” in a particular state, the respective state law establishes the basic framework for each US corporation’s rights and responsibilities.

In comparison with other capital markets, the US has the most comprehensive disclosure requirements and a complex, well-regulated system for shareholder communication. As noted above, this is directly related to the size and importance of the US securities market, both domestically and internationally.

The regulatory framework of corporate governance in the UK is established in parliamentary acts and rules established by self-regulatory organizations, such as the Securities and Investment

Board, which is responsible for oversight of the securities market. Note that it is not a government agency like the US SEC. Although the framework for disclosure and shareholder communication is well-developed, some observers claim that self-regulation in the UK is inadequate, and suggest that a government agency similar to the US SEC would be more effective. (Mazullo, 2004).

Stock exchanges also play an important role in the Anglo-US model by establishing listing, disclosure and other requirements.

Disclosure Requirements in the Anglo-US Model

As noted above, the US has the most comprehensive disclosure requirements of any jurisdiction. While disclosure requirements are high in other jurisdictions where the Anglo-US model is followed, none are as stringent as those in the US.

US corporations are required to disclose a wide range of information. The following information is included either in the annual report or in the agenda of the annual general meeting (formally known as the “proxy statement”): corporate financial data (this is reported on a quarterly basis in the US); a breakdown of the corporation’s capital structure; substantial background information on each nominee to the board of directors (including name, occupation, relationship with the company, and ownership of stock in the corporation); the aggregate compensation paid to all executive officers (upper management) as well as individual compensation data for each of the five highest paid executive officers, who are to be named; all shareholders holding more than five percent of the corporation’s total share capital; information on proposed mergers and restructurings; proposed amendments to the articles of association; and names of individuals and/or companies proposed as auditors.

Disclosure requirements in the UK and other countries that follow the Anglo-US model are similar. However, they generally require semi-annual reporting and less data in most categories, including financial statistics and the information provided on nominees (Mazullo, 2004).

Interaction Among Players in the Anglo-US Model

As noted above, the Anglo-US model establishes a complex, well-regulated system for communication and interaction between shareholders and corporations. A wide range of regulatory and independent organizations play an important role in corporate governance.

Shareholders may exercise their voting rights without attending the annual general meeting in person. All registered shareholders receive the following by mail: the agenda for the meeting including background information an all proposals ("proxy statement"), the corporation’s annual report and a voting card.

Shareholders may vote by proxy, that is, they complete the voting card and return it by mail to the corporation. By mailing the voting card back to the corporation, the shareholder authorizes

the chairman of the board of directors to act as his proxy and cast his votes as indicated on the voting card.

In the Anglo-US model, a wide range of institutional investors and financial specialists monitor a corporation's performance and corporate governance. These include: a variety of specialized investment funds (for example, index funds or funds that target specific industries); venture-capital funds, or funds that invest in new or "start-up" corporations; rating agencies; auditors; and funds that target investment in bankrupt or problem corporations. In contrast, one bank serves many of these (and other) functions in the Japanese and German models. As a result, one important element of both of these models is the strong relationship between a corporation and its main bank (Mazullo, 2004).

1.2.2. The Japanese Model

The Japanese model is characterized by a high level of stock ownership by affiliated banks and companies; a banking system characterized by strong, long-term links between bank and corporation; a legal, public policy and industrial policy framework designed to support and promote “keiretsu” (industrial groups linked by trading relationships as well as cross-shareholdings of debt and equity); boards of directors composed almost solely of insiders; and a comparatively low (in some corporations, non-existent) level of input of outside shareholders, caused and exacerbated by complicated procedures for exercising shareholders’ votes.

Equity financing is important for Japanese corporations. However, insiders and their affiliates are the major shareholders in most Japanese corporations. Consequently, they play a major role in individual corporations and in the system as a whole. Conversely, the interests of outside shareholders are marginal. The percentage of foreign ownership of Japanese stocks is small, but it may become an important factor in making the model more responsive to outside shareholders.

Key Players in the Japanese Model

The Japanese system of corporate governance is many-sided, centring on a main bank and a financial/industrial network or keiretsu (Mazullo, 2004).

The main bank system and the keiretsu are two different, yet overlapping and complementary, elements of the Japanese model. Almost all Japanese corporations have a close relationship with a main bank. The bank provides its corporate client with loans as well as services related to bond issues, equity issues, settlement accounts, and related consulting services. The main bank is generally a major shareholder in the corporation.

In the US, anti-monopoly legislation prohibits one bank from providing this multiplicity of services. Instead, these services are usually handled by different institutions: commercial bank -

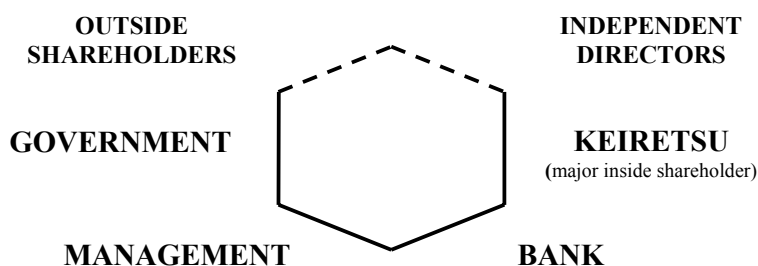
loans; investment bank - equity issues; specialized consulting firms - proxy voting and other services.

Many Japanese corporations also have strong financial relationships with a network of affiliated companies. These networks, characterized by crossholdings of debt and equity, trading of goods and services, and informal business contacts, are known as keiretsu.

Government-directed industrial policy also plays a key role in Japanese governance. Since the 1930s, the Japanese government has pursued an active industrial policy designed to assist Japanese corporations. This policy includes official and unofficial representation on corporate boards, when a corporation faces financial difficulty.

In the Japanese model, the four key players are: main bank (a major inside shareholder), affiliated company or keiretsu (a major inside shareholder), management and the government. Note that the interaction among these players serves to link relationships rather than balance powers, as in the case in the Anglo-US model.

In contrast with the Anglo-US model, non-affiliated shareholders have little or no voice in Japanese governance. As a result, there are few truly independent directors, that is, directors representing outside shareholders. The Japanese model may be diagrammed as an open-ended hexagon presented in picture 1.3.



Picture 1.3. Key Players in the Japanese Model

Source: Mazullo (2004)

The base of the figure, with four connecting lines, represents the linked interests of the four key players: government, management, bank and keiretsu. The open lines at the top represent the non-linked interests of non-affiliated shareholders and outside directors, because these play an insignificant role.

Share Ownership Pattern in the Japanese Model

In Japan, financial institutions and corporations firmly hold ownership of the equity market. Similar to the trend in the UK and US, the shift during the post-war period has been away from individual ownership to institutional and corporate ownership. In 1990, financial institutions (insurance companies and banks) held approximately 43 percent of the Japanese equity market, and

corporations (excluding financial institutions) held 25 percent. Foreigners currently own approximately three percent (Mazullo, 2004).

In both the Japanese and the German model, banks are key shareholders and develop strong relationships with corporations, due to overlapping roles and multiple services provided. This distinguishes both models from the Anglo-US model, where such relationships are prohibited by antitrust legislation. Instead of relying on a single bank, US and UK corporations obtain financing and other services from a wide range of sources, including the well-developed securities market.

Composition of the Board of Directors in the Japanese Model

The board of directors of Japanese corporations is composed almost completely of insiders, that is, executive managers, usually the heads of major divisions of the company and its central administrative body. If a company's profits fall over an extended period, the main bank and members of the keiretsu may remove directors and appoint their own candidates to the company's board. Another practice common in Japan is the appointment of retiring government bureaucrats to corporate boards; for example, the Ministry of Finance may appoint a retiring official to a bank's board.

G. Mazullo states that: "In the Japanese model the composition of the board of directors is conditional upon the corporation's financial performance."

Note the relationship between the share ownership structure and the composition of Japanese boards. In contrast with the Anglo-US model, representatives of unaffiliated shareholders (that is, "outsiders") seldom sit on Japanese boards.

Japanese boards are generally larger than boards in the UK, the US and Germany. The average Japanese board contains 50 members (Mazullo, 2004).

Regulatory Framework in the Japanese Model

In Japan, government ministries have traditionally been extremely influential in developing industrial policy. The ministries also wield enormous regulatory control. However, in recent years, several factors have weakened the development and implementation of a comprehensive industrial policy. First, due to the growing role of Japanese corporations at home and abroad, policy formation became fragmented due to the involvement of numerous ministries, most importantly, the Ministry of Finance and the Ministry of International Trade and Industry. Second, the increasing internationalization of Japanese corporations made them less dependent on their domestic market and therefore somewhat less dependent on industrial policy. Third, the growth of Japanese capital markets led to their partial liberalization and an opening, albeit small, to global standards (Mazullo, 2004). While these and other factors have limited the cohesion of Japanese industrial policy in recent years, it is still an important regulatory factor, especially in comparison with the Anglo-US model.

In contrast, government agencies provide little effective, independent regulation of the Japanese securities industry. This is somewhat ironic, because the regulatory framework in Japan was modelled on the US system by US occupation forces after the Second World War. Despite numerous revisions, the core of Japan's securities laws remains very similar to US laws. In 1971, in response to the first wave of foreign investment in Japan, new laws were enacted to improve corporate disclosure.

The primary regulatory bodies are the Securities Bureau of the Ministry of Finance, and the Securities Exchange Surveillance Committee, established under the auspices of the Securities Bureau in 1992. The latter is responsible for monitoring corporate compliance and investigating violations. Despite their legal powers, these agencies have yet to exert de facto independent regulatory influence.

Disclosure Requirements in the Japanese Model

Disclosure requirements in Japan are relatively stringent, but not as stringent as in the US. Corporations are required to disclose a wide range of information in the annual report and or agenda for the AGM, including: financial data on the corporation (required on a semi-annual basis); data on the corporation's capital structure; background information on each nominee to the board of directors (including name, occupation, relationship with the corporation, and ownership of stock in the corporation); aggregate data on compensation, namely the maximum amount of compensation payable to all executive officers and the board of directors; information on proposed mergers and restructurings; proposed amendments to the articles of association; and names of individuals and/or companies proposed as auditors.

Japan's disclosure regime differs from the US regime (generally considered the world's strictest) in several notable ways. These include: semi-annual disclosure of financial data, compared with quarterly disclosure in the US; aggregate disclosure of executive and board compensation, compared with individual data on the executive compensation in the US; disclosure of the corporation's ten largest shareholders, compared with the US requirement to disclose all shareholders holding more than five percent of the corporation's total share capital; and significant differences between Japanese accounting standards and US Generally Accepted Accounting Practices (US GAAP) (Mazullo, 2004).

Interaction Among Players in the Japanese Model

Interaction among the key players in the Japanese model generally links and strengthens relationships. This is a fundamental characteristic of the Japanese model. Japanese corporations prefer that a majority of its shareholders be long-term, preferably affiliated, parties. In contrast, outside shareholders represent a small constituency and are largely excluded from the process. Annual reports and materials related to the AGM are available to all shareholders. Shareholders

may attend the annual general meeting, vote by proxy or vote by mail. In theory, the system is simple; however, the mechanical system of voting is more complicated for non-Japanese shareholders.

Annual general meetings are almost always pro forma, and corporations actively discourage shareholder dissent. Shareholder activism is restricted by an informal yet important aspect of the Japanese system: the vast majority of Japanese corporations hold their annual meetings on the same day each year, making it difficult for institutional investors to coordinate voting and impossible to attend more than one meeting in person.

1.2.3. The German Model

The German model governs German and Austrian corporations. Some elements of the model also apply in the Netherlands and Scandinavia. Furthermore, some corporations in France and Belgium have recently introduced some elements of the German model.

The German corporate governance model differs significantly from both the Anglo-US and the Japanese model, although some of its elements resemble the Japanese model. Banks hold long-term stakes in German corporations, and, as in Japan, bank representatives are elected to German boards. However, this representation is constant, unlike the situation in Japan where bank representatives were elected to a corporate board only in times of financial distress.

Germany's three largest universal banks (banks that provide a multiplicity of services) play a major role; in some parts of the country, public-sector banks are also key shareholders. There are three unique elements of the German model that distinguish it from the other models outlined in this article. Two of these elements pertain to board composition and one concerns shareholders' rights:

First, the German model prescribes two boards with separate members. German corporations have a two-tiered board structure consisting of a management board (composed entirely of insiders, that is, executives of the corporation) and a supervisory board (composed of labor/employee representatives and shareholder representatives). The two boards are completely distinct; no one may serve simultaneously on a corporation's management board and supervisory board. Second, the size of the supervisory board is set by law and cannot be changed by shareholders.

Third, in Germany and other countries following this model, voting right restrictions are legal; these limit a shareholder to voting a certain percentage of the corporation's total share capital, regardless of share ownership position.

Most German corporations have traditionally preferred bank financing over equity financing. As a result, German stock market capitalization is small in relation to the size of the German economy. Furthermore, the level of individual stock ownership in Germany is low,

reflecting Germans' conservative investment strategy. It is not surprising therefore, that the corporate governance structure is geared towards preserving relationships between the key players, notably banks and corporations. The system is somewhat ambivalent towards minority shareholders, allowing them scope for interaction by permitting shareholder proposals, but also permitting companies to impose voting rights restrictions.

The percentage of foreign ownership of German equity is significant; in 1990, it was 19 percent. This factor is slowly beginning to affect the German model, as foreign investors from inside and outside the European Union begin to advocate for their interests. The globalization of capital markets is also forcing German corporations to change their ways. When Daimler-Benz AG decided to list its shares on the NYSE in 1993, it was forced to adopt US GAAP. These accounting principles provide much greater financial transparency than German accounting standards. Specifically, Daimler-Benz AG was forced to account for huge losses that it could have "hidden" under German accounting rules. (Mazullo 2004, page 10)

Key Players in the German Model

German banks, and to a lesser extent, corporate shareholders, are the key players in the German corporate governance system. Similar to the Japanese system described above, banks usually play a multi-faceted role as shareholder, lender, issuer of both equity and debt, depository (custodian bank) and voting agent at AGMs. In 1990, the three largest German banks (Deutsche Bank AG, Dresdner Bank AG and Commerzbank AG) held seats on the supervisory boards of 85 of the 100 largest German corporations. (Mazullo 2004, page 11)

In Germany, corporations are also shareholders, sometimes holding long-term stakes in other corporations, even where there is no industrial or commercial affiliation between the two. This is somewhat similar, but not parallel, to the Japanese model, yet very different from the Anglo-US model where neither banks nor corporations are key institutional investors.

The mandatory inclusion of labor/employee representatives on larger German supervisory boards further distinguishes the German model from both the Anglo-US and Japanese models.

Share Ownership Pattern in the German Model

German banks and corporations are the dominant shareholders in Germany. In 1990, corporations held 41 percent of the German equity market, and institutional owners (primarily banks) held 27 percent. Neither institutional agents, such as pension funds (three percent) or individual owners (four percent) are significant in Germany. Foreign investors held 19 percent in 1990, and their impact on the German corporate governance system is increasing.

Composition of the Management Board and Supervisory Board in the German Model

The two-tiered board structure is a unique construction of the German model. German corporations are governed by a supervisory board ("Aufsichtsrat") and a management board

(“Vorstand”). (Mazullo 2004, page 11). The supervisory board appoints and dismisses the management board, approves major management decisions; and advises the management board. The supervisory board usually meets once a month. A corporation’s articles of association sets the financial threshold of corporate acts requiring supervisory board approval. The management board is responsible for daily management of the company.

The management board is composed solely of “insiders”, or executives. The supervisory board contains no “insiders”, it is composed of labor/employee representatives and shareholder representatives.

The Industrial Democracy Act and the Law on Employee Co-determination regulate the size and determine the composition of the supervisory board; they stipulate the number of members elected by labor/employees and the number elected by shareholders. The numbers of members of the supervisory board is set by law. In small corporations (with less than 500 employees), shareholders elect the entire supervisory board. In medium-size corporations (defined by assets and number of employees) employees elect one-third of a nine-member supervisory board. In larger corporations, employees elect one-half of a 20-member supervisory board.

Note these two key differences between the German model and the other two models. First, the size of the supervisory board is set by law and cannot be changed. Second, the supervisory board includes labor/employee representatives (Mazullo, 2004).

While the supervisory board includes no “insiders”, it does not necessarily include only “outsiders”. The members of the supervisory board elected by shareholders are usually representatives of banks and corporations which are substantial shareholders. It would be more appropriate to define some of these as “affiliated outsiders” (Jones, 2005).

Regulatory Framework in the German Model

Germany has a strong federal tradition; both federal and state law influence corporate governance. Federal laws include: the Stock Corporation Law, Stock Exchange Law and Commercial Law, as well as the above-mentioned laws governing the composition of the supervisory board are all federal laws. Regulation of Germany’s stock exchanges is, however, the mandate of the states.

A federal regulatory agency for the securities industry was established in 1995. It fills a former void in the German regulatory environment. (Mazullo, 2004).

Disclosure Requirements in the German Model

Disclosure requirements in Germany are relatively stringent, but not as stringent as in the US. Corporations are required to disclose a wide range of information in the annual report and/or agenda for the AGM, including: corporate financial data (required on a semi-annual basis); data on the capital structure; limited information on each supervisory board nominee (including name,

hometown and occupation/affiliation); aggregate data for compensation of the management board and supervisory board; any substantial shareholder holding more than 5 percent of the corporation's total share capital; information on proposed mergers and restructurings; proposed amendments to the articles of association; and names of individuals and/or companies proposed as auditors.

The disclosure regime in Germany differs from the US regime, generally considered the world's strictest, in several notable ways. These include: semi-annual disclosure of financial data, compared with quarterly disclosure in the US; aggregate disclosure of executive compensation and supervisory board compensation, compared with individual data on executive and board compensation in the US; no disclosure of share ownership of members of the supervisory board, compared with disclosure of executive and director's stock ownership in the US; and significant differences between German accounting standards and US GAAP.

One key accounting difference in Germany is that corporations are permitted to amass considerable reserves. These reserves enable German corporations to understate their value. This practice is not permitted under US GAAP.

Until 1995, German corporations were required to disclose shareholders holding more than 25 percent of the total share capital. In 1995, this threshold was lowered to 5 percent, bringing Germany in line with international standards (Mazullo, 2004).

Interaction Among Players in the German Model

The German legal and public-policy framework is designed to include the interests of labor, corporations, banks and shareholders in the corporate governance system. The multi-faceted role of banks has been described above.

On the whole, the system is geared towards the interests of the key players. There is, nevertheless, some scope for participation by minority shareholders, such as the above-mentioned provisions concerning shareholder proposals.

The majority of German shares are issued in bearer (not registered) form. Corporations with bearer shares are required to announce their annual general meeting in an official government bulletin and forward the annual report and agenda for meeting to custody banks. The banks forward these materials to the beneficial owners of the shares. This often complicates the procedure for receipt of materials, especially for foreign shareholders.

In Germany, most shareholders purchase shares through a bank, and banks are permitted to vote the shares of German they hold on deposit. The procedure is as follows: The beneficial shareholder grants a general power of attorney to the bank, and the bank is permitted to vote the shares for a period up to 15 months. The corporation sends the meeting agenda and annual report to its custody bank. The bank forwards these materials and its (the bank's) voting recommendations to the German shareholder. If the beneficial shareholder does not provide the bank with his/her

specific voting instructions, the bank may vote the shares according to its own interpretation. This leads to a potential conflict of interest between the bank and the beneficial shareholder. It also increases the potential voting power of the bank, because some shareholders might not provide specific voting instructions and the bank may exercise the votes according to its interpretation. Because the level of individual share ownership in Germany is very low, this is not a huge problem. Nevertheless, it reflects a certain pro-bank and anti-shareholder tendency of the system.

Other obstacles to shareholder participation include the above-mentioned legality of voting right restrictions, and the fact that shareholders may not vote by mail. As noted above, shareholders must either attend the meeting in person or to be represented in person, i.e., by their custodian bank. Despite these obstacles, minority German shareholders are not inactive. In fact, they often oppose management proposals and present a wide range of counterproposals and proposals at the AGMs and EGMs of many German corporations each year. In Austria, minority shareholders are less active, perhaps because the Austrian government is, directly or indirectly, a large shareholder in many companies (Mazullo, 2004).

In this part of the work, we have introduced each model, describe the constituent elements of each and demonstrate how each developed in response to country-specific factors and conditions. It should reflect the fact that it is not possible to simply select a model and apply it to a given country. Instead, the process is dynamic: the corporate governance structure in each country develops in response to country-specific factors and conditions.

With the globalization of capital markets, each of these three models is opening (albeit slowly) to influences from other models, while largely retaining its unique characteristics. Legal, economic and financial specialists around the world can profit from a familiarity with each model.

1.3. Ownership structure

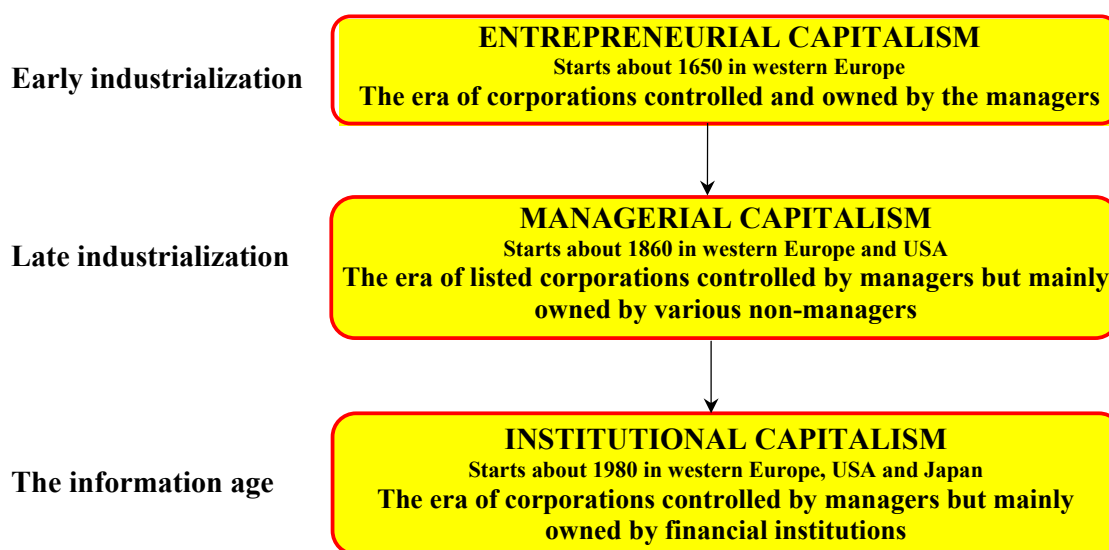
The importance of the above topic is evident in the fact that corporate governance and the ownership structure of companies is currently characterized by change processes as the economies of the world become more and more globally integrated. Ownership structures are also of major importance in corporate governance because they affect the incentives of managers, and thereby the efficiency of firms.

The ownership structure is defined by the distribution of equity with regard to votes and capital, but also by the identity of the equity owners. A classic reference is Jensen and Meckling (1976)¹⁹, who discussed the nature of agency costs associated with outside claims on the firm - both debt and equity. Their purpose was to integrate concepts into the beginnings of a theory of corporate ownership structure.

¹⁹ Jensen M. C., Meckling W. H. 1976. Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure – Journal of Financial Economics, 3, 305-360. Available at: Social science Research Network (2008-03-02)

1.3.1. The ownership history of the large enterprise

Corporate Governance Encyclopedia presents the ownership history of the large enterprises.²⁰ It is divided into three stages: entrepreneurial capitalism in the early industrialization age, managerial capitalism in the late industrialization age and institutional capitalism in the information age. Entrepreneurial capitalism starts about 1650 year in the Western Europe and it is defined as the era of corporations controlled and owned by the managers. Managerial capitalism starts about 1860 year in the Western Europe and USA. This period is called as the era of listed corporations controlled by managers, but mainly owned by various persons that are not involved in the management of the company. Institutional capitalism starts about 1980 year in the Western Europe USA and Japan. This period is called as the era of corporations controlled by managers, but mainly owned by financial institutions. Everything can be summarized as it is in picture 1.4.:



Picture 1.4. The ownership history of the large enterprise

Source: Corporate Governance Encyclopedia

1.3.2. Ownership Research and Corporate Governance

Generally, one can assume that a higher ownership stake comes with more influence on the management of the respective entity. It follows that the more dispersed share ownership one company has, the more independently the management may govern the organization. The ownership structure of companies has attracted much attention in the wake of scandals involving corporate governance. Recently there has been considerable interest in the corporate governance practices of modern corporations, particularly since the high-profile collapse of several firms.

²⁰ Corporate Governance Encyclopedia, Available at: <http://e.viaminvest.com/> (2008-10-25);

Because of concerns about money laundering and terrorist financing, it is appropriate to introduce more specific and detailed provisions that verify the identity of any owner.

The identification of share owners - be they families, banks, institutions investors, governments, or other companies - has important implications for a company's corporate strategy and performance. For example, compared to other owner identities, financial investor ownership is found to be associated with higher shareholder value and profitability, but lower sales growth. The effect of ownership concentration is also found to depend on owner identity (Thomsen, Pedersen, 2000)²¹. The identity of the ultimate owner of a corporation could have a direct influence on its dividend policy. The wealth of an individual or a family as a large block holder is directly affected by the chosen dividend pay-out policy. Things become more complicated if the state or a financial firm are ultimate owners, since these are also agents, and the notion of cash flow rights becomes blurred (Gugler, Yurtoglu, 2003)²². Owners are an important source of capital for entrepreneurial ventures, yet their considerable potential seems to go unrealized in the capital market.

There are considerable differences between the different profile, style or types of owners. This means that the various owner categories perceive the capital market differently. Accordingly, different owner classes will probably respond differently to private and public efforts introduced to stimulate the capital market. It would be especially interesting, for example, to learn more about owners as they are accumulating wealth and experience. An owner's profile or style can be defined by their preference in money decisions, such as: deciding between short term trading or long term holding; whether they are averse or tolerant to risk; whether they hold all classes of assets or just one type (stocks for example); whether they prefer a stock's value or its growth potential, big cap or small cap stocks, and their choice between defensive or cyclical stocks; their use or avoidance of derivatives; their diversification between home turf or international investments; and whether they are hands-on or prefer investment funds. In the case of state ownership, politicians are likely to have interests in addition to maximizing enterprise restructuring, such as their preserving jobs.

Efficiency. There is general evidence that state owned firms are less efficient than privately owned firms (Djakov, 1999)²³. La Porta, Lopez-de-Silanes, Shleifer (1999)²⁴ studied the ownership structures of large corporations in 27 wealthy economies to identify the ultimate controlling shareholders of these firms. They found that, except in economies with very good shareholder protection, relatively few of these firms were widely held, a finding that contrasts with Berle and

²¹ Thomsen S., Pedersen T., Ownership Structure and Economic Performance in the largest European Companies, *Strategic Management Journal* 2000, No.21(6) Available at: EBSCOhost Web. Business Source Premier. (2008-03-09)

²² Gugler K., Yurtoglu B. Corporate governance and dividend pay-out policy in Germany, *European Economic Review* 2003, No.47(4). Available at: EBSCOhost Web. Business Source Premier. (2008-03-09);

²³ Djakov S. Ownership Structure and Enterprise Restructuring in Six Newly Independent States. *Comparative Economic Studies*, 1999. Available at: EBSCOhost Web. Business Source Premier. (2008-03-09);

²⁴ La Porta R., Lopez-de-Silanes F., and A. Shleifer. "Corporate Ownership Around the World." *Journal of Finance*, 1999 No.54(2): 471-517. Available at: EBSCOhost Web. Business Source Premier. (2008-03-09);

Means's image of the ownership of the modern corporation. Rather, families or states typically control these firms. It is far less common for financial institutions to control equity. The controlling shareholders typically have power over firms, significantly over their cash flow rights, primarily through the use of pyramids and participation in management. Private individual investors and institutional investors are not equal. Individuals have to unite to take effective action. Large outside owners have opportunities to expropriate value, particularly when the minority shareholders are not well protected.

When financial institutions are large owners, there is a potential for conflicts of interest to arise that adversely affect minority shareholders. Commercial banks could face conflicts when they are large creditors of the firms in which they hold equity stakes. There can be a direct dilution of other equity holders for the benefit of the bank, for example, through higher lending spreads. Financial institutions related to banks may also have the interests of the bank as a creditor in mind when deciding which company to invest in and how to value a firm (Djakov, 1999).

However, financial institutions with an equity stake in a company can also better monitor a firm and its management, offsetting the negative effects of its involvement in the company, such as the potential for conflicts of interest to arise. The net effect of financial institutions' ownership on the valuation of a firm and its profitability is therefore unclear. Some corporate outside investors, for example, may more competently evaluate firms, based on their access to better information. Other corporate investors may be better owners as they may have access to technology or know-how not available to the firm (e.g., foreign investors) or they may have special monitoring skills (e.g., trade creditors who are owners), which may raise the valuation or profitability of the firm

Interaction with Corporate Governance. The empirical work on the association between managerial ownership and corporate restructuring dates back more than sixty years to Berle and Means (1932). They contended that widespread ownership yields significant power in the hands of managers whose interests do not coincide with the interest of shareholders. As a result, corporate resources are not used for the maximization of shareholders' value. Employee ownership has not been extensively studied. It has been argued that unionized employees more likely seek control of a firm, but the actual monitoring role of employee owners has not been well documented (Djakov, 1999). The privatization processes in Eastern Europe created ownership structures that were very different from those observed in developed Western economies.

It seems that all research on corporate governance is actually research on ownership. Ownership is the exclusive possession or control of some thing, which may be an object or some kind of property. Some consider the term to be closely associated with the idea of private or public wealth. It is also claimed by some that the exclusivity of ownership underlies much social injustice,

and facilitates tyranny and oppression on an individual and societal scale. Ownership research needs delicate and sensitive information.

1.3.3. Concentrated Ownership across Countries

A common measure of ownership concentration is whether one shareholder owns at least 20 percent of a company's voting rights; such a shareholder is called a "controlling shareholder." The first column of table 1.1. shows what percentage of the 20 largest listed companies in France, Germany, Italy, the United Kingdom, and the United States are widely held, or do not have a controlling shareholder. Dispersed ownership is common in the United States and United Kingdom and very rare in Italy, with Germany and France falling in the middle. The second column shows that, with the exception of Britain, family control is quite common even among the largest corporations. Pyramidal ownership is a common way of holding control in continental Europe. A pyramid is defined as an ownership structure in which the controlling shareholder exercises control of one company through ownership of at least one other listed company. A column 3 show that pyramidal ownership is absent in Britain and America, but is found even among the top 20 corporations in France, Germany, and Italy.

Table 1.1. Ownership concentration across the Europe, 1995.

	<i>Widely held</i>	<i>Family control</i>	<i>Pyramid control</i>	<i>Median largest voting block</i>	<i>Family wealth</i>
France	60%	20%	15%	20%	29%
Germany	50%	10%	20%	57%	21%
Italy	20%	15%	20%	55%	20%
United Kingdom	100%	0%	0%	10%	6%
United States	80%	20%	0%	5% (NYSE) 9% (Nasdaq)	N.A.

Sources: : La Porta, Lopez-de-Silanes, and Shleifer (1999), Barca and Becht (2001)²⁵; Faccio and Lang (2002)²⁶.

"Widely held" is the fraction of firms with no controlling shareholder among the 20 largest companies by stock market capitalization at the end of 1995. A company has a controlling shareholder if the sum of a shareholder's direct and indirect voting rights exceeds 20 percent. "Family control" is the fraction of the 20 largest companies where the controlling shareholder is an individual. "Pyramid control" is the fraction of the 20 largest companies, where the controlling shareholder exercises control through at least one publicly traded company. "Median largest voting block" is the median size of the largest ultimate voting block for listed industrial companies.

²⁵ Barca, Fabrizio, and Marco Becht, eds. *The Control of Corporate Europe*. 2001. Oxford: Oxford University Press.

²⁶ Faccio, Mara, and Larry Lang. "The Ultimate Owner of Western European Corporations." *Journal of Financial Economics*, 2002. no.65(3): 365– 95.

“Family wealth” is the percentage of total stock market capitalization controlled by the ten richest families.

Why do no pyramids exist in the United States or the United Kingdom? The answer probably lies in historical differences in regulation: Morck and Yeung (2005)²⁷ suggested that the taxation of inter-company dividends introduced in 1935 could explain the disappearance of pyramids in the United States. According to Franks, Mayer, and Rossi (2005)²⁸, the introduction of the mandatory takeover bid in 1968 may explain the disappearance of pyramids in the United Kingdom.

The difference between the United States and the United Kingdom on the one hand and continental Europe on the other is not restricted to the largest corporations. Going by the median fraction of votes owned by the largest shareholder in all listed companies, shown in column 4 of Table 1.1., ownership is highly concentrated in Germany and Italy, and diffused in Britain and America, with France in an intermediate position. Remarkably, in half of German and Italian listed companies, one blockholder owns at least 57 percent or 55 percent, respectively, of the votes. A final measure of ownership concentration is the share of a country’s total stock market capitalization held by the ten richest families. By this measure, displayed in column 5, company ownership in continental Europe is concentrated in the hands of a small number of wealthy individuals.

1.3.4. Legal Tools to protect owners

Dominant shareholders (and insiders more generally) have opportunities to expropriate investors. Can this problem be solved without regulation, namely via private contracting and social norms? From the available evidence, the answer is no. For instance, we know that countries with weaker investor protection have less-developed financial markets (La Porta, Lopez-de-Silanes, Shleifer, and Vishny, 2006)²⁹ and that weaker insider trading legislation and enforcement is associated with higher cost of capital. Because finance matters for growth (Zingales, 1998), financial regulation matters. In this section, we briefly describe four legal tools that are commonly used to protect owners.

Strengthening Internal Governance Mechanisms

The board of directors is the primary institution of corporate governance. Its main task is to hire and monitor top management on behalf of shareholders, and it is best placed to screen related-party transactions. Whether firms are widely held or family-controlled, the danger is that boards,

²⁷ Randall, Wolfenzon, and Yeung. “Corporate Governance, Economic Entrenchment and Growth.” *Journal of Economic Literature*, 2005, no.43, 655–720.

²⁸ Franks, Julian, Colin Mayer, and Stefano Rossi. “Spending Less Time with the Family: The Decline of Family Ownership in the United Kingdom.” In *A History of Corporate Governance Around the World*, 2005. 581–607.

²⁹ La Porta, Lopez-de-Silanes, Shleifer. “What Works in Securities Laws?” *Journal of Finance*, 2006, no.61(1).1–32.

rather than represent the interests of faceless shareholders, will bond with management, whom they interact with regularly, or with the family, who has the ultimate power to select and remove them. Regulations mandating greater independence for directors and defining the board's functions, powers, and internal workings—including matters like auditing, setting executive compensation, screening related-party transactions, and disclosure of information flows—may give the board of directors some power to challenge the dominant shareholder. So far, though, little evidence exists that these reforms have curbed controlling shareholders' abuses (Denis and McConnell, 2003)³⁰.

Empowering Shareholders

The law traditionally protects shareholders by enhancing their rights to sell, sue, and vote. First, in widely held companies, the shareholders' right to sell their shares allows for a market for corporate control to emerge as a mechanism to limit insider abuses. However, where ownership is highly concentrated, as in continental Europe, this market only disciplines the insiders of the relatively few companies that are widely held (Rossi and Volpin, 2004)³¹.

Second, regulators may empower shareholders by granting them the right to sue the company and its directors. The effect of such suits will depend on how easy or costly it is to bring them and how efficient the court system is.

Third, regulation can empower shareholders by giving them a say over key corporate governance issues. For this purpose, regulators can extend the subject matters to be decided by the shareholder meeting, mandate super-majority requirements, lower the cost of voting, limit deviations from one-share-one-vote, and mandate minority shareholders' representation on the board. The evidence in Djankov, La Porta, Lopez-de-Silanes, and Shleifer (2006) indicates that shareholders' right to vote on self-dealing transactions is particularly important.

Control transactions may also provide the occasion for self-dealing (Kirchmaier and Grant, 2005)³². Controlling shareholders may reject value-maximizing takeovers (if they are not fully compensated for the foregone private benefits of control), and accept value-destroying ones that let them appropriate the control premium. The law can protect minority shareholders by allowing them to share the control premium with majority shareholders (so as to align the incentives of controlling and minority shareholders).

³⁰ Denis, Diane, and John J. Mc Connell. "International Corporate Governance." *Journal of Financial and Quantitative Analysis*, 2003, no.38(1): 1–36.

³¹ Rossi, Stefano, and Paolo Volpin. "Cross-Country Determinants of Mergers and Acquisitions." *Journal of Financial Economics*, 2004, no.74(2): 277–304.

³² Kirchmaier, Tom, and Jeremy Grant. 2005. "Financial Tunnelling and the Revenge of the Insider System." FMG Discussion Papers dp536, Financial Markets Group. Available at: <http://ideas.repec.org/p/fmg/fmgdps/dp536.html> (2008-03-09);

Enhancing Disclosure Requirements

Whether shareholders effectively exercise their rights to sell, vote, and sue depends on their access to information. An extensive regime of disclosure may help alleviate agency problems in listed corporations. For example, mandatory disclosure of related-party transactions and of directors' compensation can be an effective tool to limit self-dealing by those in control. Disclosure of price-sensitive information helps prevent insider trading (Enriques and Volpin, 2007)³³.

Tougher Public Enforcement

Another type of regulatory intervention is enforcement of corporate and securities laws through supervisory agencies and criminal sanctions. Little evidence exists that public enforcement matters (Djankov, La Porta, Lopez-de-Silanes, and Shleifer, 2006). Yet public enforcement may be the most effective tool to prevent specific forms of expropriation, like insider trading, which are otherwise hard to detect. It may also be needed to impose sufficiently severe sanctions, like prison terms, in extreme cases.

This part of the thesis was devoted for general and basic theoretical background of analyzed issues of corporate governance and ownership structure. As it was set in objectives of the work, here was performed the theoretical overview of definitions, history, developments background, and models of corporate governance. Analysis of available models of corporate governance presented key players in the corporate environment, share ownership patterns in the given country of the model, composition of the board of directors, regulatory framework, disclosure requirements, interaction among key players and others conditional aspects. Next, the theoretical background for ownership structure was presented. Here, ownership was defined and historical development of the ownership was presented. Some theoretical interaction with corporate governance was discussed, including the identification of share owners, efficiency and concentration issues. Finally, some legal tools to protect owners were presented. According this structure of analysis we will practically develop research of the situation and peculiarities in background of Lithuania and other chosen countries in the next parts of the paper.

³³ Luca Enriques and Paolo Volpin, 2007. "Corporate Governance Reforms in Continental Europe." *Journal of Economic Perspectives*, 21(1:) 117–140. Available at: <http://ssrn.com/abstract=970796> (2008-03-09);

2. EMPIRICAL ANALYSIS OF CORPORATE GOVERNANCE AND OWNERSHIP STRUCTURE IN LITHUANIA

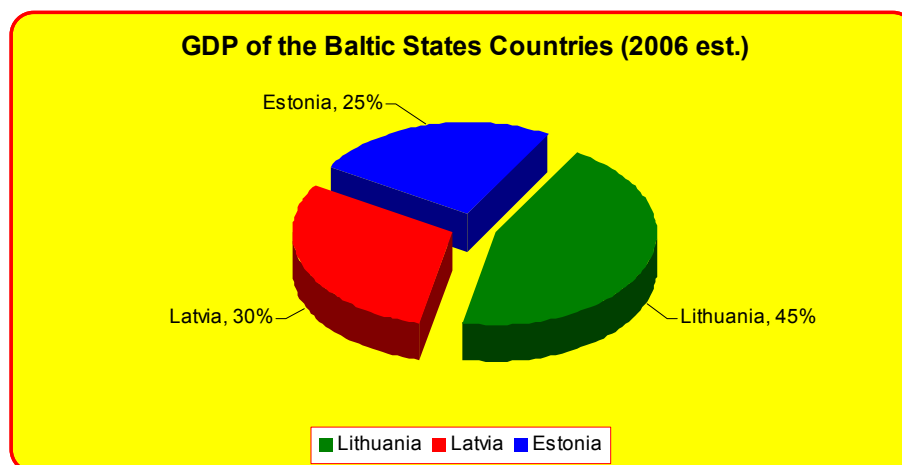
2.1. Macroeconomic situation in Lithuania

Overview of the current economical situation in Lithuania is required, as the country where the survey and whole analysis of the paper is performed, to draw the actual sketch of the analyzed business environment.

Lithuania is **the largest of the 3 Baltic States** in terms of population, territory, and economy (approximately 3, 36 million inhabitants (2007 est.); 65 300 sq meters area). It is located at the geographic centre of Europe and has common borders with Poland, Latvia, Belarus, and Russia. Lithuania is independent democratic republic, the powers of the state are exercised by the Seimas (Parliament), the President, the Government, and the Judiciary. It is a full member of NATO (March 29, 2004) and the European Union (May 1, 2004).³⁴

Lithuania has put in an **impressive economic performance** in the past few years, earning such nicknames as the “Ballistic Baltic” and the “**Baltic Tiger**” from foreign market observers for the speed and expected sustainability of its recent economic growth. The economy made a sharp turnaround in the aftermath of the Russian crisis of 1998. GDP grew by more than 6 percent in 2001-2002, 10.3 percent in 2003, and in the stable pace of approximately 8 percent in the last years (2004 - 7.4 percent, both 2005 and 2006 - 7.8 percent, and 2007 - 8.9 percent).

Lithuania is the biggest economy among the Baltic States, **producing almost half of the GDP of the region** (Picture 2.1.).³⁵



Source: Lithuanian Department of Statistics

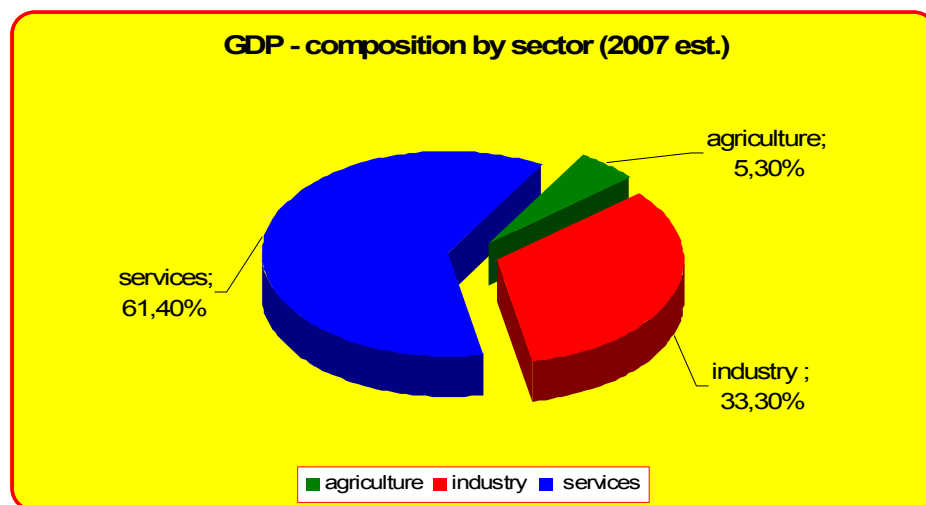
Picture 2.1. GDP of the Baltic States Countries

³⁴ The World Bank – Assessment of Investment Climate in Lithuania, 2005; Available at: http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2005/05/25/000011823_20050525091251/Original/324210LTOICA0R1May0180200501public1.doc (2009-01-09);

³⁵ Department of Statistics to the Government of the Republic of Lithuania Available at: <http://www.stat.gov.lt/en/pages/view/?id=1425> (2009-01-13);

Unemployment rate in Lithuania significantly went down from record of 17.4 percent in year 2001 to approximately 5.6 percent in year 2006 and 4.3 percent in year 2007, becoming one of the lowest in the Europe. In comparison with previous years, **inflation** grew by 4.5 percent in year 2006 and 8.1 percent in year 2007.

GDP – composition by sector in Lithuania (Picture 2.2.) represents that in year 2007 service sector formed biggest part (61.40%) of countries GDP. Sufficient part of GDP (33.30%) went to industrial, and the smallest part (5.30%) – to agricultural sectors.



Source: Lithuanian Department of Statistics

Picture 2.2. GDP – composition by sector in Lithuania

National monetary currency unit is **Litas**. On February 2, 2002, the government re-pegged the Litas from the U.S. dollar to the Euro at the rate of 3.4528 Litas for 1 Euro. The re-peg, which went smoothly, reflects a change in trade orientation and was meant to help Lithuania prepare for membership in the EU Economic and Monetary Union. However, with the appreciation of local currency against the U.S. dollar, the production costs of enterprises have been decreasing, and competitiveness increasing.

Like other Baltic States countries (Estonia and Latvia), Lithuania also has a flat tax rate rather than a progressive scheme. Lithuanian income levels still lag behind the rest of the older EU members, with per capita GDP in 2007 at 60 percent of the EU average. Lower wages may have been a factor that in 2004 influenced the trend of emigration to wealthiest EU countries, something that has been made legally possible as a result of accession to the European Union.

Foreign direct investment are growing steadily, 35.5 billion Litas (approximately 10.3 billion Euro) in year 2007, increasing approximately in 30% pace in last few years. On average, FDI per capita was 10,300 Litas or 2,980 Euro. The largest investor was Poland with 1.8 billion Euro (18% of total FDI) invested in Lithuania followed by Denmark (1.3 billion Euro or 12.9%), Sweden (1.2 billion Euro or 11.7%), Russia (966 million Euro or 9.6%), Germany (857 million

Euro or 8.6%), Estonia (587 million Euro or 5.9%), Finland (516 million Euro or 5.2%), Latvia (444 million Euro or 4.4%), and the Netherlands (429 million Euro or 4.3%).

On 1 January 2008, there were **3,396 foreign investors in Lithuania**. Most of them were from Germany (425), Latvia (310) and Estonia (295). Meanwhile, Poland, which was the largest FDI investor in Lithuania by value during the period concerned, ranked only tenth in terms of the number of investors (156) as the majority of all investments came from a single large Polish investor, i.e. the oil refining concern PKN ORLEN.

Most FDI went to the **manufacturing industry** (36.3% of total FDI, of which 23.4% to manufacturing of petrochemical products), financial intermediation (17.2%), transport, storage and communications (12.8%), wholesale and retail trade (11.5%), electricity, gas and water supply (9.3%), real estate, renting and other business activities (8.4%).³⁶

Main industries of the country: metal-cutting machine tools, electric motors, television sets, refrigerators and freezers, petroleum refining, shipbuilding (small ships), furniture making, textiles, food processing, fertilizers, agricultural machinery, optical equipment, electronic components, computers, amber and other. Agriculture products are: grain, potatoes, sugar beets, flax, vegetables, beef, milk, eggs, fish, other.

Since the Russian monetary crisis, the focus of Lithuania's export markets has shifted from East to West. In 1997, exports to former Soviet states made up 45 percent of total Lithuanian exports. In 2005, exports to the East were only 18 percent of the total, while exports to EU members amounted to 65 percent.

Exports of the country recorded 43.2 billion Litass (approximately 12.5 billion Euro) in year 2007. Main exports commodities are: mineral products 23%, textiles and clothing 16%, machinery and equipment 11%, chemicals 6%, wood and wood products 5%, foodstuffs 5% (2001 est.). Exports partners: EU 65.4%, Russia 10.4%, Latvia 10.3%, Germany 9.4%, France 7.0%, Estonia 5.9%, Poland 5.5%, Sweden 5% (2005 est.).

Imports of the country totaled 61.5 billion Litass (approximately 17.8 billion Euro) in year 2007. Main imports commodities are: mineral products 21%, machinery and equipment 17%, transport equipment 11%, chemicals 9%, textiles and clothing 9%, metals 5% (2001 est.). Imports partners are: EU 59.1%, Russia 27.8%, Germany 15.2%, Poland 8.3%, Latvia 3.9%, and Netherlands 3.7%.³⁷

Principal macroeconomic indicators, business and social environment, whole financial and economic situation in the country - all of them were increasing in enormous pace until year 2008.

³⁶ Lithuanian Development Agency - Overview of Foreign Direct Investment, 2007. (2009-01-13); Available at: www.lida.lt/files/File/InfoCentras/Atsisiusti/2416_2007_lietuvos_ekonomikos_apzvalga_en-1.pdf

³⁷ CIA (Central Intelligence Agency, USA) The World Factbook – Lithuania. Available at: <https://www.cia.gov/library/publications/the-world-factbook/geos/lh.html> (2009-01-13);

In year 2008 much of the industrialized world entered into a deep recession sparked by a financial crisis that had its origins in reckless lending practices involving the origination and distribution of mortgage debt in the United States. Sub-prime loans losses in 2007 exposed other risky loans and over-inflated asset prices. With the losses mounting, a panic developed in inter-bank lending. As share and housing prices declined many large and well established investment and commercial banks in the United States and Europe suffered huge losses and even faced bankruptcy, requiring massive public financial assistance. A global recession has resulted in a sharp drop in international trade, rising unemployment and slumping commodity prices.

According to preliminary data, annual **GDP growth in Lithuania was negative in 2008**, and economic cycle of the country turned to the downturn, as the whole economy of the world. Following extensive changes in economic development in 2008, negative GDP growth is projected for the two coming years. Domestic demand will continue to slow down, however, net exports growth will be positive. At the same time, both inflation and current account deficit will fall rapidly. GDP is expected to reach its lowest level in the second half of 2010.³⁸

The recession was clearly recognized in all segments of **Lithuanian financial market** in year 2008. Decrease of the index of the “NASDAQ OMX Vilnius” (National) Stock Exchange started in late 2007 and strongly accelerated in 2008, reaching the decrease of the index by 65%. Such change in stock prices was conditioned not only by the declining economy and decreasing financial results of the companies and expectations of the investors, but also by several panic outbreaks. Market participant, who were investing borrowed assets, withdraw from the market, due to diminished value of required pledge. It was the additional factor of the declined price of the stock. Overall turnover of the NASDAQ OMX Vilnius Stock Exchange in 2008 was 2.2 time less than in year 2007 and totaled 1.8 billion Litas, while market capitalization declined from 27 billion to 12 billion Litas.³⁹

Here should be emphasized that whole paper, including all performed surveys and analysis, has been developed in year 2007-2009. **All possible changes and discrepancies, occurred due to the economic recession started in year 2008, are not considered in analysis of the topic and have no influence for the development and results of the paper.** All referred material, statistical data and other sources required for the analysis are mainly from the period before recession have started. This provision ensures common and healthy background for the analysis of the topic.

³⁸ Bank of Lithuania – Economic outlook for Lithuania, 2009. Available at: http://www.lb.lt/eng/economy/macroeconomy/PranesimasSpaudai_200901_EN.pdf (2009-02-15);

³⁹ Securities Commission of Republic of Lithuania - Annual report, 2008. Available at: <http://www.vpk.lt/new/documents/2008%20veiklos%20ataskaita.pdf> (2009-02-15);

2.2. Survey on Corporate Governance and Ownership Structure in Lithuania

2.2.1. Background

Almost all main activities of the company, such as management, operation, financial and corporate issues have always great interest and are objects of various surveys or analysis. Not an exception is our analyzed issue of corporate governance, which is receiving noticeably more and more attention in last years.

Starting from the employees and investors, through competitors and whole society, ending with numerous statistical and educational institutions – all are somehow interested in this matter or somehow touched by it. Ones are looking for the efficient investment opportunities in the companies with verified and good governance, others to research, develop or just implement in their own business successful practice of the corporate governance of certain companies. It is important to discover and analyze available and relevant data, surveys and analysis on the matter of the corporate governance not only for understanding and grounding the adduced theory, but, what is more important, to explain and analyze current corporate governance situation with emphasize on governance characteristics and peculiarities actual for Lithuania.

It should be mentioned, that there is not many doubt, that certain corporate governance features in Lithuania should be related or even very similar with corporate governance systems practiced in other European countries. Therefore, there is need for the sound comparison and analyzes of possible analogies with other countries, that will be definitely included into our coming survey. Analysis of governance development and practices in well developed countries, such as Great Britain, France and Germany, will provide us perfect studies to compare and evaluate Lithuania's situation and perspectives. Overview of the corporate governance in the closest countries or similar economies, would give us opportunity to draw the picture of the governance in the regional and economical contexts.

We would start from the analysis of our performed survey. This survey took the form of questionnaire with the reference to the different aspects of the economical activities of the enterprises in Lithuania. Whole questionnaire was divided into such 5 categories:

1. Characteristics of the enterprise
2. Innovations and Financial aspects
3. Operating and Management (Business style)
4. Ownership Structure and Corporate Governance
5. Personnel aspects

We should note, that questionnaire was created and developed by Vilnius Gediminas Technical University prof. dr. Manuela Tvaronavičienė in year 2006-2007. This survey was formed with the aim to discover relevant and actual characteristics on the topics that are scientifically researched by the professor throughout the different topics on enterprise economics and in other research fields. In the same time, this survey provides the opportunity to use results in further university researches and scientific developments and analysis. Exactly in this case, relative parts of this questionnaire are taken from the questionnaire and used in analyzing chosen aspects of corporate governance and ownership structure in Lithuania's enterprises.

So, now we can state, that **goal of the whole questionnaire** is to overview numerous companies according different aspects of the economical activities, receive direct and exact information, that is valuable as for the economical estimation and research, as for the future development and other analysis.

Hence, the purpose of the usage relative parts of the survey is to estimate actual corporate ownership and governance situation in Lithuania's enterprises and evaluate its significance for the efficient and successful operation of the enterprise.

The **volume of survey** is 1001 enterprisers from all business sectors in Lithuania. However 213 questionnaires were denied because of incorrect filling in. The rest respondents were divided into two main groups:

- ☒ **539** - service industry enterprisers,
- ☒ **249** - manufacturing industry enterprisers

Benefit of questionnaire. Results of this survey let us evaluate actual state of governance and ownership in Lithuania's enterprises. It will lead to significant conclusions, references for further research developments and forecasting future trends. The developed method could be successfully applied in any country analyzing different business and economical data. Generalized, it can be presented as in Picture 2.3., from analyzing the results of the survey, realizing actual situation of the analyzed environment to the deriving appropriate conclusions with developing possible future trends and further research opportunities.



Source: compiled by author

Picture 2.3. Survey analysis method

2.2.2. Results and analysis

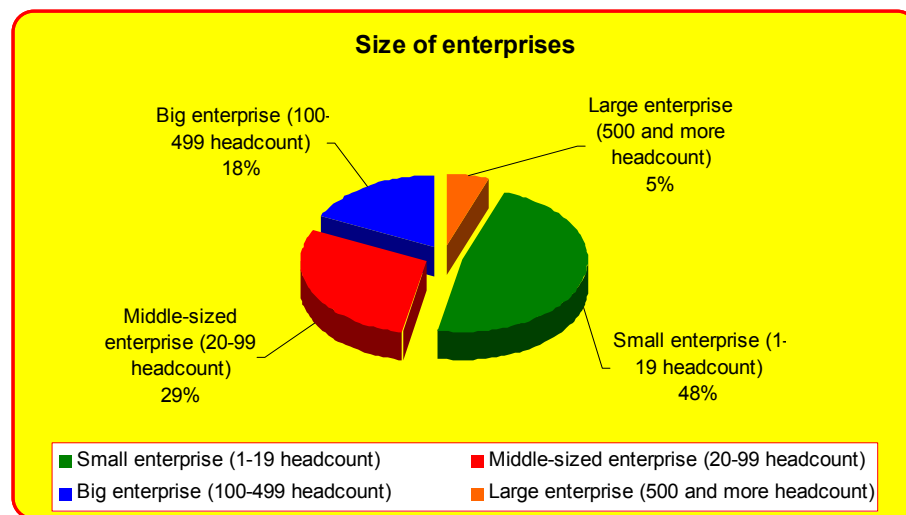
As the object of our whole work is corporate governance, ownership structure, related management and operational issues, so all related information from the survey are important for the whole our research. Completed survey gave us valuable information about discussed issues and it should be appropriately analyzed from various points. We should not omit the fact, that this survey presents information about actual situation in analyzed enterprises in Lithuania. Such survey is essential and very valuable, because there are no similar researches performed with actual Lithuanian enterprises on the particularly concentrated business activity issues, as we are analyzing throughout this whole work. Consequently, whole related results of the performed survey will thoroughly analyzed in this part of the work. Afterwards, conclusions for the whole survey and its result analysis will be presented for the further assessments.

From very first questions of the survey, we can exactly define the objects of the performed survey. Therefore, we start our questionnaire from such question:

1. How many employees do work in your company?

For this question it was decided to divide enterprises into four groups:

- ☒ Small enterprise(1-19 headcount)
- ☒ Middle-sized enterprise(20-99 headcount)
- ☒ Big enterprise(100-500 headcount)
- ☒ Large enterprise(500 and more headcount)



Picture 2.4. Graphical distribution of the answers for question no.1.

Source: own calculations according results of performed questionnaire

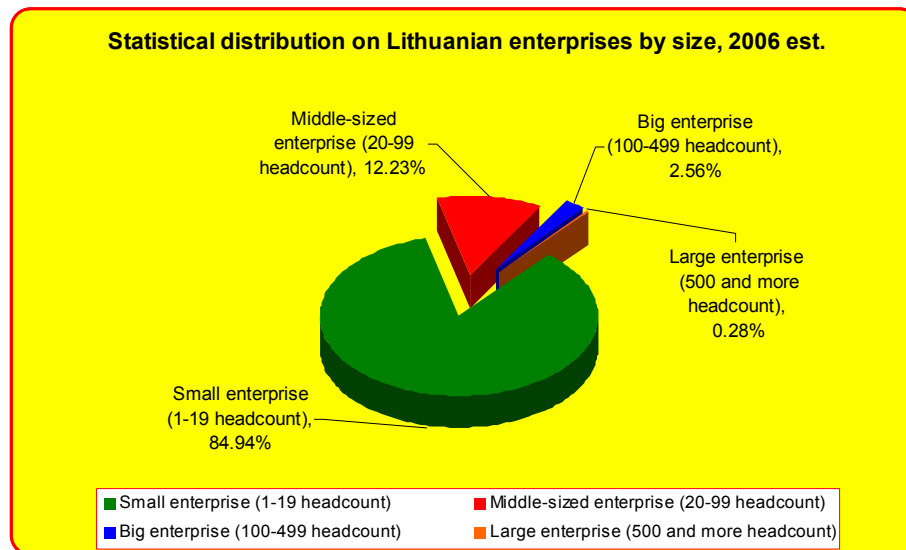
Note: All other presented pictures of the results distribution of the survey questions throughout this part of the work are own calculated according received results of performed questionnaire

Now, we can clearly see that the objects of our survey were different size enterprises. To see what size enterprises where included and how their distributed we should look into the first results distribution picture, i.e. Picture 2.4.

From this question we realize to whom the survey was designed and what type of the objects are analyzed within it. Hence, different size and type enterprises were questioned and analyzed through this survey. Results of the question 1 present us distribution of surveyed companies by their size according the amount of employees in the enterprise. This is common characteristic to describe the size of the company in various kinds of researches.

From the presented results in picture 2.4. we can see, that almost half of the surveyed enterprises (48%), that is 374 of 788 questioned enterprises, were small enterprises with 1-19 headcounts. 29 % (230 of 788) of the surveyed enterprises were middle-sized enterprises with 20-99 headcount, 18 % (141 of 788) – big enterprises with 100-499 headcounts. Large enterprises with 500 and more headcounts totaled only 5 % (43 of 788) of all surveyed enterprises.

To check the adequacy of the operated data received from this question with the actual situation, we should compare it to the available statistical data presented by Lithuanian Statistical Department. This national institution presents official statistical data of the country with the high reliability and precision, that why it is so used for all kinds of researches or scientific works. Hence, we found out exact statistical data on the size of enterprises operating in the Lithuania, that after some calculations and conversions are presented in Picture 2.5.



Source: Department of Statistics of Lithuania

Picture 2.5. Statistical distribution of Lithuanian enterprises by size

Notably, that conversions were made because of bigger range of distribution of the enterprises by size in the presented statistical data. There was distribution of enterprises by even more exact amount of employees (i.e. 1-9, 10-19, 20-49, 50-99, 100-249, 250-499, 500-999, 1000 and more headcounts), but after summing them into the groups, we got required data for our further analysis.

Analyzing this statistical data we can see, that biggest part of all Lithuanian enterprises are small enterprises with only 1-19 headcounts. It gives almost 85% of all operating enterprises. Middle-sized enterprises with less than 100 headcounts form about 12% of all enterprises. We found even smaller amount of big enterprises with up to 500 headcounts, i.e. approximately 2.5%, while large enterprises with more than 500 headcount compounds only 0.3% of all operating enterprises in the territory of our Republic.

After comparing the statistical data with the processed data from our questionnaire we can see, that percentage values of different sized enterprises analyzed in the survey is almost the same as the percentage value presented in statistical data. Shares are spread in the same level, where significantly biggest share went to small enterprises and hardly conspicuous part - for large enterprises, in such way virtually corresponds to our actual economic situation, where small enterprises are most prevailing form of business.

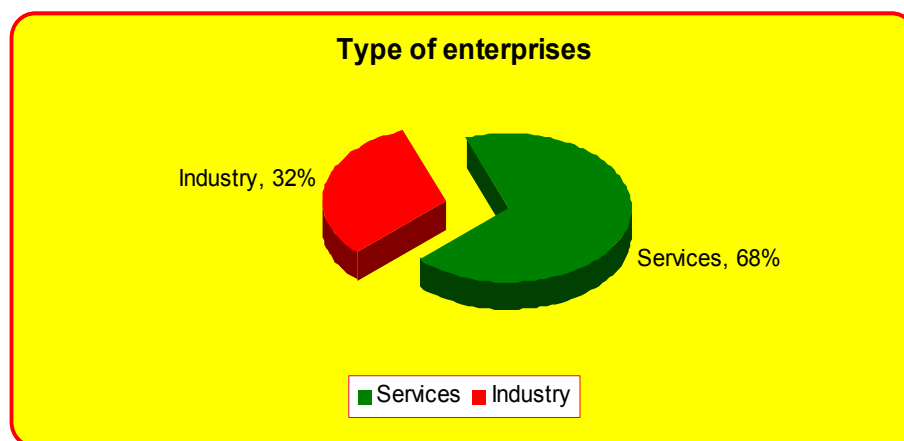
Therefore, we can freely state, that analyzed data from the questionnaire is in enough adequate with statistical data and can be used for further equitable analysis of the surveyed enterprises.

Second question in our questionnaire divides all surveyed companies by the business sector in which enterprise is operating. In other words, this is division by the company's economical activity, i.e. is it service or production enterprise. Here is it:

2. What kind of business does your company do?

- ☒ Services
- ☒ Industry

It is simple, clear and very common division of the economic units by their activities. Answers of the respondents are presented in the results distribution picture X.



Source: own calculations

Picture 2.6. Graphical distribution of the answers for question no.2.

Hence, by including this question into our questionnaire we got opportunity to distinguish our respondents by economical sectors they are involved and results were such, that more than 2/3 (68%) of our respondents were involved in service sector. Other part is involved in industry sector. This is not surprising, because we already have surveyed statistical data of Lithuanian GDP-composition by sector (Picture 2.3.), and have found out that sector distribution of our surveyed enterprises are practically very close to statistics, i.e. 61% of services, 33% of industry, and 6% of agriculture. Here we should sign addition, that completely agricultural enterprises are not included into our survey. Thus, we can state that distribution by the sector of surveyed companies is corresponds to the current situation in the country.

Coming to the next block of the questions, we should present them as questions mainly concerned on the ownership structure of survey enterprises. Questions were formulated in such way, that it would be clear to find out to whom and approximately in what scope belongs the ownership right of the surveyed enterprise. Sources of the capital (main owners or shareholders of the enterprise) were divided into common distribution: foreign capital, state (public), legal person (business unit as other enterprise), institutional investor (financial enterprises, such as banks, investment and pension funds, financial brokers, etc.), and group of natural persons (individuals). We should remember, that respondents were asked present only generalized ownership data with approximate scope of the ownership rights and ownership type, in such way we were not overpassing the confidential and strategic issues of the enterprise that were included into our questionnaire.

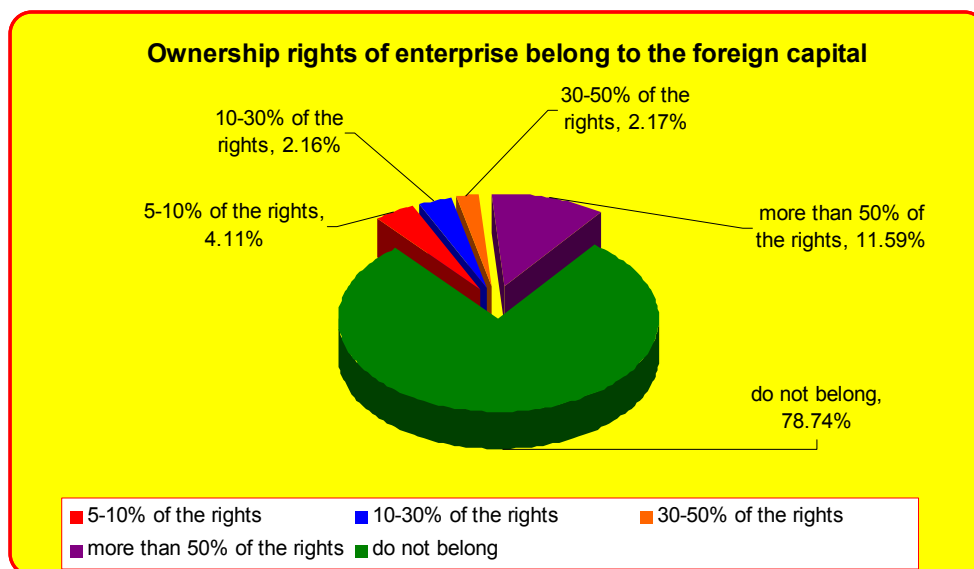
Moreover, at this point we should introduce some changes in evaluation of our questionnaire data. From the whole group of surveyed enterprises, we will extract small enterprises with 1-19 headcounts (414 units still left for the analysis), with making the presumption that small enterprises in Lithuania are private enterprises that are owned by one natural person (owner is liable for whole enterprise) or taken as family business. Additionally, such small enterprises are not participating in the stock exchange and are somehow closed for other investment sources. Other surveyed enterprises, i.e. middle-sized, big and large enterprises are still included into analysis of this coming group of questions.

Before starting analysis of whole this group of questions and the presented answers, we should also refer to the answer variants for each of those questions. Each question asked to present in what scope each ownership type is distributed within each surveyed enterprise. Thus, approximate value of ownership rights for given ownership type should be marked as it is distributed in next way: 5-10%, 10-30%, 30-50%, more than 50% of the ownership rights belong or do not belong to the presented type of ownership.

This block of questions, including graphical distribution of the respondent's answers, are starting from the question 3 presented below:

3. Ownership rights of enterprise belong to the foreign capital

- ☒ 5-10% of the rights
- ☒ 10-30% of the rights
- ☒ 30-50% of the rights
- ☒ more than 50% of the rights
- ☒ do not belong



Source: own calculations

Picture 2.7. Graphical distribution of the answers for question no.3.

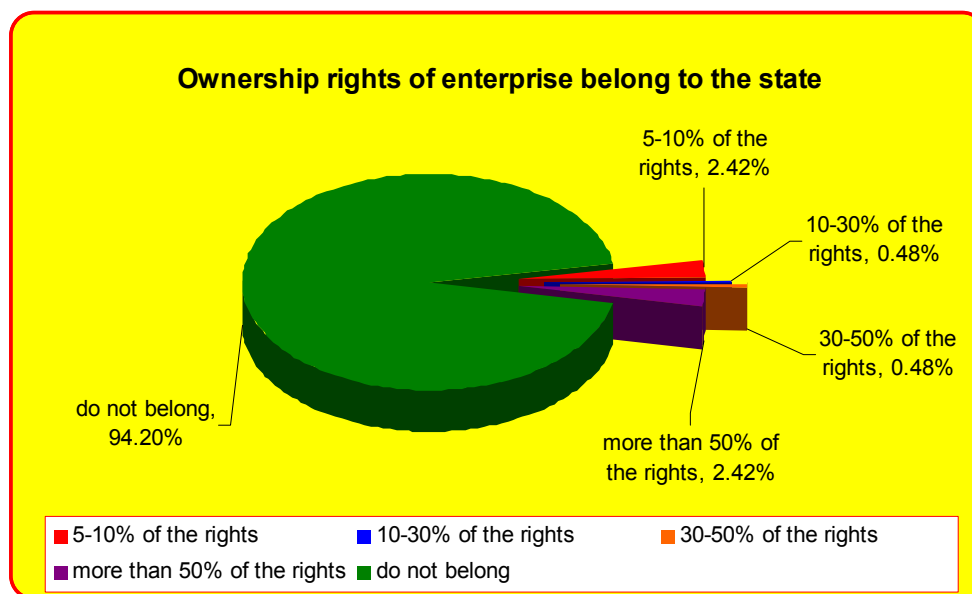
Now, let come to the question 3, which asked to present the part of ownership rights of the enterprise belong or do not belong at all to the foreign capital. From graphical distribution picture 2.7., we see that great part (79%) of respondents state that ownership rights of their enterprises do not belong to any type of foreign capital. Afterwards, we spot that if respondent called for foreign capital ownership, than it was owned by more than 50% of the enterprise ownership rights (12% of respondents). Smaller scopes of ownership rights were not even appreciable by foreign investors and that is reflected by very small percentage rates (5-10% rights 4.11% of respondents, 10-30% rights - 2.2% of respondents and 30-50% of rights – only 2.17% of respondents) of other answers.

From given results we can conclude, that if foreign capital has the ownership rights of the enterprise in Lithuania, it tend to be the more than half of all shareholdings. In such way, foreign investors keep the controlling right under their reign.

Moving to the question 4 and its graphical answer distribution picture 2.8., we see how the state ownership is distributed in our surveyed enterprises.

4. Ownership rights of enterprise belong to the state:

- ☒ 5-10% of the rights
- ☒ 10-30% of the rights
- ☒ 30-50% of the rights
- ☒ more than 50% of the rights
- ☒ do not belong



Source: own calculations

Picture 2.8. Graphical distribution of the answers for question no.4.

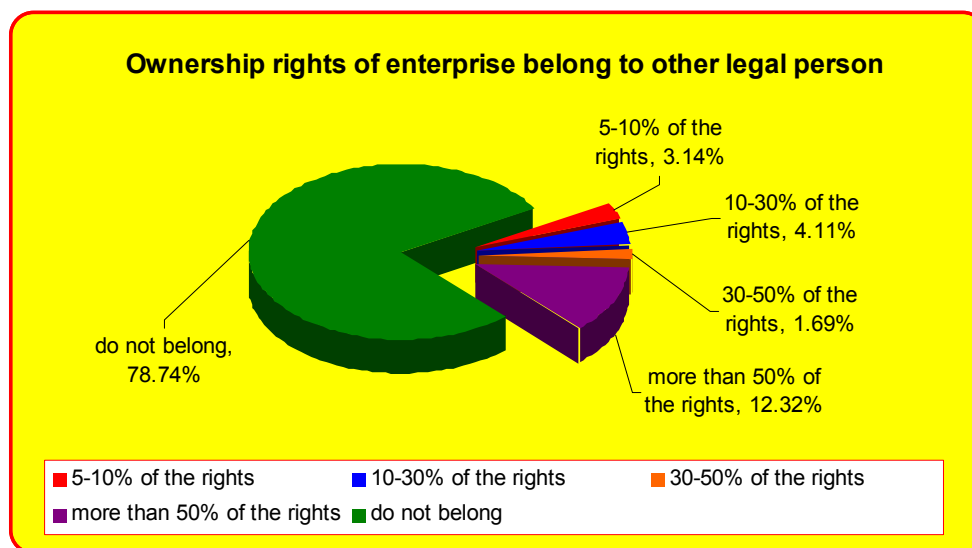
Here, we should not forget that majority of enterprises, left for analysis in this part of the survey, are middle-sized enterprises and they actually are not so much touched by hands of the state investors. Mentioned phenomenon of the privatization wave should be also considered here. Therefore, this overall result of all surveyed companies under this question can be perverted in some level. Presented results prove this presumption. Only 5.8% of all respondents spoke for state shareholding of their enterprise. Keeping analysis on the other cuts of this question, we calculated that approximately 10% of enterprises with more than 100 headcount called that state is included in the ownership of their enterprises. Meanwhile, already 20% of enterprises with 500 and more headcounts were in some level in state ownership.

Therefore, here we can conclude that only 5.8 % of all surveyed companies are in some level includes state ownership rights, and this number is significantly going up if we consider big and large enterprises.

With analysis concentrated on the ownership rights that belongs to the legal person we are moving to the next question:

5. Ownership rights of enterprise belong to other legal person:

- ☒ 5-10% of the rights
- ☒ 10-30% of the rights
- ☒ 30-50% of the rights
- ☒ more than 50% of the rights
- ☒ do not belong



Source: own calculations

Picture 2.9. Graphical distribution of the answers for question no.5.

Legal persons are named here all other business units (i.e. companies), which own certain amount of the ownership rights of the other company. These units are operating within the same country and are involved in the ownership or controlling of other company. it can be presented as the ownership of the separated branch of the company with the shareholding of its mother company. For example, suppose certain bank is the owner of the branch established as the new and separate business unit responsible for insurance business.

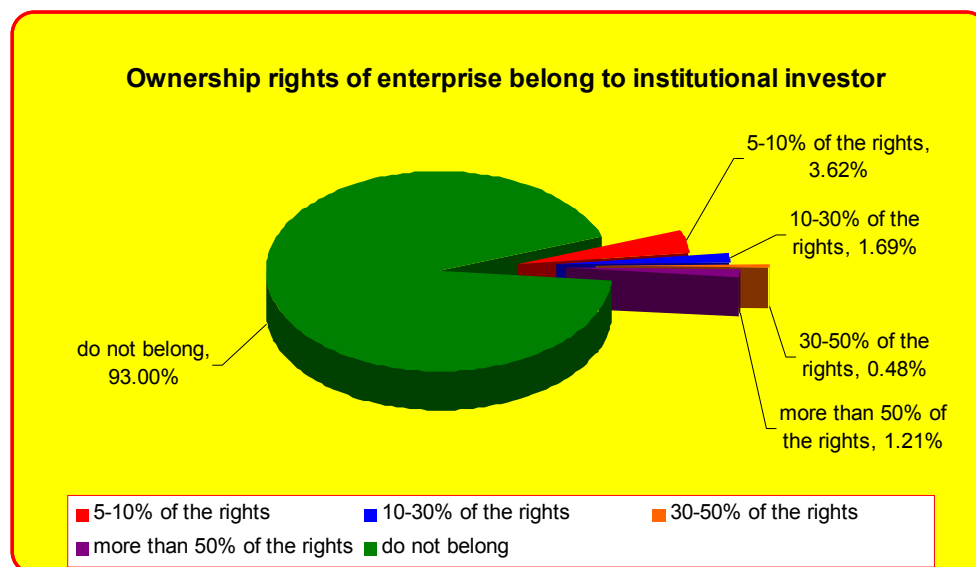
From the graphical distribution of the respondents answers for this question in picture 2.9., we already can derive such tendency of answers that biggest part of respondents called that their business do not belong for presented type of ownership. Here, we see the same situation, as 79% of respondents said that ownership rights of their enterprise do not belong for any kind of legal persons. Though, from other side we spot that slightly more than 21% of all other respondents marked for ownership rights of legal persons, where 12% got more than 50% of rights.

From that we can state, that it is already significant part (21%) of all surveyed companies are owned by some types of legal persons from the same country.

Question concerning ownership rights of institutional investors are also included in our survey. It has the same possible answers:

6. Ownership rights of enterprise belong to institutional investor:

- ☒ 5-10% of the rights
- ☒ 10-30% of the rights
- ☒ 30-50% of the rights
- ☒ more than 50% of the rights
- ☒ do not belong



Source: own calculations

Picture 2.10. Graphical distribution of the answers for question no.6.

Institutional investors are known here as all enterprises (institutions) that are directly working on investments to other business units or projects. Here, we will find, different financial institutions, including banks, insurance companies, finance broker companies, pension and investment funds, etc. All this investors are putting command capital into chosen businesses with the expectation of suitable efficiency and, of course, good returns for their investments. This is fairly not so good developed business in Lithuania at the moment, but it is growing with tremendous pace in last 5-7 years. For example, private pension funds in Lithuania started actively evolving with the pension reform in the Lithuania that started only in year 2003.⁴⁰ Such factor, including quite misleading name of “institutional investors” can be the reason of so low distribution of the answers. Only 7% (picture 2.10.) of all respondents marked that institutional investor is somehow involved in their companies’ shareholding.

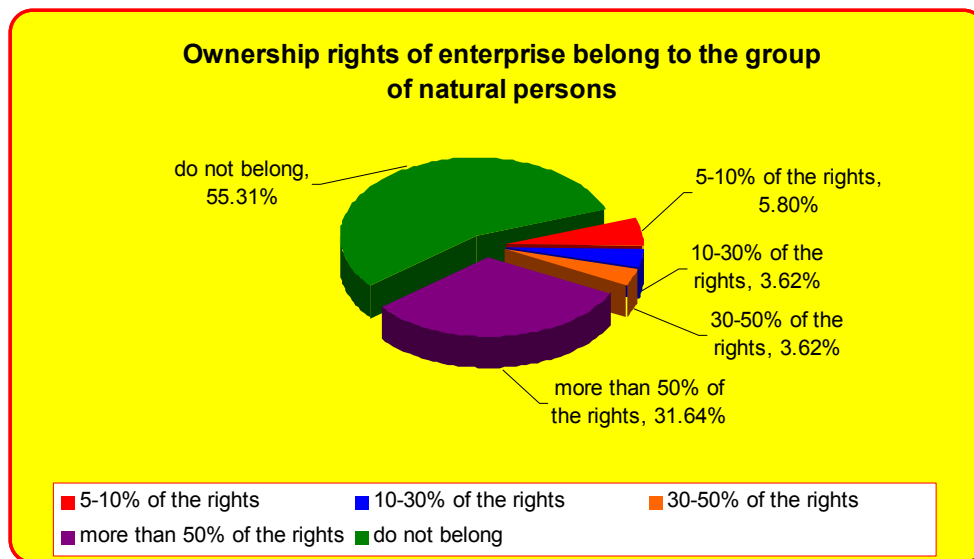
To conclude in this point, we should note that actual shareholdings of institutional investors in Lithuania should be higher or grow in enormous pace in next several years.

⁴⁰ Pensiju Sistema, Article on pension reform in the Lithuania. Available at: <http://www.pensijusistema.lt/index.php?-21540019> (2008-09-05);

Question 7 and its graphical answer distribution picture 2.11. present us how the natural persons ownership is distributed in our surveyed enterprises.

7. Ownership rights of enterprise belong to the group of natural persons:

- ☒ 5-10% of the rights
- ☒ 10-30% of the rights
- ☒ 30-50% of the rights
- ☒ more than 50% of the rights
- ☒ do not belong



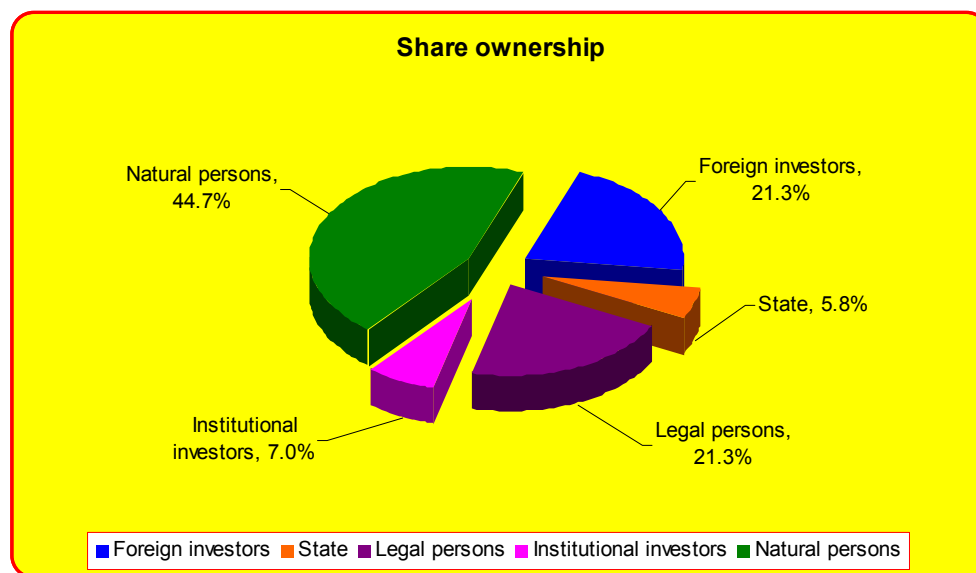
Source: own calculations

Picture 2.11. Graphical distribution of the answers for question no.7.

Remember, that majority of enterprises left for analysis in this part of the survey, are middle-sized enterprises. In most cases, all such enterprises are usually private limited liabilities enterprises including several legal or natural persons as the owners or quite average-sized public limited liabilities enterprises that are not active so much in public trades of shares, as the stock exchange. So, it is typical for such enterprises that they are owned by group of natural persons. What we see here, it is 55% of surveyed companies do not have natural persons in their ownership. From other side, significant share of 45% of surveyed enterprises, counted all together, have shareholdings of legal persons, where 32% of the enterprises have owned by natural persons with more than 50% of the ownership rights. Ownership of the smaller part of the enterprise's rights is not so significant for natural persons and it has average of 4.3% for all left answers (12% together).

Finally we can state, that natural persons are important part in ownership of the surveyed enterprises, and count approximately 45% surveyed enterprises have natural persons included in the distribution of their ownership rights.

To summarize the block of questions related to the ownership right of surveyed companies, we can plot summarizing graph, presented in picture 2.12.



Source: own calculations

Picture 2.12. Summarized Graphical distribution of the answers for questions 3-7.

In this graph we can see division of the respondents' answers concerning their enterprise ownership structure. Here we find our analyzed ownership of the foreign investors, state, legal persons, institutional investors, group of natural persons and share of respondents' answers that do not disclosed ownership characteristics of their enterprises or were confused by some reasons and could not decide where to classify ownership of their companies.

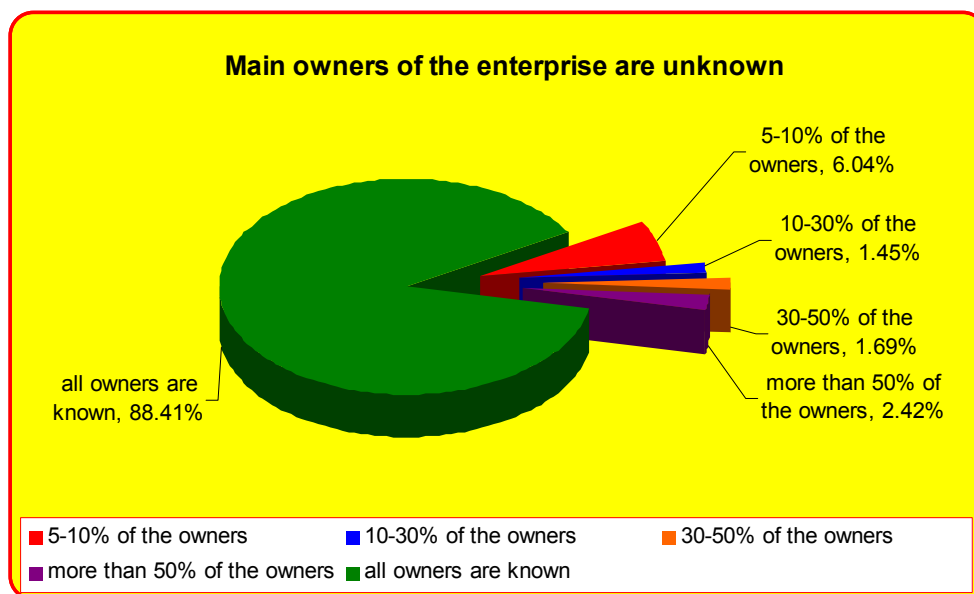
Consequently, analyzing available results we can see that almost half of all surveyed enterprises (approx. 45% of respondents) are owned in some level by natural persons. Next, with approximately 21%, come enterprises owned in some level by legal persons and foreign investors. Respondents' votes for state ownership marked almost 6% of all answers, while institutional investors' shareholdings counted approximately 7% of all respondents' answers.

To bring this group of the questions to the conclusion, we can state that such significant percentage of natural person shareholding (46%) of the surveyed enterprises can be enough convincing when we are considering such are wide range of different size enterprises with so significant number of average ones. Legal persons and foreign investor's ownership share of the surveyed companies' looks to be enough convincing and actual, and can fractionally fluctuate in real. Share of the ownership of institutional and state investors will grow significantly with the consideration of such enterprises that are active in public shareholding's market or are listed in the national stock exchange market, that are relevant to the institutional investors.

To find out, are the main owners of the surveyed enterprises known and publicly presented, we are moving to the next question of our questionnaire:

8. Main owners of the enterprise are unknown:

- ☒ 5-10% of the owners
- ☒ 10-30% of the owners
- ☒ 30-50% of the owners
- ☒ more than 50% of the owners
- ☒ all owners are known



Source: own calculations

Picture 2.13. Graphical distribution of the answers for questions no. 8.

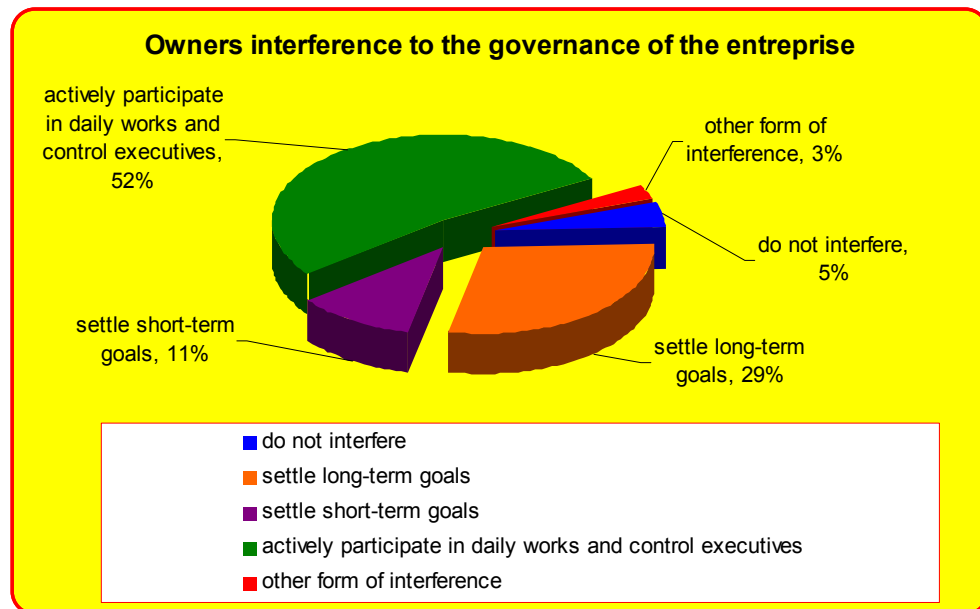
Picture 2.13. presents to us the graphical distribution of the respondents' answers for the question of the ownership declaration, i.e. if the main owners are known. From the graph we see that almost 89% of respondents said that all owners of the enterprise are known and more or less introduced publicly. Other answers with the distribution of unknown owners spread between 1% and 6%, i.e. 6% of respondents answered that only 5-10% of owners are unknown, 1.45% said that 10-30 % are unknown, 1.69% that 30-50% are unknown and 2.42% stated that 50% of the owners are unknown publicly.

To conclude concerning this question, we should say that as we found out majority of the enterprises' owners are known for all (89% surveyed enterprises), but certain amount still keeps the owners in some level of confidence and they are not presented publicly.

Question 9 asked respondents to present how the owners interfere to the management of their enterprises. Here we got such possible answers: owners do not interfere at all, they settle long or short term goals, actively participate in daily works and control executives or just do it by other form of the interference.

9. Owners interference to the governance of the enterprise:

- ☒ do not interfere
- ☒ settle long-term goals
- ☒ settle short-term goals
- ☒ actively participate in daily works and control executives
- ☒ other form of interference



Source: own calculations

Picture 2.14. Graphical distribution of the answers for questions no. 9.

What we found out is that more than half of all respondents (52%) called for owners that actively participate in daily works of their enterprises and control executives. Smaller but still significant part of 29 % of respondents called that owners settle long-term goals of the enterprise in such way interfering the enterprises' management. Other answers were that 11% of respondent companies' owners are settling short-term goals, 5% of respondents' owners do not interfere at all, and 3% - interfere by other forms (Picture 2.14.).

Conclusions to the presented data are such, that owners of Lithuanian companies are interfering enough actively to the management of their enterprise, in such way contributes to the enterprise' business activities by setting goals and objectives or by active participation in the day-to-day work and control of executives.

Next question uncovers respondent company's attitude to the business governance:

10. Attitude to the business governance:

- a) governance should be based on the strict control
- b) financial and production experts have the biggest influence for the taken decisions
- c) planning is very important in your company, orientated to the cost reduction , and usually performed before starting the activity
- d) strive that each employee would has clearly defined functions
- e) strong hierarchical structure and developed control mechanism
- f) promotion depends on activity volumes and financial results
- g) marketing and development experts has an significant influence for the taken decisions
- h) planning is orientated for decision solving and is finished not exactly before starting activity
- i) governance and control are decentralized
- j) activity results are evaluated by benchmarking, promotion for good marketing and development solutions
- k) wide planning, but not intensive
- l) activity starts after thoroughly planning
- m) activity of the enterprise strongly depends on decisions of the executive, sometimes effected by changes of the mood
- n) governance policy of the enterprise is no consistent, sometimes executive influences technical details without taking significant strategic decisions

Respondent's answers for the question are presented in the Table 2.1.

Table 2.1. Results of the question no.10 from the survey.

Attitude to the business governance	No. of votes	% of all votes
a) governance should be based on the strict control	261	12%
b) financial and production experts have the biggest influence for the taken decisions	105	5%
c) planning is very important in your company, orientated to the cost reduction , and usually performed before starting the activity	285	13%
d) strive that each employee would has clearly defined functions	458	21%
e) strong hierarchical structure and developed control mechanism	109	5%
f) promotion depends on activity volumes and financial results	328	15%
g) marketing and development experts has an significant influence for the taken decisions	56	3%
h) planning is orientated for decision solving and is finished not exactly before starting activity	69	3%
i) governance and control are decentralized	48	2%
j) activity results are evaluated by benchmarking, promotion for good marketing and development solutions	110	5%
k) wide planning, but not intensive	58	3%
l) activity starts after thoroughly planning	136	6%
m) activity of the enterprise strongly depends on decisions of the executive, sometimes effected by changes of the mood	76	4%
n) governance policy of the enterprise is no consistent, sometimes executive influences technical details without taking significant strategic decisions	56	3%
Total:	2155	100%

Concluding last question and summarizing table with answers we should state, that it has some clear points on which can be emphasized and discussed. First, 21% of respondents strive that employees of their enterprises will be clarified with their functions and responsibilities, when 12% think that governance should be based on strict control. Moreover, there should be considered 13 % of respondents with idea that promotion depends on activity volumes and financial results, when 15% is thinking that planning is very important in your company, orientated to the cost reduction, and usually performed before starting the activity.

2.2.3. Conclusions

First of all, there should be emphasized on the uniqueness and importance of performed questionnaire that gave us so valuable data for analysis and further research opportunities. Appropriate formation and processing activities of the questionnaire were the significant factors of the surveyed enterprises cooperation and receiving their answers. This survey is enough reliable and actual due to the quite big amount of respondents (1001 units), distribution of different size, activities and well-known brands' enterprises in Lithuania.

Next, results were really surprising by their adequacy to the actual situation in the country. It proves first questions and the results received, that, for example, size and activities by the sector of the surveyed enterprises practically correspond to the statistical numbers.

Answers for the block of questions 3-7 provided us important information about ownership structure of the surveyed enterprises. Here, we reduced number of surveyed companies by excluding small enterprises from analysis of this part of the survey. As it could be anticipated, biggest part of shareholdings went for natural persons and it compounded 45% of all surveyed enterprises shareholdings. As we already note, that can be enough convincing when we are considering such are wide range of different size enterprises with so significant number of average-sized ones. Legal persons and foreign investor's ownership share of the surveyed companies', each counted 21%, looks to be also enough convincing and actual, and can fractionally fluctuate in real. Share of the ownership of institutional (7%) and state (5.8%) investors will grow significantly with the consideration of such enterprises that are active in public shareholding's market or are listed in the national stock exchange market. Economic growth of the country also plays here essential role.

Continuing our research with analysis of the surveyed questionnaire data we are moving to the next parts of our work, where we will develop our surveyed data with the help of analysis of corporate governance practice of the enterprises in other countries and continuing on the analysis and survey development on situation within our country.

2.3. Corporate Governance in Lithuania

Corporate governance is yet a widespread concept associated with economic reforms or improvement of corporate performance in Lithuania. This part of the paper will focus on the main issues and actual topics for the corporate governance practice in Lithuania, starting with the sketching present background and its main players.

The dominant models of the economic entity in Lithuania are small private companies that are owned and governed by one owner (sole proprietorship), private limited liability companies that are owned by different shareholders, and public limited liability companies shares' of which are offered publicly and the owners can vary significantly.

According to the data presented by Department of Statistics to the Government of the Republic of Lithuania, **in the beginning of year 2008, there were 169 085 registered economic entities in Lithuania**, but only 81 376 were in operation, that stands for 48% of all registered entities. Here should be noted, that this statistical data combines all available legal forms of entities, including such as state, municipal, partnership, associations, social, political or non-profit units, etc. There were 39 421 operating private entities (stands for 59% of all registered), 22 704 operating individual entities (35% of all registered) and 376 operating public entities (64% of all registered). Our objects of interest are mainly business organization, namely private and, even more, public companies, which have significantly diversified ownership structure and complex corporate governance system.

Main players in the corporate governance in Lithuania are, first of all, shareholders. They are divided according the source of capital: foreign capital, state (public), legal person (business unit as other enterprise), institutional investor (financial enterprises, such as banks, investment and pension funds, financial brokers, etc.), and group of natural persons (individuals or, in other words, households). Next, not less important, are managers, executive directors and board of directors that are responsible for the proper operation of the company. Others, who have indirect impact on the governance, are all stakeholders, such as employees, suppliers, customers, banks and other lenders, regulators, the environment and the community at large.

As it was already mentioned in theory, it is not possible to apply selected **Corporate Governance model** to the certain country. In each country it is developed in response to country-specific factors and conditions. According the main features Lithuania corresponds to the European model, i.e. German one. One feature concerns the two-tiered board structure, other – certain voting restriction. Next, Lithuanian stock market capitalization is small with the big number of foreign investors. However, in comparison with typical German model, Lithuania has no mandatory inclusion of the employee representatives into the formed supervisory boards. Other differences are evolved together with its specific economical and political development of the country.

2.3.1. Role of the Supervisory and Management Board

In a broad view, all three Baltic States provide similar company governance structure while governance is performed through three main bodies of the company – general meeting of the shareholders, the supervisory board and the management board, except for Lithuania which splits the executive functions between the management board and a separate body – Chief Executive Officer (CEO). It is a general rule in the Baltic States that composition of the supervisory board is not obligatory.⁴¹

Supervisory board in Lithuania is elected by the general meeting of the shareholders. It is required that supervisory boards should consist of at least 3 members, while the maximum number of members reaches 15 members. Executive functions are split between the board and CEO providing the latter with the right of representation. Due to such split of executive powers, both the board and the supervisory board are not compulsory. If the board is not comprised all executive functions here concentrate in the hands of CEO.

The main responsibility of supervisory board is to represent the interests of the shareholders between shareholder's meetings and to supervise the activities of the management board. However, in practice the supervisory board only oversees the activities of the company's board and management once a year by reviewing the annual financial statements. It is supposed to be shareholders' watchdog, but for many reasons, it does not serve that purpose. One of such reasons is that most of the supervisory board members are elected with majority shareholders' votes. Then with a simple majority of the votes in the supervisory board all board members are elected from those loyal to majority shareholders. Thus, in most cases shareholders elect to bring shareholder actions directly rather than expect the supervisory board to act.

The management board plays an active role. The board acts as a trustee of the shareholders, as a supervisor and controller and as a body that directs company's activities. In implementing this role the management board appoints the CEO and the other top managers, oversees management's activity, organizes shareholders' meetings, approves the annual financial statements and the board's report, considers and approves major transactions (LAWIN, 2008).

Remuneration of both supervisory board and board members is directly related to the results of the company. Payments from the net profit are the only expressly permitted form of board members' compensation for their membership and those payments have to be approved by the shareholders' meeting. The only good feature of such a system is that compensation is known to

⁴¹ Lideika, Petrauskas, Valiūnas ir partneriai, LAWIN, Key Aspects of Corporate Governance in the Baltics: Roles of the supervisory and management boards.
Available at: <http://www.lawin.lt/en/docs/download/1181.php> (2008-12-14);

shareholders. But good corporate governance requires that non-executive members' compensation is not related to the results of the company because this encourages manipulation of financial results. Unfortunately, this was not the thinking of a Lithuanian legislator who simply thought that board members would work harder to achieve profit if their compensation was related to it. The legislator forgot that companies need competent board members also at times when they voluntarily elect to be unprofitable in the short-term in order to invest into growth and gain more profits later. As fixed compensation for the board membership is not expressly allowed, there is no motivation for competent people to become non-executive board members.

What happens in Lithuanian practice is that management board members are employed in the company in some executive position or become consultants of the company to be able to receive a compensation for their efforts both as such employees or consultants and as board members. Naturally, such payments are not disclosed to shareholders (it formally is a remuneration only for work or consulting) and is not approved at the shareholders' meeting (or the supervisory board). Obviously in those cases board members are not independent. Companies put less value on good corporate governance than on hiring competent people. The above-described system of board members' compensation is one (but not only) of the reasons that leads to the concentration of power in the hands of CEO, the major part of whose remuneration does not depend on company's results.

It is often emphasized that to ensure good corporate governance board members need to sign the financial statements and be collectively responsible for it. In Lithuania the CEO and CFO (Chief Financial Officer) sign the financial statements even though the management board approves it. Furthermore, the management board is not required to approve the quarterly results and ad hoc disclosure of material events in listed companies, or even to control the company's department which has the responsibility. Therefore, there is **no collective responsibility of the management board** for financial and other results of the company as such.

However, in Lithuania supervisory or management board members can be found collectively liable if it is proven that their decisions were adopted in violation of the laws and were harmful to the company or its shareholders. So far there is not much judicial practice in this area. Nevertheless, management board members can even be subject to criminal liability if their actions vis-à-vis the company, its shareholders or others have seriously violated the law (LAWIN, 2008).

In Corporate Governance Code of the companies listed in the NASDAQ OMX Vilnius Stock Exchange, it is recommended that a company should set up both supervisory board and management board. Where a company chooses to form only one collegial body, it is recommended that it should be a supervisory board. Where a company should decide not to set up a supervisory board but rather the board, it is recommended that the chairman of the board and CEO of the company should be a different person. The mechanism of the formation of a collegial body to be

elected by a general shareholders' meeting should ensure objective and fair monitoring of the company's management bodies as well as representation of minority shareholders. These members should stay independent through whole the time of they tenure. We should note, that candidate to be member of collegial body elected by a general shareholders' meeting can be considered independent if he conforms to independency' criteria. The sample list of all factors affecting the candidate's independence is included into the Corporate Governance Code.

The Code does not provide for a concrete number of independent members to comprise a collegial body. Many codes in foreign countries fix a concrete number of independent members (e.g. at least 1/3 or 1/2 of the members of the collegial body) to comprise the collegial body. Moreover, it is recommended that the collegial body should establish nomination, remuneration, and audit committees. The key objective of the committees is to increase efficiency of the activities of the collegial body by ensuring that decisions are based on due consideration, and qualified and independent investigation of the certain specific issues. Member of supervisory and management board of the company should avoid the situations when his private interests may be against the interests of the company. But in case such situation occur, he should inform appropriate bodies of the company and do not participate in decision taking process (NASDAQ OMX Vilnius, 2008).

2.3.2. Shareholders rights

From the very beginning, it should be noted that the basic list of rights granted to shareholders was strongly unified with the other states in Europe with the Lithuanian accession to European Union in year 2004. Here is acknowledged and highly respected the equal treatment principle – the shareholders shall be treated equally under equal circumstances without making any privileges or enabling discrimination based on national or other difference. All shareholders should have the same rights and obligations. Difference may only occur between different kinds of shares, for example, owners of preference shares may have the right to receive dividends earlier than other shareholders.

Looking generally, a share grants the shareholder the following rights well-known to many good-standing economies in the world:

- ☒ right to participate in the general meetings of shareholders;
- ☒ right to participate in the distribution of profits (in form of dividends or otherwise);
- ☒ pre-emption right to acquire shares by the company;
- ☒ right to receive, upon dissolution, the remaining assets of the company;
- ☒ right to information;
- ☒ right to challenge decisions of corporate bodies of the company, etc.

Every shareholder irrespective of the amount of owned shares is entitled to enforce the above rights which seem to be fundamental for every investor. They ensure the underlying opportunities for investors to influence in certain manner the company and its management seeking for more transparency in company's activities and usage of its capital.

Not all shareholders' rights are available to every shareholder. There are certain groups of rights which may be implemented only by shareholders that own certain parts in the capital of the company. Thus, shareholders in Lithuania that owns at least 10% of the share capital may demand for:

- ☒ the inclusion of new issues on the agenda of general meeting of shareholders;
- ☒ special general meeting to be held;
- ☒ commencement of audit of a company on matters of management or financial situation;
- ☒ appointment of liquidators by a court in a compulsory dissolution;

Shareholders' liability is also among the principal issues which are traditionally important to investors. As a rule, the shareholders enjoy limited liability, i.e. they have no other proprietary obligations to the company except for the obligation to pay for the subscribed shares and cannot be held liable for the obligations of a company.

However, Lithuanian legislation is allowing the switching of liability not only to shareholders-corporate entities, but also to shareholders-natural persons. Two conditions should be met in order to trigger the liability for shareholder - the shareholder should be able to exercise the decisive influence over the company and actions of such shareholder resulted in inability for the company to perform its duties.

Notably, **the rights of shareholders are not static**, they constantly change, and certain new rights appear. As an example, in Lithuania prior the year 2004 the right to receive all information about the company was granted every shareholder or group of shareholders owning more that 10% of all shares. However, after the new Law on Companies entered into force from the beginning 2004, the threshold for exercise of the right to access to all information of a company was raised up to 50%, i.e. only absolute majority shareholders may enjoy the right. Later on, several additional requirements in respect of right of information were established in court practice – courts allowed to refuse to submit information even to those shareholders who owns more than 50% of shares based on clearly subjective criteria. For example, if there is a basis to presume that this may cause significant damage to the interests of the company (LAWIN, 2008).

Speaking about the new rights which were introduced recently, the mandatory sale and mandatory purchase of shares rights should be mentioned. The practical usage of both these rights became available only form beginning of the year 2005, when appropriate amendments to the legislation took effect. In order to implement the mandatory sale of shares right, it is required to

have at least 95% of all votes in the company. It should be noted, that such number of votes can be held either by one shareholder or by several shareholders acting in agreement.⁴²

After the rights of shareholders are analyzed, we should move towards the identification of the role of shareholders in the companies and their place in the structure of the company as a business vehicle.

The main principle remains unchanged – **general meeting of shareholders is the supreme body of the company**. The competence of the general meeting is described in details by the laws and is of rather narrow nature. It is worth noting that the Lithuanian laws also prevent the general meeting from expanding its competence, since the rule under which the general meeting may not in any case involve in performance managing functions applies. Therefore the separation of capital owners and managers of the company (i.e. control and management function) is acknowledged more expressly in Lithuania than in neighboring Baltic States.

All shareholders are entitled to participate in the general meeting of shareholders and thus exercise majority of their rights in the company (by voting in favor or against proposed decision, sharing comments with other shareholders, initiating discussions on important issues etc.). If there is only one shareholder in the company, then the general meeting needs not to be convened, but the sole shareholder is entitled to adopt written decisions instead.

According to the laws the **general meeting is competent for** example to amend the Article of Association, increase and reduce share capital, elect and remove members of one-level-lower collective body, elect of auditor of the company, approve the financial statements, annual report and distribute profit, decide on dissolution, merger, division or transformation of the company. As a rule, general meeting may adopt resolutions if over one-half of the votes represented by shares are present unless the Articles of Association prescribe for a greater quorum requirement. The resolution of the general meeting is deemed adopted if the number of votes given in favor of adoption of such resolution is larger than the number of votes given against (i.e. the abstaining votes do not count). Notably, qualified majority vote (two thirds, three quarters or other established in the Articles of Association) also apply for adoption of certain resolutions (LAWIN, 2008).

It is important to maintain the **powers of shareholders over the collective bodies** of the company. Even if shareholders are not allowed to interrupt in the activities of collective bodies and adopt decisions falling with the competence of such bodies, they always hold in their hands another effective measure to influence the activities of collective bodies: the shareholders may remove the members of the collective body elected by them at any time irrespective of reason for that.

⁴² Lideika, Petrauskas, Valiūnas ir partneriai, LAWIN, Key Aspects of Corporate Governance in the Baltics: shareholder rights. Available at: <http://www.lawin.lt/en/docs.download/921.php> (2008-12-14);

Furthermore, they may contest in court decision adopted by such bodies and to demand for compensation of losses incurred by the company and shareholders due to such decisions.

The interests of the shareholders are also protected through establishing several central duties for the members of company's bodies. Thus, members of managing bodies in Lithuanian companies are required to be loyal to and act in the interests of the company as well as its shareholders and avoid the conflicts of interests or notify about it. Undertaking of a shareholder to always vote under the instructions of the managing bodies or to always accept their proposals, or to "sell" the votes (i.e. vote in return for a payment), is prohibited under Lithuanian law.

However, the control given to shareholders is not limited only in respect of the members of collective bodies of the company. **Shareholders may also control each others.** In case it is found that one of the shareholders acts to the detriment of the company (blocks adoption of necessary decisions, acts otherwise not in compliance with the purposes of the company or fails to perform the shareholder's obligations to a material extent), other shareholders may force such breaching shareholder to be excluded from the company (however, this right applies only in respect to private limited companies). This may be triggered by shareholder or group of them that owns a third of the share capital.

Day-to-day management of the company is being among the main functions of the director. Only the director is entitled to execute transactions on behalf of the company. If no other bodies are formed in Lithuanian companies, then the shareholders are entitled to exercise direct control over the director. Since all transactions executed by the director even in excess of his/her competence do bind the company, the loyalty of the director and the effective supervision of director's activities by the shareholders play a fundamental role. But the shareholders are not fully unarmed – alongside with exercising of control function, they always claim for indemnification of the company's damages by the director (LAWIN, 2008).

It is commonly understood that guaranteeing of business oriented corporate governance with wide opportunities for the investors to control the use of the funds makes a perfect ground for attracting new investments in the region and ensuring continuous economic growth. Constant striving for liberalization of the legislation in order to provide the investors with the possibility to structure the business in the most convenient way may be named as one of the most important features characterizing the recent strategy of the local governments.

After the detailed analysis of role, activities, rights and responsibilities of the main actors in the corporate governance in Lithuanian companies, we can move further disclosing the other conditional factors, regulatory framework, and information disclosure requirements of the corporate governance system in the country.

2.3.3. Conditional Factors influencing Corporate Governance

There can be various factors that can in different ways influence the corporate governance and business activities of the company. Main important factors that can have strong influence on the corporate governance in Lithuania can be:

- ☒ Size of the company
- ☒ Activity of the company
- ☒ Being part of foreign company
- ☒ Confidence in the management
- ☒ Ownership concentration

First of all, considering **size of the company**, we should note, that such issues as size of authorized capital, amount of shareholders and employees, company's growth tendencies can change a lot corporate governance of the company. From other side, comprehensive corporate governance system can be too complicated and versatile for the smaller enterprises.

Coming to **the activity of the company**, we found that wide spectrum of the company's activities requires specific and comprehensive skills in governance of the company. Also, it is quite essential matter of liabilities' division while carrying out important social decisions.

When **company is part of the foreign business**, they are obliged in certain level to use accountability and governance system of the controlling company. This factor can have both negative and the positive influence on the company's activities, while it is opportunity to learn from and implement international governance practice. In last several years, foreign direct investments formed more than half of all investment in Lithuania. According current tendencies, more and more investment comes from the North and it has influenced that "North" governance tradition are taking up in Lithuania.

Confidence in the management of the company is the issue that also should be taken seriously. Company and its shareholders should be protected from not proper activities of the non-loyal managers. Collective decision taking can be the solution, but far from the best one.

Though, the most important issue to emphasize on is **ownership concentration in Lithuania**. Here we should note that it has major influence on the corporate governance in Lithuania. Company is an instrument for the creation of the shareholders' wealth. Shareholders are mainly interested on the total control of the company. Biggest public companies, listed on the Stock Exchange, are dominated by one or several large shareholders that possess majority of absolute ownership votes, while majority is structured by small shareholders. Such situation only creates antagonistic relationships between big and small shareholders. Thus, there is need to analyze deeper the ownership concentration background.

Data presented in table 2.2. shows that in majority of Lithuanian public liability companies small shareholders do not have significant influence on the company. Significant part of the companies is owned only by some major shareholders that are controlling and governing the organizations without any significant influence of other minor shareholders. **Rights of the minor shareholders** can be only protected by the appropriate actions of the governance, requirements of various legal acts and corporate governance codes (will be discussed in following parts of the work), that shareholder should be honest in respect of other, even smallest shareholder.⁴³

Table 2.2. Distribution of the shareholders in the major Lithuanian Public Companies

Name of Company	Authorized capital, Mill. Litas	Number of shareholders, 2001	Number of shareholders, 2003	Part of three major shareholders, 2001 (%)	Part of three major shareholders, 2003 (%)
Mažeikių nafta	707,5	2 584	2 318	92,30 (2 holders)	94,36 (2 holders)
Lietuvos energija	689,5	5 704	5 392	96,71 (2 holders)	96,6 (2 holders)
Lietuvos telekomas	814,9	10 444	9 381	87,49 (3 holders)	72,4 (2 holders)
Lietuvos dujos	340,9	2 867	1 964	92,36 (1 holder)	94,0 (3 holders)
Ekranas	174,5	3 476	2 667	47,2 (3 holders)	43,06 (3 holders)
Lifosa	220,8	526	595	66,3 (3 holders)	92,0 (2 holders)
Rokiškio sūris	47,46	12 179	9 470	60,7 (3 holders)	62,82 (3 holders)
Lietuvos jūrų laivininkystė	200,9	2 968	1 895	79,6 (1 holder)	73,04 (2 holders)
Pieno žvaigždės	54,0	5 876	4 166	37,74 (3 holders)	44,45 (3 holders)
Kauno energija	118,31	427	434	93,28 (2 holders)	94,14 (3 holders)

Source: Presentation of Advocates Bureau “Lideika, Petrauskas, Valiunas and Partners”, 2004

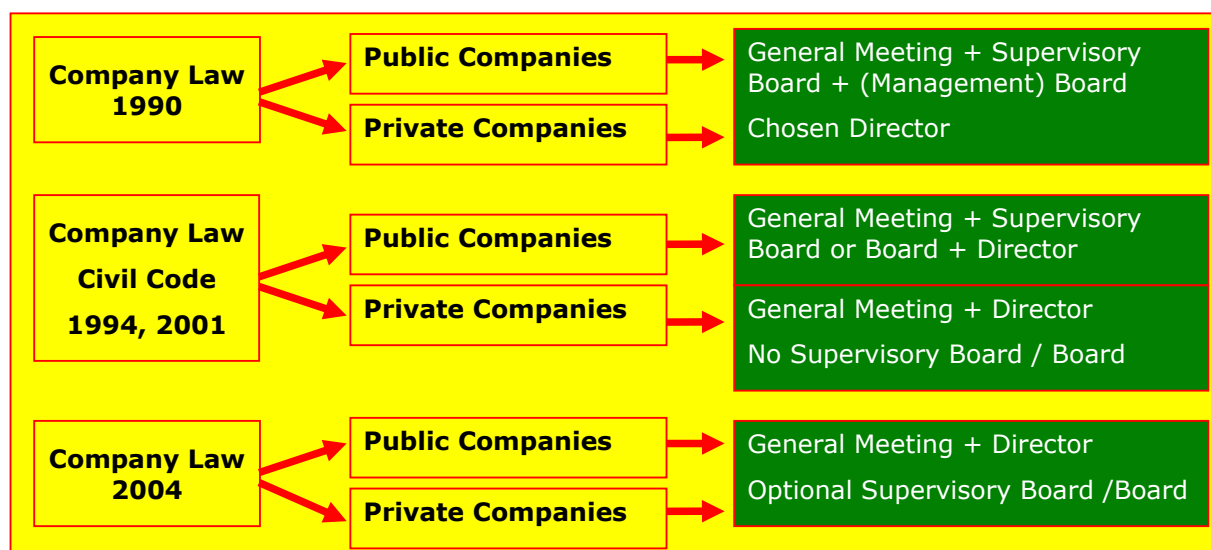
Therefore, such situation in Lithuania called for necessity of the additional tools for solving such problems in the governance of the big enterprises. German Shareholders Association has performed the research on the rights of the shareholders of 15 new members of European Union.⁴⁴ According to this research, in Central and Eastern Europe are not publicly trade of the shares by means of available information, so called “inside dealing” and practical implementation of the minority shareholders’ interests. Therefore, both ownership rights concentration and distribution surveys and other researches prove the **necessity to guarantee the right to participate in the corporate governance for all shareholders of the company**. Most of the researches agree that effective instrument to attain the target is implementation of additional and proper government policy and various legal acts, even more strict information disclosure requirements and introduction of the requirement to present the compliance with corporate governance code.

⁴³ Presentation of Advocates Bureau “Lideika, Petrauskas, Valiunas and Partners” Available at: <http://www.pfsprogram.org/file.php?id=Presentation+-+Valiunas+-+February+11%2C+2004.ppt> (2008-04-15)

⁴⁴ Comparative analysis of corporate governance and shareholders' rights in the 15 European Union (EU) countries. Available at: http://www.ewmi.hu/publications_cacg.html (2008-09-15)

2.3.4. Regulatory framework and Corporate Governance Code

In February of year 2004, during the conference “Corporate Governance” in Vilnius, there were lots of various discussions on the Corporate Governance practice in Lithuania and relative issues. For instance, legal frame of Corporate Governance was also included into discussion due to its change through the last several years. Hence, if we take a look from historical perspective, we should spot outright the changes on the Law of Republic of Lithuania on Companies concerning various governance issues, as role of management bodies in governance of the company. The law on (Public) companies of the year 1990, stated **such distribution of the management bodies in the company**: General Meeting (shareholders meeting) with supervisory and management boards in Public (Limited Liability) Companies, and the chosen director in Private (Limited Liability) Companies. In years 1994 and 2001, concerning the Law on (Public) companies and the Civil Code, this distribution can be presented as: General Meeting with supervisory board or management board with director in public companies, and General Meeting and director (in the Law called: single-person management organ - the manager) without any supervisory or management boards in private companies. Last edition on the Law of Republic of Lithuania on Companies issued in year 2004, do not obligate for creation of the Supervisory Board and Management Board for the public companies, but just to have the director (manager) and the General Meeting. The same obtains and for private companies. Some extracts from this Law of Republic of Lithuania on Companies are presented in appendixes no. 1 and no. 2. All that was said can be summarized as in Picture 2.15.

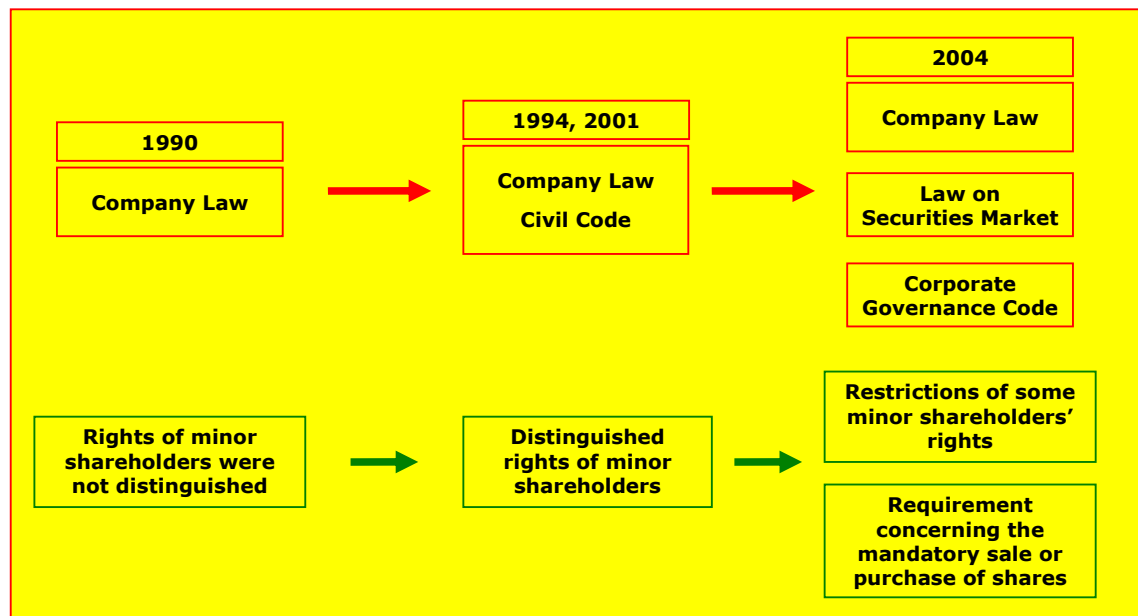


Picture 2. 15. Role of management bodies in governance of the company

Source: Presentation of Advocates Bureau “Lideika, Petrauskas, Valiunas and Partners”, Conference on “Corporate Governance” in Vilnius on February, 2004

Thereby, referring to the data presented, we can state that currently introducing Supervisory Board and (Management) Board is not required for the companies, but it is rather optional. But, as

we will see in our next topics, it is still offered to create these boards (or some parts of them). Such issues can affect accountability and transparency of the activities of companies' executives and in that way company itself.



Picture 2.16. Change of role of rights of minor shareholders in the legal acts in Lithuania 1990-2004

Source: compiled by author

In the picture 2.16., we can see the **development of the legal background of corporate governance** in Lithuania with the emphasis on the rights of minor shareholders. Here we are going through 3 stages that can be summarized by legal acts developed (or supplemented) in these stages. In the Company Law from the year 1990 rights of minor shareholders were not clearly distinguished. Rights of minor shareholders were slightly distinguished in developed Company Law and Civil Code from the period between 1994 and 2001. However, such changes were just superficial without any significant influence on the situation, where major shareholders have favourable conditions. Law on Securities Market issued in 2004 includes **the rights of mandatory sale or purchase of shares** (extract presented in appendix no.3) that was adopted from beginning of year 2005.⁴⁵ Mandatory sale provides the right to claim for sell of the shares of other shareholders. In case investor, operating on one's own or with other persons, have acquired not less than 95% shares of the company, he has the right to claim that all other shareholders in the required manner would sell their shares. Minor shareholders have analogical right to claim for purchase of the shares.

Main goals of the mandatory sale of shares are:

- ☒ Protect company from minor shareholders' abuse of their rights;
- ☒ Protect minor shareholders from contravention of their rights;

⁴⁵ Verslo Banga, Article on Mandatory sale and purchase of shares Available at: <http://verslas.banga.lt/lt/patark.full/41d53079a5c01> (2008-04-23);

Actually, such mandatory sale works only in favor of the major shareholders that are willing to keep the control of the company in one hand and have complete freedom in decision taking processes. Therefore, ownership concentration is significantly high and government is acting against the natural ownership spread. Nevertheless, rights of the shareholders should be equalized, and all shareholders, minor or major, should be involved in the governance of their owned enterprises. In such situation, significant role is played by Corporate Governance Code.

NASDAQ OMX Vilnius Stock Exchange (former National (Vilnius) Stock Exchange of Lithuania) took the initiative in 2004 to codify principles and standards of corporate governance and to propose **Corporate Governance Code** for the listed companies on the Stock Exchange. However, the first code has not enclosed requirements for companies to disclose their compliance with the recommendations of the Code. Starting from 2007 listed issuers have to disclose in their Annual Report how they comply with the recommendations provided for in the Corporate Governance Code, i.e. on the basis of the “comply or explain” principle. In other words, company have the right not to comply with the requirements of the code, however it must disclose and indicate the reasons of such decision. Such disclosure must be public, for instance in the annual report or internet website of the company. Example of Report on compliance with Governance Code is presented in appendix no.4.

We should note that Corporate Governance Code is not the standard legal act. Its compliance is not mandatory. Corporate governance principles, standards and implementation methods included in the code take just recommendatory character. These standards ensure protection of interests of shareholders, adequate balance and distribution of functions between corporate bodies, adequate disclosure of corporate information. Code is applied only by companies that are listed on the Stock Exchange. Objectives of the code are presented in the table 2.3.⁴⁶

Table 2.3. Principle objectives of the Corporate Governance Code

- ☒ Recommend the listed companies what basic principles they should follow in order to ensure equal understanding of transparent management and operation not only by domestic but also by foreign investors.
- ☒ Encourage the listed companies to improve their governance structure and disclosure of information on their activities.
- ☒ Encourage the listed companies to enhance quality management as a means to improve the company's performance.
- ☒ Promote the activities of the listed companies on the international level and enhance confidence of domestic and foreign investors as well as other stakeholders in the companies and their governance structure.
- ☒ Boost confidence of domestic and foreign investors in the Lithuanian capital market.

Source: NASDAQ OMX Vilnius Stock Exchange

⁴⁶ Presentation: Corporate Governance Code for the NASDAQ OMX Vilnius Stock Exchange. (2008-10-15); Available at: <http://www.pfsprogram.org/file.php?id=Presentation+-+OMX+Vilnius+Stock+Exchange+-+May+10%2C+2007.pdf>

We need to notice, that the corporate governance principles and standards are not static. They will evolve and improve in the course of time. Therefore, such codes should be periodically reviewed and supplemented. Changes in the legal, economic and social environment, enhancement of good corporate governance practice and new developments should be taken continually incorporated into such codes. New Code aims to protect interests of shareholders by making adequate balance and distribution of functions between corporate bodies. Also there are additional duties as provided in the laws regarding adequate disclosure of corporate information. As an example, extract of Lithuanian Corporate Governance Code is presented in the appendix no.5.

The basis idea of Code is encouragement of the listed companies to enhance quality management as a means to improve the company's performance and enhance confidence of domestic and foreign investors as well as other stakeholders in the companies and their governance framework. From other hand, existence of such Code will have to bolster confidence of domestic and foreign investors in the Lithuanian capital market. Although a lot of important principles of proper corporate governance have already been stipulated in laws and regulations of the Republic of Lithuania (Civil Code, the Company Law, the Law on the Securities Market) therefore Code provisions were not to repeat existing legal provisions but rather to fill in the gaps in current legal regulations and, recommend the companies to follow even higher standards than those set out in the law. Summary of main areas of regulation of Corporate Governance Code are presented in table 2.4.

Table 2.4. Main areas of regulation of the Corporate Governance Code

- ☒ An appropriate balance and distribution of functions between the company's management and supervisory bodies.
- ☒ Protection of shareholder rights and equal treatment of shareholders.
- ☒ Avoidance of conflicts of interest and attitude towards other stakeholders in the company.
- ☒ Proper disclosure of information about the company.

Source: NASDAQ OMX Vilnius Stock Exchange

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. The corporate governance framework should protect the rights of the shareholders. The corporate governance framework should recognize the rights of stakeholders as established by law and encourage active co-operation between companies and stakeholders in creating the company value, jobs and financial sustainability. The concept "stakeholders" includes investors, employees, creditors, suppliers, clients, local community and other persons having certain interest in the company concerned.

Corporate Governance Code has also some weaknesses. There are lots of various Corporate Governance Codes in different organizations around the world and there is no lack of various regulation systems or mechanisms, however, they existence do not guarantee their observance. It is not enough to have the Codes alone, if there is no efficient their implementation system of effective protected and realized rights of private investor.

Naturally, acceptance of the Governance Code is positive feature of the Corporate Governance development, because it has to be more transparent and public. As other legal acts, the Code can not protect from misapplication of corporate governance. However, we should note and the potential problems of the additional legal act:

- ☒ Risk of the over-estimated regulation in the private business.
- ☒ Code does not anticipate the inclusion of the company's employees into the governance.
- ☒ Compliance of the Code is not mandatory, thus there is no possibilities for its effective implementation.

However, **Lithuanian Corporate Governance Code has very significant role.** Process of companies' listening in the NASDAQ OMX Vilnius Stock Exchange encourages transparent and fair activities of the companies. If company strives to attract the capital on the market by offering its shares and stocks publicly, it should provide investors with the detail information about the company. Such disclosure of information is essential for transparent functioning of the finance markets. Corporate Governance Code of the companies listed on the Vilnius Stock Exchange, though it takes just recommendatory character, prompts companies for even more detailed and transparent presentation of company's information.

Main goal of the company is named in the Code – to meet the requirements of all shareholders, also it is emphasized, that supervisory and management bodies of the company to warrant the respect of the rights and interests not only of shareholders, but also of other stakeholders of the company, i.e. employees, creditors, clients, society.

In last decades, there is significant growth of society interest and demand for corporate accountability and publicity that have stimulated lots of companies for implementation of different systems for accountability for their performed business activities. Usually, such reports include economical, environment protection and social aspects of the company's activities. Main stakeholders of the companies more and more expect positive impacts on social and environmental protection activities and are willing to be informed about, how companies are proceeding in these spheres. Therefore, it is commendable, that in the Corporate Governance Code of the companies listed on the NASDAQ OMX Vilnius Stock Exchange recommends revealing information on the company itself, stakeholders, strategy on the human resources, programs of employees' involvement in the decisions on shareholders capital of the company, etc. Consequently, such

requirements will boost on putting more attention for development of the company's social liability concept.

In last several years, finance societies around the world observe, that non-financial factors have influence on long-term financial activities of the companies listen on stock exchanges. Environmental, social and governance factors are the most important non financial factors becoming standard characteristics in analysis and risk assessment, which can be met by the companies available on the exchange. Institutional investors around the world, especially in Europe, are referring about growing tendencies to use environmental, social and governance factors taking the important investment decisions (NASDAQ OMX Vilnius, 2009).

Therefore, Lithuanian Corporate Governance Code is an evidence of good corporate governance practice developments in Lithuania and abroad. It incorporates principles of independency of corporate bodies, respect of minority shareholders rights, and transparency of the remuneration of corporate bodies, that are so essential for efficient corporate governance and protection of the investors. All above mentioned principles of the code (respect of shareholders rights and duties, transparency in discovering corporate governance structures) will increase investors' confidence in the enterprise. Implementation of modern corporate governance principles and theories will lead the way to major investments and will prevent bankruptcy of the enterprises.

2.3.5. Information disclosure requirements

NASDAQ OMX Vilnius stock exchange, as all stock exchanges around the world, has set strict information disclosure requirements for listed companies.⁴⁷ Listed companies have to disclose, without delay, any information that may have an effect on the price of a security. The purpose of disclosure is to provide information to the market about any significant events in the issuers (listed company) business and ensure that the investors and other market participants, on the basis of this information, would be able to take investment decisions about the listed securities.

To assure an equal access to the information to all market participants, the issuer has to submit it to the stock exchange prior to or simultaneously with releasing it to mass. The information is disseminated to investors via the exchanges website, in national languages plus in English language.

Taking closer look on NASDAQ OMX Vilnius Stock Exchange, issuers, whose securities are listed in the Main List, the Secondary List or the Debt Securities List shall prepare their **financials reports** using the accounting policies and methods that comply with the **International Financial Reporting Standards**. An issuer must submit to the stock exchange the issuer's **audited**

⁴⁷ NASDAQ OMX Vilnius Stock Exchange, Information disclosure requirements.
Available at: <http://www.nasdaqomxbaltic.com/?id=1997892#> (2009-02-05)

annual accounts and the auditor's opinion not later than on the day they are submitted to the issuer's shareholders (NASDAQ OMX Vilnius, 2009).

An issuer must submit to the stock exchange the issuer's Annual Report prepared in accordance with the requirements of the law at least 10 days before the General Shareholders' Meeting. If the issuer's shareholders are given access to the Annual Report earlier, the issuer must submit this Report to the Stock Exchange.

In the manner established by the Board of the Stock Exchange, in the Annual Report an issuer must **disclose its compliance with the Governance Code**, approved by the Stock Exchange for the companies listed on the regulated market, and its specific provisions. If an issuer fails to comply with the Corporate Governance Code or certain provisions thereof, it must be specified which provisions are not complied with and the reasons of non-compliance.

An issuer must submit to the Stock Exchange periodical reports, prepared in accordance with the Lithuanian Securities Commission rules, within the same time limits as to the Lithuanian Securities Commission.

Issuers, whose securities are listed in the Main List, the Secondary List or the Debt Securities List, must file with the Stock Exchange **a balance sheet, a profit (loss) account, a cash flow statement, a statement of changes in the equity capital**, and notes or appendices of the three, six, nine, and twelve months no later than 2 month after the end of the accountable period. An issuer must submit a notice about the company's preliminary result (profit or loss) for the previous year no later than within 2 months after the end of the financial year.

Issuers, whose securities are admitted to the Main List, the Secondary List or Debt Securities List, must disclose information about material events through the information system of the Stock Exchange. The material events that must be disclosed through the information system of the Stock Exchange shall be all the events specified in the list provided in the Rules on Disclosure of Information on Issuers' Material Events passed by the Lithuanian Securities Commission and the events related to the issuer's activities which are specified in the Trading Rules of Stock Exchange.

An issuer shall immediately disclose the details of any major changes in its business or other circumstances relating to the issuer which are not directly specified in Trading Rules of NASDAQ OMX Vilnius Stock Exchange, but which are not public knowledge and which may, by virtue of their effect on the issuer's assets, liabilities, operations or reputation, affect price of its listed securities.

All notices that an issuer announces through the information system of the Stock Exchange and periodic reports shall be submitted in Lithuanian and English. An issuer shall make public all notices intended for disclosure in both languages simultaneously. An issuer shall ensure that financial details would be specified at least in Litas and Euro (NASDAQ OMX Vilnius, 2009).

There are some **additional information disclosure requirements** for the companies listed in the main and secondary list of the NASDAQ OMX Vilnius Stock Exchange, which are summarized next:

- ☒ An issuer must place a notice about a resolution to convene a general shareholders' meeting. Where the agenda of the general shareholders' meeting include an issue of the increase or reduction of the authorized capital, in its notice an issuer shall disclose the purpose and method of the intended increase or reduction of the authorized capital. Where the general shareholders' meeting passes a resolution to increase or reduce the authorized capital, change the par value of the shares or convert securities, the issuer shall immediately disclose to the public a detailed procedure and time limits for implementation of these resolutions.
- ☒ An issuer must make public the draft resolutions to be adopted by the general meeting
- ☒ An issuer must place a notice about a resolution that the competent bodies of the issuer passed and/or intend to pass concerning reorganization of the issuer.
- ☒ An issuer must place a notice through the information system of the NASDAQ OMX Vilnius Stock Exchange about a resolution that the competent bodies of the issuer passed and/or intend to pass concerning payment (not payment) of dividend. The notice shall contain information about the amount of dividend to be paid per share and the procedure and the date of payment of the dividends.
- ☒ An issuer shall file with the Stock Exchange a written notice which shall include the actual date when the documents concerning the increase or reduction of the issuer's authorized capital or the change in the par value of shares are to be rendered to the manager of the Register of Legal Entities for registration, where the registration of said information means implementation of the decision of the general shareholders' meeting referred to in section 15.6 of Trading Rules of NASDAQ OMX Vilnius.
- ☒ An issuer must report about changes in its founding documents or the Articles of Association.

2.3.6. Corporate Social Responsibility

Currently in Lithuania, as well as in whole Europe, expansion of socially responsible business ideas is getting stronger. In our country business orientation to activity which results are pointed not only to profit gain but also to interested actors' needs and the dimensions as human rights, environmental consideration, social solidarity and cohesion is getting more and more important. Socially responsible business ideas and practice reach our country in various ways. It is influenced by globalization, the EU politics towards socially responsible business and particular local problems which cannot be solved by common methods or valid laws (Bernatonyte, Simanaviciene, 2008).

Some important differences can be noticed on comparison Lithuanian experience in socially responsible business sphere with foreign countries experience. The main factor that encourage **businessmen' responsible attitude** is the pressure of clients or society. In Lithuanian enterprises such initiatives (projects) are prompted by foreign partners or mother enterprises. These projects work inside enterprises and concern their partners they collaborate with. Lithuanian enterprises pursuing similar initiatives often follow internal moral or ethical needs. This fact illustrates that in Lithuania the main incentive mechanism of socially responsible business concept, i.e. attention to requirements of responsible consumers does not work yet. Despite all the differences and restrictions socially responsible business ideas spread continually in Lithuania.⁴⁸

The main **barriers for the development of Corporate Social Responsibility** in Lithuania are: economic, environmental and social. The economic barriers include: low innovation in enterprises; slow modernization of production facilities and updating of technological processes; insufficient growth and uneven distribution of investments by regions of the country. The social barriers are: weak co-operation with stakeholders; insufficient care in competence and motivation of personnel; low awareness of society about companies' activities and indebtedness of heat consumer (Bernatonyte, Simanaviciene, 2008).

Felicitous description of the **social responsibility strategy** of the business can be found out in the Corporate Social Responsibility report of year 2008 of company VST.⁴⁹ Each socially responsible business organization must be concerned about its environment – society. Certain ethical, moral, economic and political principles should be applied in the organization's communication with society. Adherence to these principles means that the organization is prepared to be responsible for its behavior; social responsibility obligates businesses to be responsible for their actions. Short-lived social projects that have no continuity or are contrary to the company's operations usually have little value. Therefore, a socially responsible organization has to ensure continuity of activities initiated by it as well as social justice and correspondence to the values declared (VST, 2009).

Other, well known and important company, such as TEO LT, soundly presents its Corporate Social Responsibility Policy and its purpose. The purpose of the Corporate Social Responsibility Policy of company is to define the main policies of company in implementing the culture as well as practice of socially responsible and harmoniously developed business in the Company and its environment.

⁴⁸ VST company, Corporate Social Responsibility report, 2008.

Available at: http://www.vst.lt/uploads/tmp/socialine_ataskaita_en.pdf (2009-04-05);

⁴⁹ Bernatonyte, Simanaviciene, Case study of Corporate Social Responsibility in Lithuania's Business Society, 2008. Available at: http://www.vgtu.lt/leidiniai/leidykla/BUS_AND_MANA_2008/soc-economical/501-505-G-Art-Bernatonyte_Simanaviciene.pdf (2009-03-15);

This Policy is based on the understanding that company, being a big Lithuanian business enterprise and an influential member of Lithuanian society, must take into consideration the social and nature protection aspects of business, assume responsibility for the short-term and long-term consequences of its activities as a market participant, as an employer, as a consumer and as a society member.⁵⁰

Generally, socially responsible company implements its social policy through corporate activities in the following areas (TEO LT and VST, 2009):

- ☒ relations with employees;
- ☒ relations with customers (or market);
- ☒ relations with the public (or society);
- ☒ environmental protection;

All presented areas of the activities of the socially responsible business are included and overviewed in both (VST and TEO LT) mentioned companies' Corporate Social Responsibility annual reports.⁵¹ It should be noted, that both reports are taken as the available benchmarks for other local business units, because both companies were awarded in the 2008 NASDAQ OMX Baltic stock exchange market awards: VST receive award of the best annual report in the Baltic States in 2008, while TEO LT was awarded for the best investor relations in the NASDAQ OMX Vilnius Stock Exchange.⁵²

From all mentioned can be stated, that corporate governance must consider various sides of business environment: not only meeting expectations and requirements of economic-benefit seeking stakeholders of the company, but also be socially responsible for the whole environment in which company is operating. Thus, social responsibility is a deciding factor of business enterprises reputation from the view of not only operational business environment, but also from the view of encouraging better investor relations. Reputation, in turn, is more and more important factor of common success. Reputation determines how the society considers the enterprise which is in market, do the consumers want to choose this enterprise as the supplier of the certain product or service, can this enterprise employ the best employees, do the partners are interested in it, what is the investors' attitude towards this enterprise? Social responsibility is becoming a competitive factor beside price, quality and environmental questions.

⁵⁰ TEO LT, Corporate Social Responsibility. Available at: http://www.teo.lt/en/social_partnership-1345.html (2009-04-05);

⁵¹ TEO LT, Corporate Social Responsibility report 2008. (2009-04-05); Available at: http://www.teo.lt/gallery/Dokumentai/Investuotojams/MA/2008_CSR_report.pdf (2009-04-05);

⁵² NASDAQ OMX Baltic, The Baltic Market Awards 2008. Available at: <http://www.nasdaqomxbaltic.com/?id=3261621> (2009-04-05);

2.4. Ownership Structure in Lithuania

Development background of the corporate governance and ownership structure in Lithuania was influenced by historical and economical situation of the country. When the country became independent in year 1990, there was time of the economical transition, formation of the government, introducing own legal acts, etc. At the moment of such transition, occurred in most of East and Central Europe countries, enormous number of companies was presented for the privatization. Such a phenomenon can be completely unknown for certain economies, even such well developed as USA, where state ownership has always been very small. Therefore, such privatization wave has raised the issue how the newly privatized corporations should be owned and governed.

2.4.1. Primary and secondary privatization waves

In the process of privatization certain amount of state share ownership are acquired by the private natural or legal person, which stand as local or foreign investors. Thus, initial privatization period can be treated as the primary stage of ownership structure and corporate governance system formation in the region. Privatization period of 1991-1995 is characterized and oriented in creation of private sector, strengthening private ownership and ownership rights, which also was consisted with the restoration of the statehood, which was vested with the huge euphoria. In Lithuania, as in other East and Central Europe countries, occurred the preference for the closest parts to the privatized objects, local were better preferred to the foreign investors, and workers, including managers, of privatized companies – to the other outside investors groups (Solnyškinienė, 2004).

Privatization was and still is the important mean to draw the foreign direct investments. It was projected, that major share holdings in Lithuania could be traded for the foreign investors in the converted currency. Though, foreign investors were not interested in the object included in privatization offered list, that lead to “foreign” privatization of only 4 companies until year 1995.⁵³

Primary post-privatization ownership structure in Lithuania was stipulated by the diversified starting positions of subject groups involved in it. In privatized economic entities, ownership rights on 52% of capital belonged to private natural and legal persons, while 48% of capital belonged to the state. 7.4% of total privatized property, on simplified conditions and easy terms, were provided for employees, 2/3 of which – for managers of privatized company. Investment stock companies have made significant role in this period. In the beginning of year 1994, there were 379 such companies and they controlled 39% of privatized property.⁵⁴

⁵³ State property fund of Lithuania - reports and reviews. Available at: http://www.vtf.lt/index.php?option=com_content&view=article&id=40&Itemid=34&lang=lt (2009-04-03);

⁵⁴ Šimėnas, A. Ekonomikos reforma Lietuvoje (1996), Vilnius.

In Lithuania, differently from other Baltic State countries, employees have few advantages in acquiring stocks of small privatized companies, in comparison with large privatized companies. Therefore, **employees have acquired mainly the stocks of medium and large size of privatized companies**, while ownership of small companies was taken over the managers of those companies. Until 1997, in majority of the public companies in Lithuania, ownership structure was different from the Western and some Eastern Europe countries. From one side, foreigners were practically not involved in acquisition of privatized entities, from another, extremely big part of shares belonged to the managers and other employees, sufficiently big part still left for the state and slight part – for other institutional investors, such as banks, funds, etc.

Different interest groups of stakeholders were forming in the period of reorganization of the state companies to the public companies: state as a stockholder, private stockholders, managers and stockholders of the company, large and small stockholders, local and foreign investors. According the agency theory, different groups of stockholders are presenting different interests: common stockholders expects the growth of the stock value and the dividends, state expects the cooperation with governmental institutions and creation of new work places, creditors – liquidity of the equity and risk reduction, foreign investors – entering new market and rising sales. **In 1991-1996 there was no corporate governance experience in Lithuania** and legal framework was not yet regulated. Therefore, managers of the companies were presenting their private interest, despite the interests of stockholders (Solnyškinienė, 2004).

In the period of 1991 - 1996, **complete inefficiency in operation** of economic units can be observed as in private, as in state business sectors. It was not the priority for managers of the companies and privatization agencies to keep operational efficiency of economic activity of such companies by the time of separation and division of equity, capital and influence. There was need of financial actives to solve the day-to-day problems in the countries of new democracy, as a result, privatization agencies were only interested in the scope of privatization, while managers - in opportunity to take the possession and total control over the company. In addition, development of production was in shortage of financing and new owners were lacking of competence and experience.⁵⁵

Ownership structure after primary privatization wave is not meeting the expectations of different stockholders and can not be taken as the efficient way to divide the ownership and influence between the different interest groups. As world practice shows, **secondary privatization**, stock and equity sales and exchange becomes very intensive in such case, because majority of new owners are not satisfied with the amount of available stockholdings or investment portfolios.

⁵⁵ Solnyškinienė, J. Property structure choice in Lithuanian Stock Companies – Journal TILTAI (2004), Klaipėda.

Sale of the privatized companies stocks was very complicated and slow in the newly developing economy countries, because of undeveloped financial credit system and market of capital and stock exchange, slow procedures of bankruptcy and acquisition of the ownership rights, bureaucracy and corruption, others.

In Lithuania, as in others East and Central Europe countries, ownership structure changes in private sector in respect to certain owners' constellations were slight. It is observed clear tendency of transfer stockholdings of large part of employees to the managers of the company. In the majority of the companies ownership concentration of stockholdings was rather small, not reaching 50 % of the ownership of major stockholder. It is obviously, that in 1991- 1996 period, ownership structure and corporate governance has just started formation in such newly developing country as Lithuania. Therefore, **significant and constant changes in ownership structures in the Lithuanian companies should be related with the prolonged primary and secondary privatization.**

It is spotted such tendency in ownership structure changes in 1998 – 2003 year period: Lithuanian economic entities concentrate the capital increasing number of the controlling shares by the secondary privatization and by combinations of vertical and horizontal consolidations and by various activity diversification principles. Among others Baltic States, Lithuania distinguishes by emergence of the large national capital companies and group of companies, such as “VP Market”, Alita, “Achema group” concern, “Vakarų Skirstomieji Tinklai“, etc (Solnyškinienė, 2004).

2.4.2. Role of foreign investors

Considering small fraction of “green field” foreign investments, privatization was and still is the important way to attract the foreign direct investments. Lately, it became quite common, that foreigners become the owners of the state capital by privatization process, especially of large, usually strategic and infrastructural state objects. It can be stated, that foreign investors take over major and most profitable East and Central Europe countries markets almost without any challenges or long and costly negotiations. In Lithuania such phenomenon can be depicted by the examples of privatization by foreign investors of number of profitable strategic, somehow market monopolistic and infrastructural state companies, such as “Mažeikių Nafta”, “Danisko sugar”, “Klaipėdos Laivų Remontas”, “Lietuvos Telekomas”, “Vilniaus Energija”, “Lietuvos Dujos”, and number of others.

Differences of the foreign direct investment scopes in Lithuania can be related with the changes in the investment climate within the country, including changes in regulation of the capital, ownership and earning flow abroad, some tax privileges, etc. Until the year 1997, investment climate for foreign investors in Lithuania was not favorable, due to implementation of such investment restrictions:

- ☒ presented list of non-privatized state objects;
- ☒ prohibition of selling land for the foreigner;
- ☒ fixed share of state in the privatized units: in strategic state objects only 10-20% of capital can be privatized, in major infrastructure and production entities, state controlling shareholdings can not measure less than 50%;

Moreover, foreign investors were not interested in the object included in privatization offered list, that lead to “foreign” privatization of only 4 companies until year 1995.

Principles and priorities of privatization have changed, when first privatization waves have flooded back. In 1996 - 2003 year period, transactions were designed by the principles of the highest offered price, and considering foreign strategic investors, who can assure the aspects of continuous benefit with constructive and responsible operation of the unit in future.

General conclusion is presented in almost all research papers, where influence of the ownership structure on the efficiency of company operation is analyzed. It is that certain types of owners have certain influence on the efficiency of the company, while foreign are better then local investors. It is stated, that local investors, including state, managers and employees of the company, certain legal or natural persons, have the different objectives than are related with the profit maximization. It can be higher wages or dividends, assured employment, stable operational or working conditions, etc. In contrary, foreign investors were striving to reorganize and modernize privatized companies, having better financial opportunities, corporate governance competences, excellent management skills, access to the international business networks and markets.

In different East and Central Europe countries, **activities of foreign investors have more or less influenced the changes in ownership structure**, occurred in public companies of the countries. High concentration of foreign investors in the strategic and market-monopolistic privatized companies provides certain problems in the national level, influence economical stability, in some level, creates threat for national safety. In international business level, such foreign investors’ activities weaken the positions of national economic entities and definitely have influence in the global market competition. Therefore, it is necessary and purposeful to regulate and control certain activities of such economical entities, such as pricing policies, strict requirements for quality of the provided products and services (Solnyškinienė, 2004).

Considering theoretical assumptions and all analyzed data above, it can be stated, that **tendencies in ownership structure changes in 1998 – 2003 year period were positive and ensured background for growth of the efficiency in Lithuanian companies in the future.**

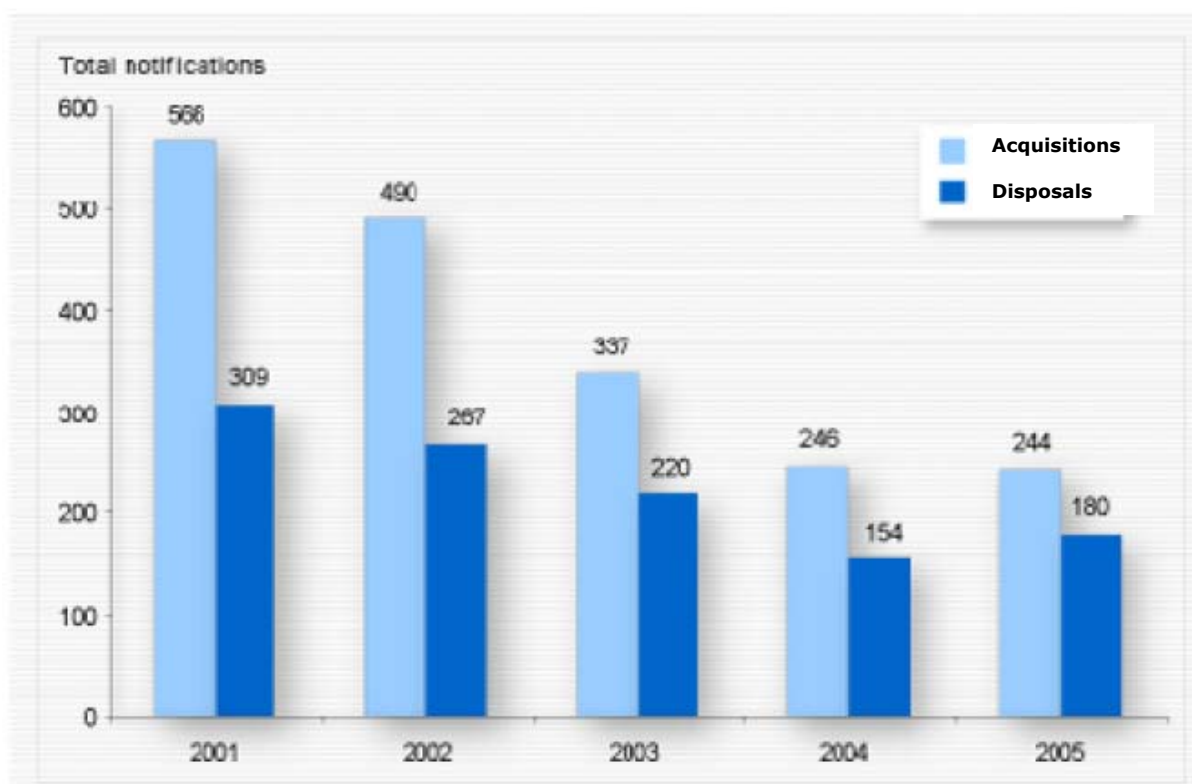
After such detailed analysis of primary ownership structure development in Lithuania, it is time to proceed to the analysis and development of the statistical patterns of the country’s ownership structure.

2.4.3. Changes in ownership patterns after Lithuania's EU accession

The year 2005 in the history of NASDAQ OMX Vilnius Stock Exchange will be recorded as the period of in depth changes. The integration of the Lithuanian securities markets into the common Nordic capital market was the impetus of equal importance to the accession of the Lithuania into the European Union in May 2004. The Lithuanian securities market has become more readily accessible to foreign investors, which naturally enhanced the investment influxes.

The NASDAQ OMX Vilnius Stock Exchange membership has become more readily accessible to foreign intermediaries who have brought into the Lithuanian market numerous new investors. The influx of foreign investors triggered the securities demand up, which, however, had a controversial impact upon the development of the market. The share prices were growing rapidly, eventually overstepping the performance indicators and no longer reflecting the actual conditions of prospects of issuers; while shares of some companies have become overly overpriced.

Corresponding the Annual report of securities market development in 2005 issued by Securities Commission during the year 2005 was submitted total 424 notifications, on the acquisition and the disposal of the blocks of shares of 149 issuers of which 244 (57.5 %) were acquisitions and 180 (42.5%) – cases of disposal of the blocks of shares (Picture 2.17).⁵⁶



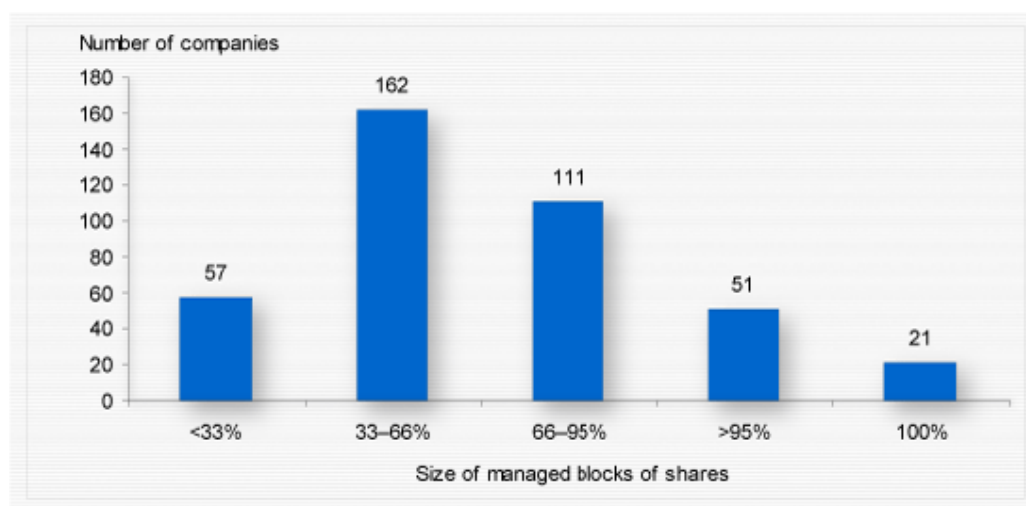
Picture 2.17. Notifications received in 2001–2005 on the acquisition and disposal of the blocks of shares

Source: 2005 Annual report and trends of the Securities market development

⁵⁶ 2005 Annual report and trends of the securities market development. Digital version on CD. Can be also found on the website of Securities Commission of Lithuania: <http://www.vpk.lt>

The submitted data provides clear evidence on the decline in the number of notifications filed by persons acting independently or in association with other persons. This draws to the conclusion that the capital of most companies has been accumulated in the hands of major shareholders. This assumption is additionally substantiated by the information provided in the annual prospectuses-reports on the major shareholders owing more than 5% of the votes. The blocks of shares not sufficient to grant the vote right (entitled by a holding of 33% and more) held by major shareholders were recorded in 57 (14%) out of the total 402 examined companies. It follows that in 86% of the companies major shareholders own 33% of votes and over. The average block of shares managed by shareholders in 2005 was 62% of votes (2003 – 53.5%, and in 2004 – 58%).

In two thirds of the 402 companies surveyed, holdings entitling to 33–95% of votes are managed by major shareholders (Picture 2.18.). In about 20% of all companies major shareholders have accumulated the holdings in excess of 95% of votes. The management of nearly 5% of all companies is concentrated exclusively in the hand of the major shareholders due to their 100% ownership of the company's capital which enables them to pass all the most important decisions disregarding the interests of minor shareholders (VPK, 2005).



Picture 2.18. Breakdown of companies by the size of blocks of shares managed by companies in year 2005

Source: 2005 Annual report and trends of the Securities market development

The analysis of the block of shares accumulation process allows a conclusion that **nearly half of all investors accrue their holding by initially acquiring comparatively minor blocks and further increasing the holding acquired.** In 2003, most notifications concerned exceeding of the 20% threshold, while the prevailing figures in 2004 were 33%, and in 2005 – the exceeding of the threshold of 10% and 20% of the holding votes. A minor share of all notifications on the acquisition of the blocks of shares (some 10%) were filed by investors who had at a single transaction acquired major shareholdings (over 40%) which is clearly an indication of the take-over of the target company by a major investor.

The disposal of a block of shares most often follow a single scenario whereby the block of shares is disposed of in a single transaction. During the accounting period such transactions accounted for about 10% (in 2004 – 26%) of all transactions in blocks of shares. To conclude, the number of **notifications on the changes in the blocks of shares is steadily decreasing as a result of the trend towards the concentration of the capital of public companies with major shareholders.**

Out of public companies notifying of the acquisition (disposal) of securities blocks of shares approximately 10% are companies listed on the Official and Current List of the Stock Exchange, and 90% are represented by non-listed companies. The reasons for the acquisition and disposal of the blocks of shares range in character significantly. In about 13% of cases such notification were placed following the respective deals on the Stock Exchange, while the major volume of trades are concluded on the over-the-counter market (59%), in about 10% of the notifications reorganization of the company is indicated as the main reason for the exceeding of the voting threshold, or acquisition of the blocks of shares by acquisition or transfer of the block of shares within a group of companies.

About two fifth of the companies has reported foreigners among their shareholders. Foreign investors were mostly recorded in the companies wherein the major shareholders have in the range of 66-95% of votes. This is a reflection of the general trend among foreign investors tending to invest in companies where the votes are concentrated to the extent facilitating the passing of the decision concerning the most vital issues. During the accounting period the Commission received 80 (19%) of notifications filed by foreign investors of the changes in the blocks of shares (in 2003 – 12%, and in 2004 – 11%) of which in 52 cases the notifications concerned the acquisition of the blocks of shares and in 28 cases the issuers notified of the disposal of the blocks of shares. Foreign investors come from different countries: Estonia, Luxemburg, Poland, Russia, USA, Sweden, Belgium, Germany and other countries.

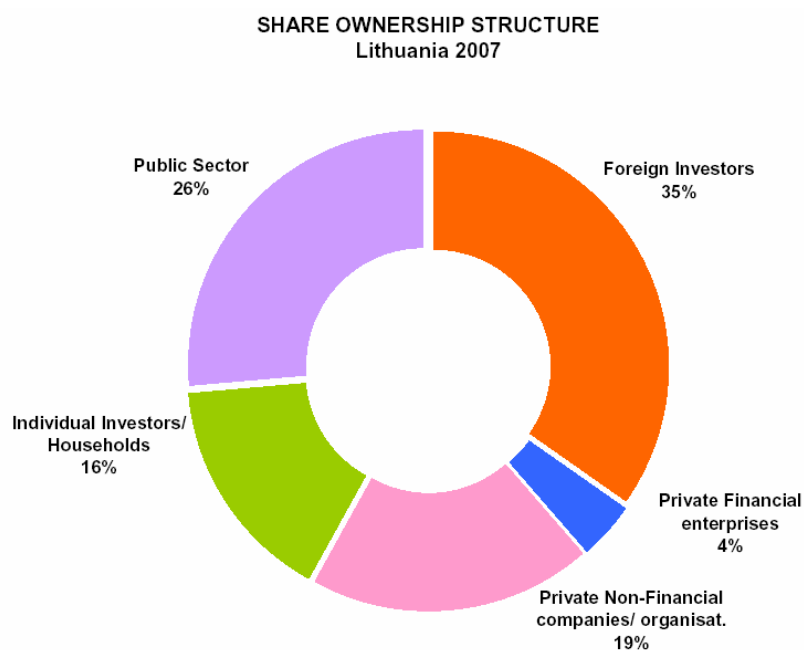
The assessment of the information accumulated in the course of the accounting period allows a conclusion that the capital of public companies is mostly concentrated with the major shareholders therefore the number of notifications on the changes in the structure of the blocks of shares is gradually decreasing; also, it may be concluded that **foreign investors are more inclined to invest into the targets wherein the capital is concentrated at least to the extent allowing the shareholders to jointly hold the veto right (VPK, 2005).**

All data presented in this part of the paper, has provided us opportunity to evaluate changes of the ownership patterns in the companies listed in the stock exchange in the period after the Lithuanian accession to the European Union.

2.4.4. Current ownership patterns

Now, we will proceed to the more concentrated analysis of the ownership structure of the companies listed in the NASDAQ OMX Vilnius Stock Exchange. For this purpose we will analyze data presented by the Federation of European Securities Exchanges (FESE) that summarizes ownership patterns of shareholdings in different European countries' stock exchanges. This data is presented in well-developed annual report of this organization called "Share Ownership Structure in Europe (2007)". Data gathered in the present survey are relevant to 2007 in general terms and in some cases to 2006. Information on Lithuania situation for this international survey was provided by the Central Security Depository of Lithuania (CSDL).⁵⁷

According mentioned report, ownership structure of the companies listed in the NASDAQ OMX Vilnius Stock Exchange can be presented graphically as it is in the picture below (picture 2.19.).



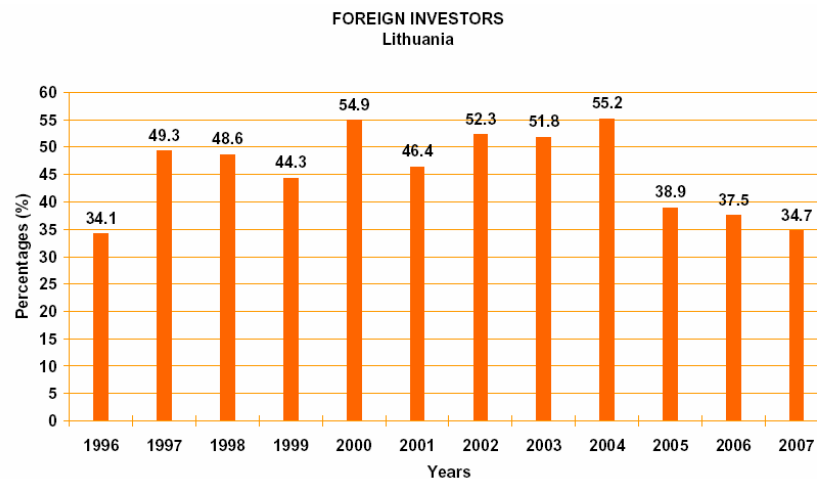
Picture 2.19. Share Ownership Structure in Lithuania (2007)

Source: FESE, Share Ownership Structure in Europe (2007)

From the data presented above, we can see that major part of all shareholding goes to the foreign investors and it counts 35%. Here we can conclude that foreign capital is widely spread in our country's stock exchange and it reaches more attention in recent years. Therefore, other 65% is spread between domestic investors: private financial enterprises have only 4%, private non-financial organizations compound 19%, individual investors, so called households, reach only 16% and public sector has 26%.

⁵⁷ Federation of European Securities Exchanges (FESE), Share Ownership Structure in Europe (2007) Available at: http://www.fese.be/_lib/files/Share_Ownership_Survey_2007_Final.pdf (2008-12-19);

Closer look should be made on the tendencies of the foreign investors. As it was discussed before, huge influence of the investments of foreign companies was made by the investment conditions formed by the government in the first two privatization waves. In the picture 2.20 we can see the tendencies of the ownership changes of foreign investors. First, in the 1996 – 1997 period, after primary privatization wave, second, in year 2000, other privatization wave, and in year 2003 – 2004, when Lithuania became the member of European Union. It should be emphasized, that there were major changes in the classification of securities owners in year 2005. The comparison of data for year 2005 and previous years is likely to be not so accurate. Nevertheless, it has no influence to draw the tendencies from the previous years.

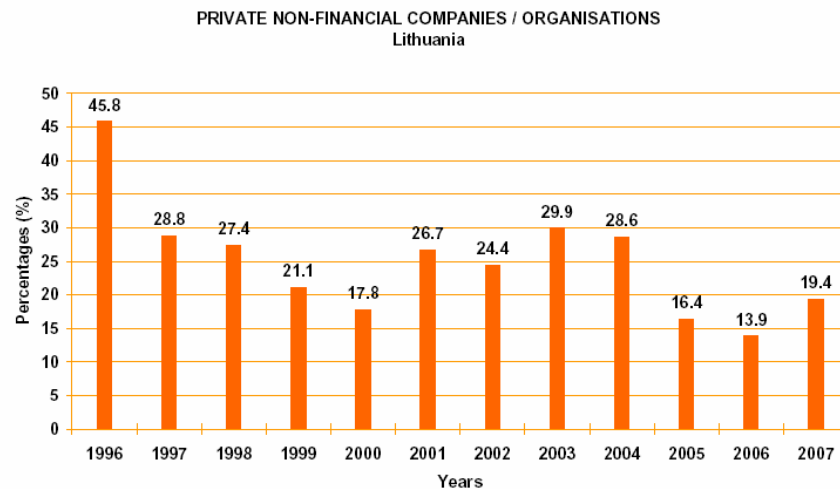


Picture 2.20. Percentage change of the Share Ownership of Foreign investors in Lithuania in 1996 - 2007

Source: FESE, Share Ownership Structure in Europe (2007)

If we take a look on the development of the private non-financial company ownership, presented in the picture 2.21., we will recognize the significant decline until the year 2000. This is related with the secondary privatization, analyzed in the previous parts, where newly privatized private companies were acquired not only by foreign investors, but by more active local private institutional and individual investors. Share of the investment of private financial companies in this 1996 – 2001 year period has increased from 4% to 11%, while households' share ownership reached 12% from 10% in the beginning. Nevertheless, the biggest influence was made by foreign investment to the country that went up from 34% to 54% in analyzed 1996 – 2001 period.

In 2000 – 2004 year period private companies were recovering their position in the overall shareholdings by reaching almost 30 % in years 2003 – 2004, from 18% in year 2000. Considering fact that there were no significant changes in the share of foreign or private households' ownership in this period, thus this can be explained by changes and fluctuations in the investment of the financial companies, which have stabilized only after creation one common and more stable financial system after Lithuania's integration into European Union in year 2004.



Picture 2.21. Percentage change of the Share Ownership of Private Companies in Lithuania in 1996 - 2007

Source: FESE, Share Ownership Structure in Europe (2007)

In the appendix no. 6 whole table from Federation of European Securities Exchanges (FESE) annual report “Share Ownership Structure in Europe (2007)” on the share ownership structure and development in the period 1996 – 2007 in Lithuanian is presented.

Once again, it is important to emphasize strongly, that there were major changes in the classification of securities owners in year 2005. The comparison of data for year 2005 and previous years is likely to be not so accurate. Nevertheless, it has no influence to draw the tendencies from the previous years. However, it has no influence to draw the tendencies from the previous years.

Such statistical data provides opportunity to recognize the tendencies in changes of ownership structure in Lithuania. Role of privatization and foreign investors, discussed in previous parts of the paper, can be noted in the statistical charts presented above. Foreign capital was fluctuating near the 50% of all shareholdings in the 1997 – 2004 year period. As it was mentioned before, principles and priorities of privatization have changed, when first privatization waves flooded back. In 1996 - 2003 year period, privatization transactions were designed by the principles of the highest offered price, and considering foreign strategic investors, who were somehow excluded from the first privatization wave. After year 2004, foreign investors’ shareholdings have stabilized in approximately 37% level and keep the same level until today.

Generally, tendencies in ownership structure changes in 1998 – 2003 year period were positive and ensured background for growth of the efficiency in Lithuanian companies in the future.

Period of year 2004 – 2005 with the integration of the Lithuanian securities markets into the common Nordic capital market was the impetus of equal importance to the accession of the Lithuania into the European Union in May 2004. The Lithuanian securities market has become more readily accessible not only for foreign, but also for local investors.

2.5. Aspects of Corporate Efficiency

Lots of economical and business researchers and scientists have investigated the problem of corporate governance and control effectiveness. They have produced a number of arguments and maintained that ownership structure influences the indicators of company's effectiveness. All this main scientific research aspects we have analyzed in the appropriate theoretical part of the paper.

At this point, we will summarize and analyze in short main issues influencing the operational efficiency of the company, considering corporate governance and ownership structure broadly analyzed in previous parts.

Starting from the main stakeholders involved in the corporate governance we have distinguished shareholders, boards and director of the company. Shareholders are divided according the source of capital: foreign capital, state (public), legal person (business unit as other enterprise), institutional investor (financial enterprises, such as banks, investment and pension funds, financial brokers, etc.), and group of natural persons (individuals or, in other words, households). Different groups of shareholders are presenting different interests: common shareholders expects the growth of the stock value and the dividends, state expects the cooperation with governmental institutions and creation of new work places, creditors – liquidity of the equity and risk reduction, foreign investors – entering new market and rising sales.

It is empirical evidence on the shareholdings' influence on the efficiency. One is that, there is **negative association between the share of state ownership in a company and the efficiency of the company operation**.⁵⁸ Here can be noted, that activity of state enterprises is bureaucratic, economy subjects are not initiative, there are no risk-stimuli, their activity is not directed towards the introduction of cost reducing technologies. This was evident in the state owned companies and such situation was changing with involvement of private capital. Privatization in Lithuania, analyzed in this paper before, is the significant issue relating to the subject of boosting efficiency. However, in the first privatization wave of 1991 – 1996 in Lithuania, **complete inefficiency in operation** of economic units can be observed as in private, as in state business sectors. It was not the priority for managers of the companies and privatization agencies to keep operational efficiency of economic activity of such companies by the time of separation and division of equity, capital and influence. There was need of financial actives to solve the day-to-day problems in the countries of new democracy, as a result, privatization agencies were only interested in the scope of privatization, while managers - in opportunity to take the possession and total control over the company. In addition, development of production was in shortage of financing and new owners were lacking of competence and experience.

⁵⁸ Zelenyuk V., Zheka V. Corporate governance and firm's efficiency: the case of a transitional country, Ukraine. 2006, Springer Science.

From other point of view, older people still remembers highest productivity scopes, full employment and high-activity operations in the economical units of former Soviet Union, that were practically all state governed and controlled. However, we should not forget, that whole Soviet system was aimed on the maximum involvement of the available recourse (human, operational or production), while operational efficiency was far away from top priorities.

State as an owner differs from other owners by different aspects. First of all, state is the political organization, thus the incentive system significantly varies from the private owners' incentive system, aimed on profit maximization. Stated owned companies are under the political pressure not for just boosting the operational efficiency, but to solve the social problems or to perform economically irrational activities, in order to keep the popularity of involved political forces. Control and supervision functions of state-owned companies are also in hand of state officers and politicians, while state has the legislation "monopoly" too. **Nature of the state it self is conditioning that operation of state-owned companies is not enough efficient.**

Private natural or legal person in the face of local or foreign investors were brought by privatization to the public sector. Local investors, including state, managers and employees of the company, certain legal or natural persons, have the different objectives than are related with the profit maximization. It can be higher wages or dividends, assured employment, stable operational or working conditions, etc. In contrary, foreign investors were striving to reorganize and modernize privatized companies, having better financial opportunities, governance competences, excellent management skills, access to the international business network markets. Thus **foreign ownership has significant positive effect on the efficiency and the quality of corporate governance.**

Coming next, there is empirical evidence **that concentrated ownership positively affect efficiency of the company, and the relationship between ownership concentration and the efficiency of the company is U-shaped.**⁵⁹ Concentration issue was already analyzed in this work before, presenting the negative influence for the rights of the minor shareholders of the company. Nevertheless, concentrated ownership provides significantly better and more efficient operational environment for the business, while strengthening supervision and governance of the company's operations. From one more point of view, highly dispersed ownership provides environment for collective, more mature and in-detail analyzed and discussed solutions of the involved parts, which are definitely contributing to the success and growing efficiency of the economical unit.

All issues mentioned above are only some main remarks recognized through the analysis of our main topics of the thesis, corporate governance and ownership distribution, and how they are influencing overall corporate operational efficiency.

⁵⁹ Chen Lin, Yue Ma, Dongwei Su. Corporate Governance and Firm Efficiency: Evidence from China's Publicly Listed Firms. Managerial and Decision Economics, 2009, vol. 30, issue 3, pages 193-209.

3. COMPARATIVE ANALYSIS OF CORPORATE GOVERNANCE AND OWNERSHIP STRUCTURE IN OTHER COUNTRIES AND IN LITHUANIA

In this part of the work we will analyze the corporate governance background in other countries. As the basic models of corporate governance were presented in the theoretical part, so here we will concentrate only on more practical implementation of the governance systems, putting strong emphasis on the ownership structures in other countries.

3.1. Background

The differences between countries in shareholder ownership patterns influence the nature of their corporate governance systems. According to Franks and Meyer (1992)⁶⁰, there are fundamental differences between the corporate control systems of the UK and the USA and France, Germany and Japan. The former⁶¹ they describe as outsider systems and the latter as insider systems. The characteristics that distinguish the systems are listed in Table 3.1.

Table 3.1. Characteristics of outsider and insider systems

Characteristics	UK and USA	Europe and Japan
Listed companies	Many	Few
Trading ownership	Frequent, liquid capital market	Infrequent: illiquid capital market
Inter-company holdings	Few	Many
Shares	Widely held	Large holdings
	Dispersed individuals	Concentrated companies
	Financial institutions	
Concentration of ownership	Low	High

Source: Data compiled according the references of discussed authors, i.e. Franks and Meyer.

Insider systems are characterized by relatively few quoted companies, concentrated ownership, dominance of corporate and/or institutional shareholders and reciprocal shareholding. Shares are infrequently traded, but when they are they often involve large blocks. Takeover activity is largely absent, and where mergers take place they are largely done by agreement. However, Vodafone did acquire Mannesmann following a hostile bid. These characteristics, it is argued, lead to more active owner participation. Owners and other stakeholders are represented on the boards of companies, and there is active investor participation in controlling the company; this minimizes external influences in the control of the company. Ownership lies within the corporate sector rather than with a multiplicity of individual shareholders.

⁶⁰ Franks, J. and C. Meyer Corporate ownership and corporate control: A study of France, Germany and the UK. *Economic Policy*, 1990, no.100, 189-232.

⁶¹ Franks, J. and C. Meyer Corporate Control: A Synthesis of the International Experience (Working paper). 1992. London Business School.

Directors are representatives of other companies and interest groups, while a two-tier board structure allows a wider group of stakeholders to offer the company a broader spectrum of advice tending to reinforce longer term goals and stability for the company. Information about the firm's problems and performance is available more readily to corporate or institutional shareholders than to individual shareholders; this enables them be better informed about the firm's performance because they have inside information.

Germany is an example of an insider system. It has according to Franks and Meyer (2001) around 800 quoted companies compared with nearly 3,000 in the UK. Ownership is much more concentrated with 85% of the largest quoted companies having a single shareholder owning more than 25% of the voting shares. Large ownership stakes tend to rest in the hands of families or companies with interconnected holdings. Where shares are more widely dispersed then the influence of banks is stronger.

For example, the largest shareholder in BMW is the Quandt family which owns 46% of the voting equity. Stefan Quandt is one of four deputy chairmen, and his sister Susanne is a member of the supervisory board. Head of the family is Joanna Quandt, who is the majority owner of Altana, a pharmaceutical manufacturer; this makes them the controllers of two of Germany's top 30 companies (Financial Times 16 August 2002). The supervisory board appoints the management board. When the company's acquisition of British Leyland was deemed unsuccessful the chairman of the management board and two other directors were quickly dismissed in early 1999 by insider action.⁶²

Outsider systems are characterized by dispersed share ownership, with the dominant owners being non-bank financial institutions and private individuals. Owners and other stakeholders are not represented on the boards of companies. Shareholders are seen as passive investors who only rarely question the way in which a company is being operated. Shares are easily sold and tend to be held for investment purposes, as part of a diversified portfolio, rather than for control purposes; this discourages active participation in company affairs since shares are easily traded. Thus, dissatisfaction with the performance of a company leads the shareholder to sell shares, rather than initiate moves to change the management or even company policies. Dispersed ownership is assumed to mean managerial control; this is particularly true when financial institutions hold numerous small stakes. While such institutional investors may have information advantages, they do not use this to influence management directly but to maintain the value of their investment portfolios on behalf of clients (Franks and Meyer, 2001).

⁶² Franks, J. and C. Meyer Ownership and control of German corporations. *Review of Financial Studies*. 2001, no.14(4), 943-977.

The monitoring of managers is said to be superior in insider systems, with deteriorating performance more quickly acted on. In the outsider system, changing management and policies is a slower process and may involve the takeover of the failing business by other enterprises (Franks and Meyer, 2001).

3.2. Patterns of ownership structure in chosen countries

The pattern of share ownership varies between countries and with time. Comparative data analysis of the ownership structures in France, Germany, Italy, Spain and the UK for the year 2000 and 2007 are presented in Table 3.2. and Table 3.3. respectively.

Table 3.2. Structure of share ownership in Europe, 2000.

Type of investor	France (%)	Germany (%)	Italy (%)	Spain (%)	UK (%)
Individuals	7.4	16.8	22.4	30.5	16.0
Institutions	28.9	30.6	23.8	14.3	45.4
Companies	19.6	37.8	28.3	20.3	2.9
Public sector	6.3	2.3	9.8	0.2	0.0
Foreign investor	38.8	12.5	15.7	34.7	35.7
Total	100.0	100.0	100.0	100.0	100.0

Source: Own calculations according data from FESE, 2007 report

Table 3.3. Structure of share ownership in Europe, 2007.

Type of investor	France (%)	Germany (%)	Italy* (%)	Spain (%)	UK* (%)
Individuals	6.7	13.3	26.6	20.1	12.8
Institutions	28.8	24.2	23.2	17.5	44.4
Companies	13.1	39.3	26.6	25.4	2.7
Public sector	10.3	1.9	9.7	0.2	0.1
Foreign investor	41.1	21.3	13.9	36.8	40.0
Total	100.0	100.0	100.0	100.0	100.0

Source: Own calculations according data from FESE, 2007 report

* - available only data from year 2006

Here, each of presented country will be commented in short. Starting from **France**, it should be said, that it still has rather significant part (10%) of the state ownership, comparing with other countries. It has rather high share of non-resident investments, reaching 40%. Foreign investors have mainly focused on the largest companies. A majority of them are located in the euro area; American investors come second and British in third position. Number of individual investors was decreasing steadily until 1999 and from that time has stable share of approximately 7%, which presents French individual investors as the less active from all analyzed countries. From other hand, stable number from year of approximately 20% of collective investments forms almost whole number of institutional investments (29%).

Germany is distinguishing from other countries by the big share of the private no-financial organization and companies that from year is reaching steady 40%. Number of foreign investors was slightly falling till the year 1995, when it reached only 8%, but from that time it was growing each year, currently reaching 21%. Slight peak of financial institutions was in the period of 1997-2002, when they share was reaching 30%, but it fluctuating around 25% for now.

Italy seems to have most dispersed ownership structure from all presented countries. None of investor is overcoming the 30%, where individual, private financial and non financial organizations are playing in the cycle of 25%. Decrease in the role of the public sector has been spotted. As a result is has reduced from 29.8% in 1996 to 9.8% of 2000 due to the privatization process of important companies which were previously owned by the State. In the following years its role remains quite stable. With comparison to 20% of collective investment in France, number of 13% that forms more that a half of all institutional investment of the country seems enough impressive, additionally considering quite high number of individual investments.

Since the beginning of the 90's and with a considerable stability in **Spain**, foreign investors account for more than one third of the total market capitalization. In year 2007 they accounted for 37% of market, one of the highest levels in the last 16 years. The increase in the participation of foreign investors in 2007 is related to the major stakes they are gaining in important companies listed in the Spanish Stock Exchange. Individual investors rapidly increased their share during the privatization of state-owned companies (1996-1999). Since then, their percentage has decreased significantly but still accounts for 20% in 2007. The drop in the percentage of share ownership by the State is also one the most significant features not only on the exchange but also in the Spanish economy. The public sector's share in the Spanish Exchanges' capitalization fell from 16% in 1992 to almost zero in 2000. As a result of privatizations, shares formerly owned by the state are now in the hands of foreign investors and households (via direct investment or via Collective Investment Institutions).

In the United Kingdom, as in the United States of America, ownership is more widely dispersed than in continental Europe or Japan where it is more concentrated.⁶³

In each country the structures are different in broad terms compared with the UK:

- ☒ Holdings by financial institutions are lower.
- ☒ Holdings by non-financial companies are more important, particularly in Germany.
- ☒ Individual ownership is more important in Italy and Spain, but less so in France.
- ☒ Foreign owners are more important in France and Spain but less significant in Germany or Italy.

⁶³ National Statistics Department of The United Kingdom, Share Ownership. Available at: http://www.statistics.gov.uk/downloads/theme_economy/ShareOwnership2003.pdf (2008-04-25);

Table 3.4. Shareholdings in the United Kingdom (1963 – 2006)

Owners	1963 (%)	1975 (%)	1989 (%)	1994 (%)	1997 (%)	2001 (%)	2004 (%)	2006 (%)
Individuals	54.0	37.5	20.6	20.3	16.5	14.8	14.1	12.8
Institutions	30.3	48.0	58.5	60.2	52.5	47.5	47.7	44.4
Companies	7.2	5.3	6.1	2.4	3.1	2.0	1.7	2.7
Overseas	7.0	5.6	12.8	16.3	27.8	35.7	36.4	40.0
Public	1.5	3.6	2.0	0.8	0.1	0.0	0.1	0.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: National Statistics Department of The United Kingdom, edited by the date from FESE

Table 3.4. presents data on share ownership in the UK from 1963 to 2006. The key features are next:

- ☒ The largest groups of domestic owners of company shares are financial institutions.
- ☒ Financial institutions' share of ownership increased between 1963 and 1994, but stabilized to approximately 45% in the 2001 – 2006.
- ☒ Individual ownership of shares has been in long-term decline and fell to 12.8% in 2006.
- ☒ Overseas ownership in UK was increasing continuously and reached 40% in 2006. This trend reflects the growing internationalization of the asset portfolios held by financial institutions.

The pattern of share ownership at company level varies widely. In the UK, quoted companies ownership is generally described as being widely dispersed among large numbers of shareholders. The largest shareholder often owns 5% or less of the stock and a significant proportion is owned by non-bank financial institutions. The board of directors typically owns a tiny proportion of the shares, often much less than 0.5%.

Thus, managers rather than owners control many medium and large-sized companies and set the firm's objectives. In France and Germany shareholding tends to be more concentrated with greater blocks of shares held by companies and banks. According to Denis and McConnell (2003) concentrated ownership structures are more likely to be found in most countries in contrast to the dispersed ownership patterns that are typical only of the UK and the USA.

How then can companies be classified as owner or managerially controlled? If a single shareholder holds more than 50% of the stock, assuming one vote per share, then they can outvote the remaining shareholders and control the company. If the largest shareholder owns slightly less than 50% of the equity then they can be outvoted if the other shareholders formed a united front. If the majority of shareholders do not form a united front or do not vote, then an active shareholder with a holding of substantially less than 50% could control the company.

Control of a company is therefore a function of the following factors:

- ☒ The size of the largest holding.
- ☒ The size and distribution of the remaining shares.
- ☒ The willingness of other shareholders to form a voting block.
- ☒ The willingness of other shareholders to be active and to vote against the controlling group.

3.3. Common average of share ownership in Europe

In this part of the work, we will perform analysis of the ownership structure in other European countries through the overview of the official survey of the Economics and Statistics Committee of the Federation of European Securities Exchanges (FESE) that reviews ownership structures in whole Europe. Data gathered in the present survey are relevant to 2007 in general terms and in some cases to 2006. This survey is an extraordinarily interesting tool when it comes to analyzing new global scenarios in the future. Identifying the ownership structure of listed shares in European markets is a very useful tool which allows one to compare the differences between European markets and the progress made in harmonization. This survey also allows those managing each market to place it within Europe as a whole, in such way crating some “benchmarking” comparison analysis.

Analyzed FESE survey on Share Ownership Structure in Europe edition of year 2008 is the most representative to date as it covers 27 countries. It covers most of Western Europe and includes a significant representation of Eastern European countries too. As a result, the global share ownership structure in Europe, which calculates the data of each market on the basis of its market capitalization at the end of year 2007, is even more accurate than in previous versions of this survey. Moreover, this new edition of the Survey is aimed at identifying the main trends in European exchanges between 1999 and 2007.

Up to the year 2007, a year that may become a reference towards the future, the **Share Ownership Structure in Europe has reached a considerable degree of maturity**. The period 1999-2007, which began with the launch of the Euro as the common currency in 11 countries of the European Union saw significant ups and downs in the exchanges. These factors do not reveal dramatic changes in the share ownership structure of the companies listed in the member exchanges of FESE. However, there are relevant trends that can be appreciated over long periods of time.

The proportion of non-resident investors of the listed shares of European markets during 1999-2007 has increased, and this trend has spread in 2005-2007. The weighted average amounts to 37%. Between 2005 and 2007 it reached 4 percentage points. The degree of globalization of the European Exchanges in terms of Share Ownership was already important before the introduction of the Euro. Since then it has followed a growing trend with no dramatic changes.

Between 1999 and 2007 **the percentage of private financial companies in the share ownership structure of European exchanges decreased.** Between 2005 and 2007 it goes from 31% to 27%, 5 points below. This group includes Collective Investment Institutions (investment and pension funds, unit trusts, etc.) as well as Banks & Savings Banks.

In relative terms the ownership of Banks & Saving Banks has experienced the biggest reduction, changing from 7% to 5% and enhancing the trend noted in the long term. Also the proportion of domestic shares in the portfolios of collective investment institutions has decreased. This suggests that the international diversification of the portfolios of these institutions embrace non-European markets (America, Asia, etc.) and also reflects a decrease in the holding of shares in the last few years.

There are significant differences between the participation of private financial companies in the United Kingdom and in the rest of the European markets. This explains why the weighted average of this sector in European exchanges is 27%. Only the United Kingdom (44.4%) is well above the average. This still remains the most relevant difference between the UK and other European exchanges. A significant group of eight European markets lies in the range between 18% and 30%, which is perhaps more illustrative of the situation in continental Europe.

There are big differences in the participation of private non-financial organizations in the different markets. In Germany they account for almost 40% of market capitalization while in the United Kingdom it is only 2.7%.

In Europe, private non-financial organizations hold 17% of the market value of listed shares increasing one point since 2005. 14 countries are above the standard average, which is deeply influenced by the low participation of the United Kingdom. In the long run, between 1999 and 2007 there was an increase in the participation of private non-financial companies in the ownership of listed shares.

One of the most successful world-wide growth strategies for companies during the past years was the acquisition of market share through the purchase of other companies both from listed and not-listed. Moreover, the acquisition by some listed companies of other listed companies which belong to different sectors aimed to boost diversification.

Individual Investors, or in other words Households, amount to 14% of the market value of listed shares in Europe, but there are also significant differences between markets. Only two countries have Individual Investor participations of more than 20% and seven countries are below 10%.

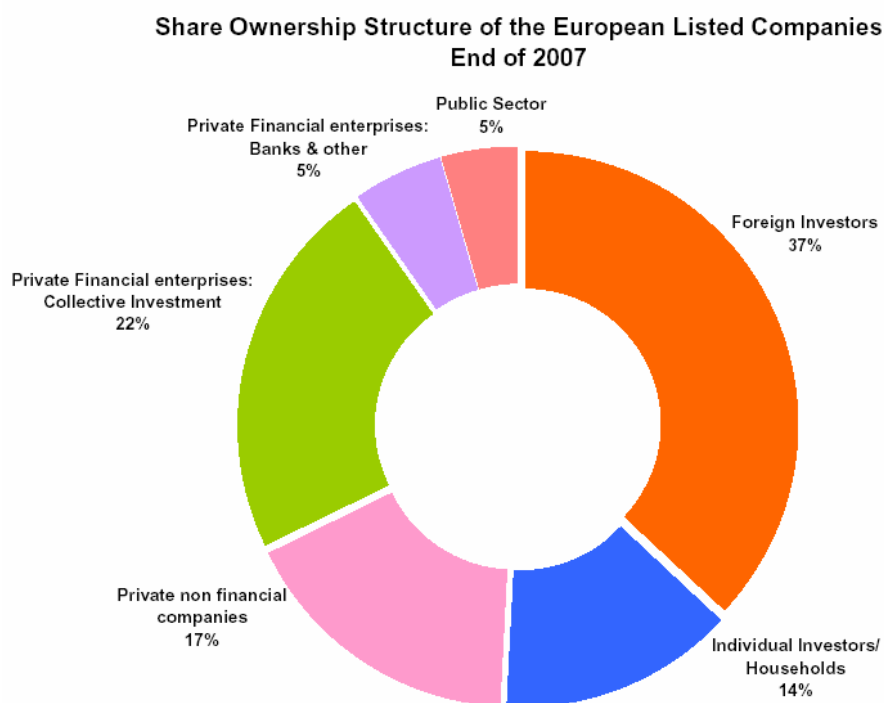
Between 1999 and 2007 there was a **continuous decline in the participation of individual investors** which remains similar between 2005 and 2007. With few exceptions, the effect of the three year stock market crisis between 2000 and 2002 still remains, despite the following four years

of recovery. The first effects of the market turmoil during the second half of 2007 begin to become apparent.

The participation of the Public Sector in European Exchanges is 5%, the lowest of the large sectors analyzed. In 16 out of 22 countries, the participation of the public sector is less than 10% and in seven markets it is almost insignificant, less than 1%. Between 1999 and 2007, with few exceptions, there was a decline. This shows that even during the crisis and recovery years for stock markets the public sector continued to reduce its participation in the share ownership.

The average “European benchmark” confirms the profound differences between markets that were already shown in previous surveys. Two major markets such as the United Kingdom and Germany are far from the average structure. The reason for this in the UK is that half of the shares are owned by private financial enterprises while in Germany almost half are in the hands of private non-financial companies.

All this data analyzed above can be graphically summarized as it is in picture 3.1.



Picture 3.1. Share Ownership Structure of the European Listed Companies End of 2007

Source: FESE, Share Ownership Structure in Europe (2007)

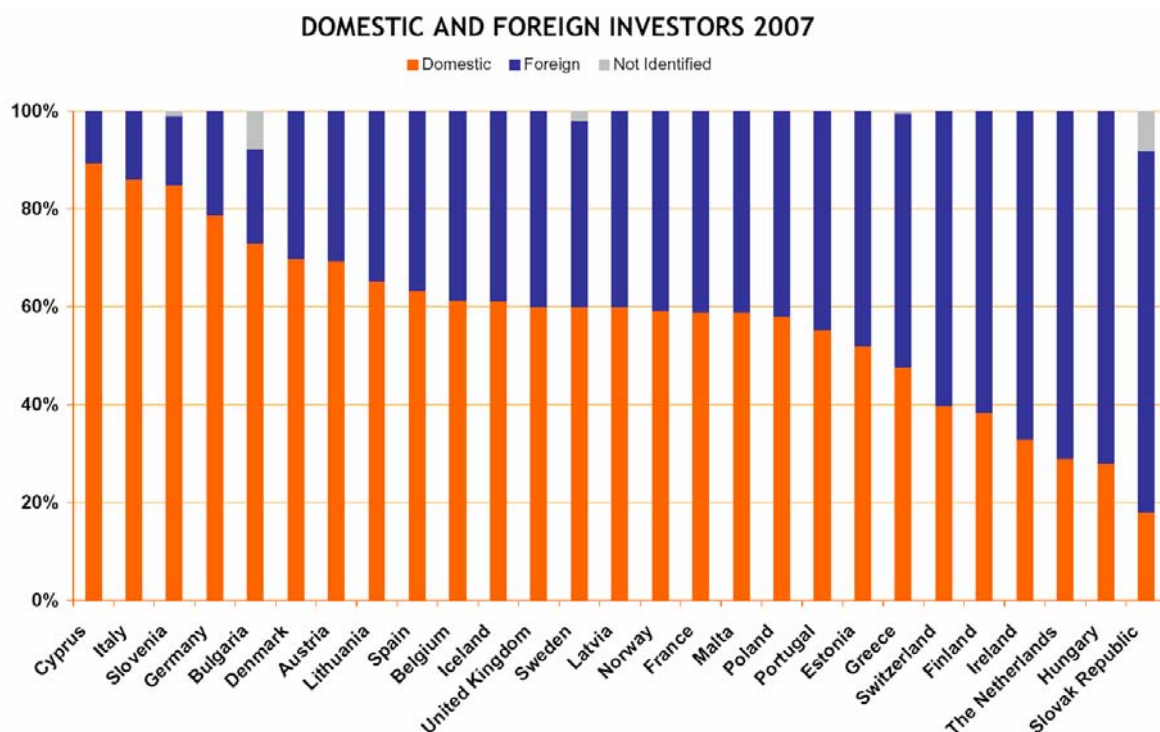
3.4. Lithuania ownership structure in the European picture

In this part of the work we will develop analysis on the ownership structure comparison of all most important countries in the Europe and distinguish Lithuania's data in that overall picture. For this we will use data from annual report on Share Ownership Structure in Europe of the year 2007 presented by the Federation of European Securities Exchanges (FESE).

First of all, starting from the comparison of the share of **domestic and foreign investors** presented in the Picture 3.2. It shows the share ownership of the markets split into two main categories: domestic and foreign investors. The low percentage figures for unidentified investors reflect the improved quality of the information. The countries are placed in order of the size of the ownership of domestic investors (from large to small). Cyprus is the first and the Slovak Republic is the last.

The simple average of domestic investors is 58% while the weighted average is 63%. In seven countries (Cyprus, Italy, Slovenia, Bulgaria, Germany, Denmark and Austria) the share ownership is significantly concentrated in domestic investors (equal or higher than 70%). In the other seven countries, domestic investors own less than 50% of the shares listed: Greece, Switzerland, Finland, Ireland, The Netherlands, Hungary and Slovak Republic (FESE, 2008).

Lithuania with the 65% shareholdings of domestic investors takes place very close to the European average of 63%.

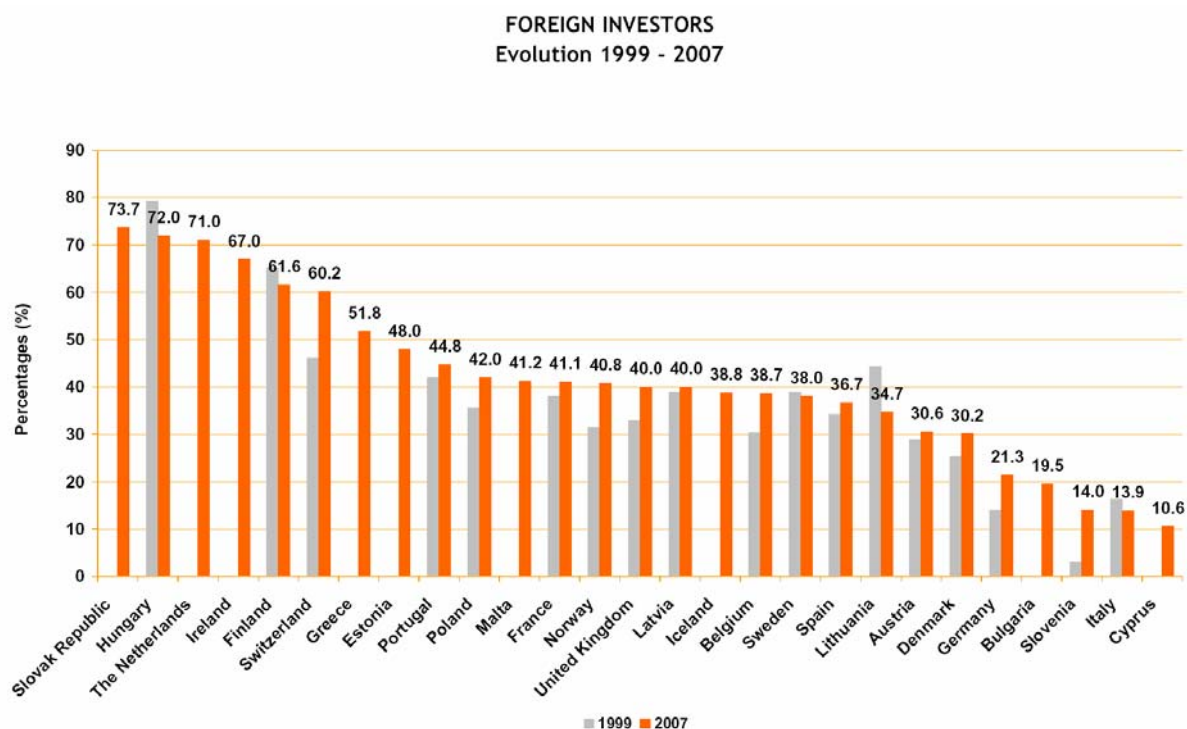


Picture 3.2. Distribution of European domestic and foreign investors, 2007

Source: FESE, Share Ownership Structure in Europe (2007)

At the end of 2007 **foreign investors** (presented in Picture 3.3.) owned 37% of the value of listed shares of European exchanges. The figure is the average weighted by capitalization. There are ten countries whose figures for foreign ownership are between 30% and 40% and Lithuania with 35% is in the very middle of this sample. The weighted average (37%) is lower than the simple average (41%) as a result of the low foreign ownership in two important markets in terms of capitalization (Germany with 21% and Italy with 14%).

In general terms, between 1999 and 2007 the participation of foreign investors in European exchanges has slowly increased. The simple average for 1999, less representative, was 35.9% and for 2007 is 41.6%.



Picture 3.3. Foreign investors in European countries. Evolution from 1999 to 2007.

Source: FESE, Share Ownership Structure in Europe (2007)

As we already find out, the study divides **domestic investors** into four main groups with one additional group for unidentified investors:

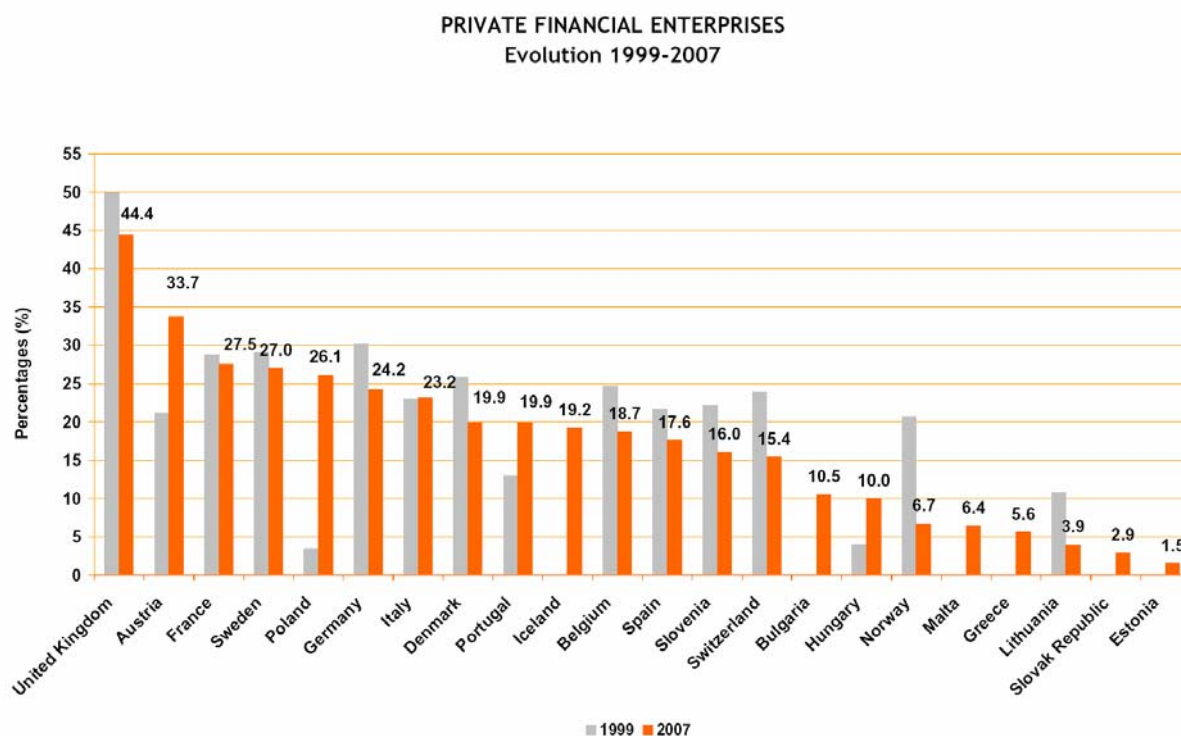
- ☒ Private financial enterprises;
- ☒ Private non-financial companies;
- ☒ Individual investors;
- ☒ Public sector;
- ☒ Unidentified domestic investors;

Four subgroups are included under the **private financial enterprises** category:

- ☒ **Collective investment:** The first subgroup covers institutional investments in the strictest sense (pension funds, insurance companies, mutual funds and collective financial investment companies).
- ☒ **Commercial and savings banks:** The second covers banks that hold listed shares on their own account.
- ☒ **Bond issuing mortgage companies:** The third is for countries where mortgage companies play an important role.
- ☒ **Others not identified:** Unidentified investors within the group of private financial enterprises.

As in previous studies there is a significant difference between the participation of private financial enterprises in the United Kingdom and in other European markets, and this explains why the average weighted participation of this sector is 27%. Only the United Kingdom is well above this figure at 44% and Austria is 34%. The other countries are below the weighted average. In other words, while in the UK almost half of the market value of listed companies is in the hands of domestic private financial companies, in the rest of the markets this figure is less than one third. This still remains the most relevant difference between the UK and other European exchanges.

A significant group of eight European markets lies in a range of between 19% and 27%, which serves as a more illustrative picture of the situation in continental Europe.



Picture 3.4. Private financial organizations in European countries. Evolution from 1999 to 2007.

Source: FESE, Share Ownership Structure in Europe (2007)

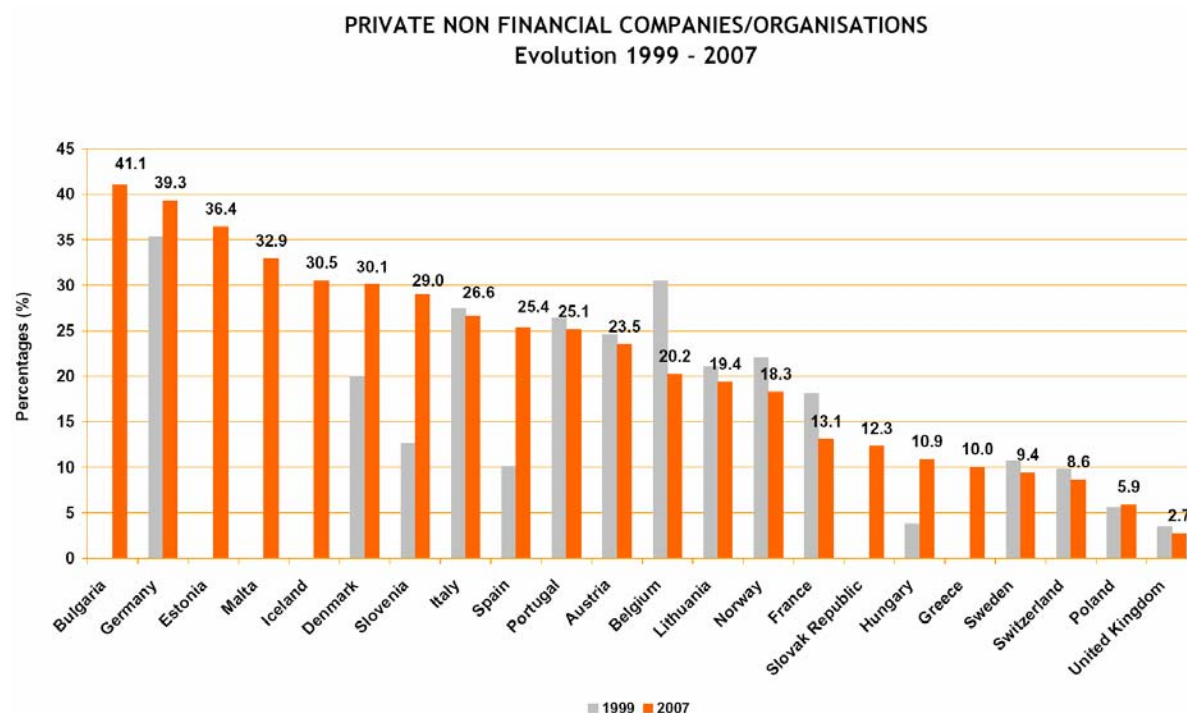
Picture 3.4. shows a decline in the participation of private financial companies from 1999 to 2007. The simple average decreased from 22% to 17% and is very significant in countries like the UK (-5.5 points), Norway (-14 points), Germany (-6 points) or Denmark (-6 points). These figures explain the remarkable decline in ownership of the financial sector in European exchanges.

In Lithuania also decline is recognized, while such data can be very perverted by the fresh development of the financial market in Lithuania in the discussed period. However, in contrast to the main European trend, we note the case of Poland that goes up to 22 percentage points, and the case of Austria (+12 points) and Hungary (+6 points) (FESE, 2008).

Three subgroups are included within the category of **private non-financial organizations**. They are such:

- ☒ **Limited companies;**
- ☒ **Private organizations and trusts:** This subgroup covers private organizations such as foundations and other institutions that hold shares;
- ☒ **Others not identified:** Unidentified investors within the group of private non-financial organizations;

Private non-financial organizations (presented in Picture 3.5.) in Europe own 17% (while 19% in Lithuania) of the market value of listed shares. They are particularly important in Bulgaria and Germany where they account for 40% of the value of listed companies. In fourteen countries out of 22 they represent more than 18% and only 8 countries are below the weighted average, 17%.



Picture 3.5. Private non-financial organizations in European countries. Evolution from 1999 to 2007.

Source: FESE, Share Ownership Structure in Europe (2007)

This enormous dispersion is because of the particular case of the United Kingdom, where a mere 1.7% of listed shares are in the hands of non-financial companies, almost forty points less than Germany. Both this group and the Private Financial Companies reveal the big differences between the share ownership structure of the United Kingdom and Germany, two of the biggest European markets.

Lithuania shareholdings of private non-financial companies are in the European average, without major changes in comparison with the primary research period.

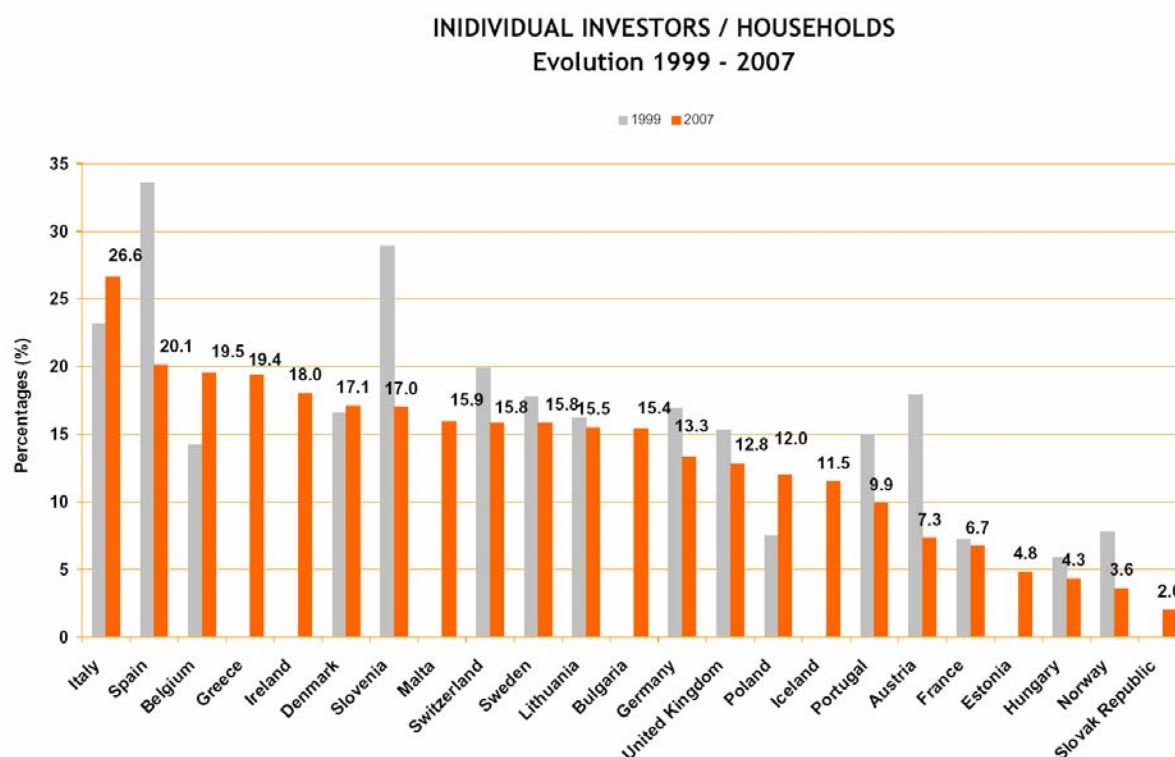
Between 1999 and 2007 there was an increase in the participation of private non-financial companies in the ownership of listed shares. This had already been detected in the previous survey and it can be explained as a combination of various factors. First as a consequence of the 3-year crisis in stock markets during the period 2000-2002: private non-financial companies acted as a support for share prices and increased their ownership of listed companies as prices became more attractive. The trend has not reversed during the following years in which share prices have gone up. Another factor is related to the two most successful world-wide growth strategies by listed and non-listed companies during the past years: firstly, the acquisition of market share through the purchase of other companies, and secondly the diversification of activities by companies of mature or cyclical sector. If these strategies were implemented buying listed companies, the execution of the operation would be easier; with higher visibility. The abundant liquidity in the system and the low interest rates have also been supportive factors for those types of operations. A third factor is the repurchased shares that have also increased the participation of non-financial companies in the share ownership structure (FESE, 2008).

A peculiarity extracted from the figures is that these trends do not have the same explanation in countries with highly developed collective investments schemes. This is the case of the UK where the participation of non-financial companies is almost negligible.

Individual Investors (graphically presented in the picture 3.6.) own 14% of the market value of listed shares. Only two countries, Italy and Spain, have Individual Investor participations of more than 20%. Lithuania in this data sample is once again practically in the average level combining 16% of all shareholdings in the hands of individual investors.

Seven countries are below 10% and the main market in terms of market capitalization. The United Kingdom is slightly below the average (12.8%). Between 1999 and 2007 there was a general decline in the participation of individual investors. While the simple average in 1999 was 16.5%, in 2007 it was 13.2%. The effect of the three years stock market crisis during the period 2000-2002 still remains despite the recovery over the following three years. Poland, Belgium, Denmark and Italy are the only exceptions and show increases of Individual Investors percentages.

The first effects of the market turmoil of the second half of 2007 can already be noted in the data. When comparing 2007 to 2005 we note a fall from 15% to 14% (FESE, 2008).



Picture 3.6. Individual investors in European countries. Evolution from 1999 to 2007.

Source: FESE, Share Ownership Structure in Europe (2007)

The participation of the **public sector** in the ownership of listed shares in European markets is particularly high in Norway (30.5%), Lithuania (26.5%) and Slovenia (23%) mostly as a result of the partial privatization and subsequent listing of large companies in terms of capitalization.

In most countries, 16 out of 22, the participation of the public sector represents less than 10% and in seven markets it is almost insignificant, less than 1%. The market capitalization weighted average is 5% in Europe, the lowest of the large sectors analyzed.

Between 1999 and 2007, except for Norway and Lithuania, there was a decline. This shows that even during the crisis and recovery years for stock markets the public sector continued to reduce its participation in share ownership. The simple average in 1999 was 10.6% and in 2007 was 7.6% (FESE, 2008).

The data of public sector shareholding is not presented graphically due to the subjective opinion that the presented data is perverted in the high scope. Nevertheless, quite high stake of public sector shareholding in comparison with the European average seems to be quite presumptive, due to the number of available, completely or partly, state-owned and controlled major strategic objects within the country.

3.5. Juxtaposition of the researched evidences

In this part of the work, we will juxtapose of the main researched evidences and results. This will help us in summarizing whole the analyzed material before, present appropriate conclusions from the received results and bring some future development tendencies.

First of all, we will compare the results from our performed questionnaire and the actual statistical data of the ownership structure in Lithuania.

Table 3.5. Comparison of the share ownership in Lithuania from survey results and statistical data

Type of investor	Survey Results (%)	Statistical Data* (%)
Individuals	45.0	15.5
Institutions	7.0	3.9
Companies	21.0	19.4
Public sector	6.0	26.5
Foreign investor	21.0	34.7
Total	100.0	100.0

* - only companies listed in the NASDAQ OMX Vilnius Stock Exchange

Source: compiled by author according data from questionnaire results and FESE, Share Ownership Structure in Europe (2007)

Before starting analysis of the presented table 2.9., we should emphasize on the fact that here are considered slightly different companies, i.e. statistical data presents only data on companies listen in the NASDAQ OMX Vilnius Stock Exchange, while survey presents various companies, not only listed in the stock exchange. Though, survey provided us opportunity to extract small companies that practically are only sole proprietorships and very small private limited liability companies that are somehow closed for public investors. Survey provides us unique opportunity to analyze ownership structure starting from middle-sized companies that have not been presented by other statistical data. Moreover, Lithuanian Stock market is rather small and our capital market is illiquid in comparison with other economies of developed countries. Thus, to have additional and enough trusty source of data is very useful and efficient in development our analysis.

Therefore, from the table we can see, that are quite big differences in the lines of foreign investors, individual, so called household, investments and the public sector. This can be logically explained as, individual shareholdings are usual in all type of Private or Public Limited Liability companies and they are not so active in shareholdings of the Public Companies that are listed on the Stock Exchange. Foreign investors are playing important role in ownership of the companies listed in the Stock Exchange market. Reasons are simple: good economical conditions and availability of the companies for privatization. Taking wider spectrum of the companies, we will see that this level of the foreign ownership falls down but still remain enough significant to state, that foreign capital

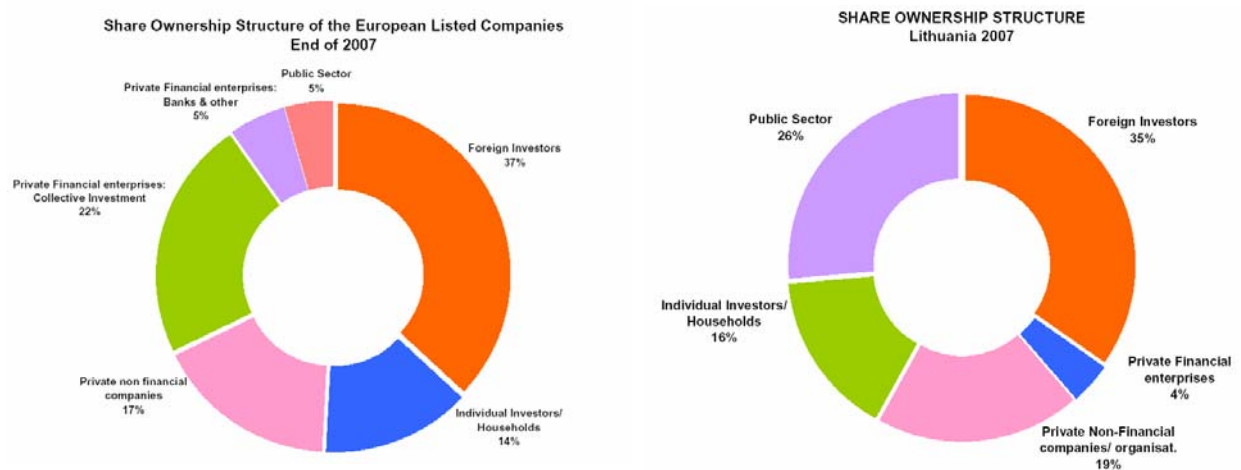
plays very important role in Lithuanian shareholdings. Other, non-financial organizations (legal persons) are keeping similar level of 20% shareholdings, both in the stock exchange's companies and in the more diversified ones. Thus, local businesses are also interesting in investment into the available companies, in such way expanding their own businesses or fulfilling other strategic policies, as acquisition of the market share through the purchase of the other companies. Institutional investment, not exceeding even 7%, looks to be similar in both cases. This numbers must grow in the future due to the development of financial market. Important role here will play introduced pension reform and developing other forms of collective investments. Public sector share ownership comparison presents that state keeps the quite significant share of ownership in the listed companies, while is rather not participating in the shareholdings of small and middle-size of private companies.

Therefore, to present overall conclusions on this comparison, we should emphasize on the high level of the foreign capital shareholdings in the companies listed on the stock exchange, while from the survey data we can add that foreign investors are tended in possession of the significant part of the shares to have the right and influence on decision taking processes in the owned companies. Next, private non-financial enterprises are much more active in the shareholding investments in companies when we are considering other companies, not only those ones that are listed in on the stock exchange.

Coming to the next comparison block, we will analyze share ownership structure of the Lithuania companies that are listed on the NASDAQ OMX Vilnius Stock Exchange and the summarized average data of all European companies that are listed on their national stock exchanges. Graphically this comparison is presented in the picture 3.7.

From the first view, data presented in the graphs looks to be proportional. The biggest share of each graph goes to the foreign investors, which in Lithuania (35%) practically corresponds to the average in Europe (37%). The biggest difference can be spotted in private financial institutions and the public sector. Currently, Lithuania is far away from the European average of institutional investments with the result of only 4% to European average of 27%. This is because in some European countries, as for example United Kingdom, private financial sector is highly developed and reaches even more than 40% of all shareholdings. State shareholdings in Europe fluctuate in the frame of the 5%, while Lithuania is presenting data of quite impressive number of 26% of state ownership. However, several factors can influence and somehow pervert this data. First, it is quite actual share, considering the state shareholding, in the biggest and strategic objects in the country, are still significant and quite extensive. Second, this number is still depicting that privatization process started in the 1991 is not yet finished. From other point of view, there was a change in presentation of statistical data in the period 2004 – 2005, where lots of state ownership was counted

and included to the annual reports, where companies listed in the regional stock exchange are presented. For example in U.K., from the year there is no shareholdings in public sector at all, while, for example, in Italy it stably counts more than 10% of all shareholdings. Finally, private (16% to the 14%) and non-financial companies' (19% to the 17%) shareholdings of Lithuania are only in 2% difference, that present them enough close to the European averages and they seem to be corresponding to the actual situation.



Picture 3.7. Comparison of the Share Ownership Structure in the Europe and Lithuania, 2007.

Source: compiled by author according data from FESE, Share Ownership Structure in Europe (2006)

To summarize this comparison block, we should say that shareholdings of private financial enterprises in Lithuania will tend to rise in the future. This can be predicted according the observation of the changes in ownership patterns in other countries within last 10 years. Considering other shareholdings, we can state that they will be fluctuating in the certain frame, predicting the continuous privatization, which will reduce the share of the state and the increase of the foreign ownership by the future foreign direct investments activities.

Now, it is time to take closer look on the comparison of the ownership systems between Lithuania and chosen European countries. First of all these systems are reflection of the corporate governance models that were analyzed in the theoretical part of the work. United Kingdom and United States of America form the outsider system that corresponds to the Anglo-US model of the corporate governance, while Europe (German model) and Japan form insider system. Those two systems were compared in-between in previous section. So, what is left, is introduce Lithuania and describe it by the given factors. Whole the summary of the discussed comparison is presented in the table 3.6.

Table 3.6. Characteristics of outsiders and insider systems and Lithuania situation

Characteristics	UK and USA	Europe and Japan	Lithuania
Listed companies	Many	Few	Few
Trading ownership	Frequent, liquid capital market	Infrequent: illiquid capital market	Infrequent: illiquid capital market
Inter-company holdings	Few	Many	-
Shares	Widely held	Large holdings	-
	Dispersed individuals	Concentrated companies	Concentrated companies
	Financial institutions		Foreign investors
Concentration of ownership	Low	High	High

Source: Data compiled according the references of Franks and Meyer (1992) and author's edition.

Analyzing presented table, we should state that in Lithuania there is even less than “Few” listed companies on the Stock Exchange in comparison with the European scope. Lithuanian capital market is highly illiquid and significant ownership trading is rather infrequent. Concentration of the ownership is very high. All those factors concerning Lithuania were proven in the previous sections.

To conclude, we can state that Lithuanian ownership structure significantly corresponds to the insider system, i.e. to the European. As it was mentioned before, each country has some ownership patterns characteristic only to that country, though corresponds to the general European patterns. In Lithuania this pattern is covered by the significant number of local (companies and individuals) and foreign shareholdings, and rather small number of financial institutions' shareholdings. To realize the difference of the ownership structure of Lithuania and in other countries, we can draw the comparison table (table 3.7.)

Table 3.7. Comparison table of share ownership in Europe and Lithuania, 2007

Type of investor	France (%)	Germany (%)	Italy* (%)	Lithuania (%)	Spain (%)	UK* (%)
Individuals	6.7	13.3	26.6	15.5	20.1	12.8
Institutions	28.8	24.2	23.2	3.9	17.5	44.4
Companies	13.1	39.3	26.6	19.4	25.4	2.7
Public sector	10.3	1.9	9.7	26.5	0.2	0.1
Foreign investor	41.1	21.3	13.9	34.7	36.8	40.0
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: Own calculations according data from FESE, 2007 report * - available only data from year 2006

Each country has its own unique ownership structure and investors' volumes differ across them. For example, Germany is the leader in the investment of the legal persons, while U.K. - in the institutional ones. Lithuania is distinguishing from that group of countries with the high level of foreign investments. As it was noted before, all countries had different backgrounds that results such a distribution of the ownership. Thus, with operating in different ownership patterns requires and divergent corporate governance that should be developed and renewed constantly with the changing environment, especially considering so fast whole world globalization.

CONCLUSIONS AND RECOMMENDATIONS

The importance of interrelationship between corporate governance and ownership structure is evident in the fact that corporate governance and the ownership structure of companies is currently characterized by change processes as the economies of the world become more and more globally integrated. Ownership structure has the major importance in corporate governance because it affects activity and operational efficiency of the economic entity. Thus, proper and efficient corporate governance depends on the ownership structure, rights and preferences of shareholders, corporate environment with whole legal and economical system of the country and number of other factors disclosed throughout this thesis.

Development background of the corporate governance and ownership structure in Lithuania was influenced by historical and economical situation of the country. When the country became independent in year 1990, there was time of the economical transition, formation of the government, introducing own legal acts, etc. At the moment of such transition, occurred in most of East and Central Europe countries, enormous number of companies was presented for the privatization. Therefore, such privatization wave has raised the issue how the newly privatized corporations should be owned and governed.

Prolonged primary and secondary privatization stipulated the significant and constant changes in ownership structures in the Lithuanian companies. Firstly, it is characterized by distributed share ownership with the dominant owners being foreign investors, private local companies and state. Secondly, there are few listed companies on the Stock Exchange in comparison with the European scope. **Lithuanian capital market is highly illiquid and significant ownership trading is rather infrequent. Concentration of the ownership shareholdings is very high.** All this states that Lithuanian ownership structure corresponds to the insider system, i.e. to the “German” corporate governance model. Furthermore, comparing Lithuania with the ownership structure averages in Europe, practically homogeneous shareholding of foreign investors, local households and private non-financial companies can be noted.

However, the major differences are in the share ownership of financial institutions and the state. **Shareholdings of private financial enterprises in Lithuania will tend to rise in the future,** because it is completely inadequate to the European average. This can be predicted according the observation of the changes in ownership patterns in other countries with the similar corporate governance model within last 10 years. **Continuous privatization will be constantly reducing the share of the state** and increasing the share of all others investors.

There is empirical evidence that **state owned companies are less efficient than privately owned units.** Nature of the state it self is conditioning that operation of state-owned companies is not enough efficient. Local investors, including state, managers and employees of the company,

certain legal or natural persons, have the different objectives than are related with the profit maximization. In contrary, foreign investors were striving to reorganize and modernize privatized companies, having better financial opportunities, governance competences, excellent management skills, access to the international business networks and markets. Thus **foreign ownership has significant positive effect on the efficiency and the quality of corporate governance.**

Significant issue to emphasize on is **very high ownership concentration in Lithuania.** From one point of view, concentrated ownership positively affects efficiency of the company, as stock concentration can be connected to the possibility of the owners to monitor the management with a probable reduction of the conflicts and costs of agency. From other point of view, higher concentration of the rights to vote by the controlling shareholders would be associated with a higher expropriation of the minority stockholders and thus lower value and performance of the company. Therefore, it is proven **necessity to guarantee the right to participate in the corporate governance for all shareholders of the company.** Recently, it is attempted by the strict information disclosure requirements, introduction of corporate governance code for the companies listed in the Stock Exchange and other significant methods.

However, **Law on companies prompts rights of major shareholders.** Such factors, as withdrawal from the mandatory requirement of creation Supervisory Board and Management Board for the companies and leave it optional, plus introducing the mandatory sale and purchase of shares from minor shareholders, states is implementing the regulation policy in favor of major shareholders, in such way, **state is increasing ownership concentration and coming against natural shareholdings distribution within the country.** From the foreign experience can be stated, that **ownership will spread more in the future,** because Lithuania is in transition stage of the development of corporate governance, so called “Managerial Capitalism”.

Remarkably, socially responsible business ideas are currently spread in Lithuania. **Corporate social responsibility become one of business reputation deciding factors, encouraging better investor relations** and, as a common norm, being socially and environmentally responsible business of the healthy and prosperous society.

Tendencies in ownership structure changes are positive, ensuring background for business oriented corporate governance, operational efficiency growth in Lithuanian companies and the perfect ground for attracting new investments in the region and ensuring continuous economic growth of the country in the future.

While the general research and conclusions according raised objectives of the analysis of corporate governance and ownership structure has been established, knowledge on specific issues or channels is still weak in a number of areas.

Recommendations for future researches include the following:

The role of institutional investors. Institutional investors are increasing throughout the world, and their role in corporate governance of company is consequently becoming more important. But the role of institutional investors in corporate governance is not obvious. In many countries, institutional investors have purposely been assigned little role in corporate governance, as more activism was considered to risk the company's fiduciary obligations. Whole practice of institutional governance in Lithuania is quite young and should be researched and analyzed by the various aspects. Furthermore, the governance of the institutional investors themselves is an issue, as they will not exercise good corporate governance without being properly governed themselves.

Best practice in relation to other stakeholders. Little empirical research in Lithuania has been conducted on the relationships between corporate governance and other stakeholders, corporate social responsibility, corporate efficiency and so on.

The dynamic aspects of institutional change. Finally, little is known about the dynamic aspects of institutional change, whether change occurs in a more evolutionary way during normal times or more abruptly during times of financial or political crises. In this context, it is important to realize that enhancing corporate governance will remain very much a local effort. Country-specific circumstances and institutional features mean that global findings do not necessarily apply directly to each and every country and situation. As such, the progress with corporate governance reform depends upon local capacity, in terms of data, people, and other resources.

Further changes in ownership structure and corporate governance. It is significantly relevant to observe further changes in the ownership structure in Lithuania and it's continues influence on corporate governance. Changes and affects of future governmental policies and legislation should be also followed and analyzed within the influence on the overall system of corporate governance environment.

In the end, it can be reasonably stated that all tasks of the work are executed and the goal of work is obtained – essential objects of the interrelationship between the ownership structure patterns and modern corporate governance systems and principles, and they influence on operation of the economic entities have been revealed.

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APPENDIXES

Appendix no. 1. Extract from the Law of Republic of Lithuania on Companies⁶⁴

Official translation

REPUBLIC OF LITHUANIA LAW AMENDING THE LAW ON COMPANIES

13 July 2000 No. VIII-1835

Vilnius

(as amended by 11 December 2003 No. IX-1889)

Article 1. New Version of the Law of the Republic of Lithuania on Companies

The Law of the Republic of Lithuania on Companies shall be amended and set forth to read as follows:

LAW OF THE REPUBLIC OF LITHUANIA ON COMPANIES

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CHAPTER FIVE MANAGEMENT OF THE COMPANY

Article 19. Company Organs

1. A company shall have the General Meeting and a single-person management organ - the manager.

2. A collegial supervisory organ - the Supervisory Board and a collegial management organ - the Board may be formed in the company.

3. If the Supervisory Board is not formed in the company, its functions shall not be assigned within the scope of powers of other management organs.

4. Where the Board is not formed in the company, the functions assigned to the competence of the Board shall be fulfilled by the company manager, except where this Law provides otherwise.

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⁶⁴ Law of Republic of Lithuania on Companies. Available at: <http://www3.lrs.lt/cgi-bin/getfmt?C1=e&C2=233471> (2008-04-19);

Appendix no. 2. Extract from the Law of Republic of Lithuania on Companies

CHAPTER ONE GENERAL PROVISIONS

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Article 2. Public Limited Liability Company and Private Limited Liability Company

1. The company is an enterprise whose statutory capital is divided into shares.
2. The company is a legal person with limited liability.
3. The amount of the statutory capital of a public limited liability company may not be less than LTL 150,000. Its shares may be offered for sale and traded in publicly in compliance with the legal acts regulating securities market.
4. The amount of the statutory capital of a private limited liability company may not be less than LTL 10,000. A private limited liability company must limit the number of its shareholders to 250. The shares of a private limited liability company may not be offered for sale or traded in publicly, unless other laws provide otherwise.
5. The public limited liability company shall have its name defining the legal form it has taken including the words “*akcinė bendrovė*” (public limited liability company) or the acronym "AB". The private limited liability company shall have its name defining the legal form it has taken including the words “*uždaroji akcinė bendrovė*” (private limited liability company) or the acronym "UAB".
6. The documents the company uses in its relations with other persons must contain the information specified in Article 2.44 of the Civil Code. The above-mentioned information must also be given in the company website, where available.
7. The registered office of the company must be situated in the Republic of Lithuania.
8. The company shall act in compliance with the Statutes, the Civil Code, this Law and other laws and legal acts.

Article 3. Shareholders

1. Shareholders are natural and legal persons who have each acquired shares in the company.
2. Each shareholder shall have such rights in the company which are incidental to the shares in the company owned by him. All shareholders who are in the same position shall have equal rights and duties.

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REPUBLIC OF LITHUANIA
LAW ON SECURITIES MARKET
16 January 1996, No. I-1169
Vilnius

New version of the Law: (the name of the Law changed)
No. IX-655, 2001-12-17, Official Gazette, 2001, No. 112-4074 (2001-12-30)

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CHAPTER 3
ACQUISITION OF A SHAREHOLDING
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„Article 19. Mandatory sale and purchase of shares

1. The shareholder of an accountable issuer incorporated in the Republic of Lithuania acting independently or in concert with other persons and having acquired shares representing not less than 95 percent of the total votes at the general meeting of shareholders of the issuer shall have a right to require that all the remaining shareholders of the issuer sell the voting shares owned by them, and the shareholders shall be obligated to sell the shares in the manner established by the present Law.

2. Votes of the shareholder acting independently or in concert with other persons shall be calculated in accordance with Article 16 of this Law. Where the issuer has issued shares of different classes, the votes shall be counted and the rules for the sale and purchase of shares shall be applied individually in respect of each class of shares. Where, in the manner stipulated by this Article, the shareholder purchases shares acting independently or in concert with other persons:

1) persons acting in concert shall be jointly liable for the fulfilment of the obligation to acquire the shares;

2) the number of shares acquired by persons acting in concert shall be proportionate to the number of votes of the issuer held thereby at the moment of the submission of the notification referred to in par. 7 of this Article unless the agreement concluded by persons acting in concert provides differently.

3. Where a shareholder acting independently or in concert with other persons is obligated to submit a mandatory tender offer, the sale and purchase of shares in accordance with this Article may be executed only after the shareholder's obligation to submit the mandatory tender offer is fulfilled in the prescribed manner.

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⁶⁵ Law of Republic of Lithuania on Securities Market. Available at:

<http://www.vpk.lt/uploads/Law%20on%20Securities%20Market%20-%202006-08-02.doc> (2008-04-20);

Appendix no. 4. Extract from report on compliance with Governance Code(Example)⁶⁶

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TEO LT, AB DISCLOSURE CONCERNING THE COMPLIANCE WITH THE GOVERNANCE CODE FOR THE COMPANIES LISTED ON THE REGULATED MARKET IN 2006

TEO LT, AB (hereinafter 'TEO' or 'the Company') following paragraph 3 of Article 21 of the Law of the Republic of Lithuania on Public Trading in Securities and item 20.5 of the Trading Rules of the Vilnius Stock Exchange, discloses its compliance with the Governance Code, approved by the VSE for the companies listed on the regulated market, and its specific provisions.

PRINCIPLES/ RECOMMENDATIONS	YES/NO /NOT APPLICABLE	COMMENTARY
.....		
Principle VI: The equitable treatment of shareholders and shareholder rights The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. The corporate governance framework should protect the rights of the shareholders.		
6.1. It is recommended that the company's capital should consist only of the shares that grant the same rights to voting, ownership, dividend and other rights to all their holders.	Yes	The share capital of the Company consists of 814,912,760 ordinary registered shares of one litas nominal value each. All shareholders of the Company's shares (except treasury stocks) are given equal rights.
6.2. It is recommended that investors should have access to the information concerning the rights attached to the shares of the new issue or those issued earlier in advance, i.e. before they purchase shares.	Yes	The By-Laws of the Company that stipulates all the rights of shareholders are publicly available on the Company's webpage.
6.3. Transactions that are important to the company and its shareholders, such as transfer, investment, and pledge of the company's assets or any other type of encumbrance should be subject to approval of the general shareholders' meeting. All shareholders should be furnished with equal opportunity to familiarize with and participate in the decision-making process when significant corporate issues, including approval of transactions referred to above, are discussed.	No	The shareholders approve transactions that, following the Law on Companies and the By-Laws of the Company, should be approved by the shareholders.

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⁶⁶ Report on compliance with Governance Code of the company "TEO" Available at: http://www.teo.lt/en/annual_reports-1068.html (2009-01-21);

Appendix no. 5. Extract from the Corporate Governance Code for the Companies Listed on the Vilnius Stock Exchange⁶⁷

APPROVED:

Lithuanian Securities Commission
Minutes No. 9K-16
As of 26 July 2006

APPROVED:

Board of the Vilnius Stock
Exchange
Minutes No. 06 - 72
As of 21 August 2006

The Corporate Governance Code for the Companies Listed on the Vilnius Stock Exchange

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Principle VI: The equitable treatment of shareholders and shareholder rights

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. The corporate governance framework should protect the rights of the shareholders.

6.1. It is recommended that the company's capital should consist only of the shares that grant the same rights to voting, ownership, dividend and other rights to all their holders.

6.2. It is recommended that investors should have access to the information concerning the rights attached to the shares of the new issue or those issued earlier in advance, i.e. before they purchase shares.

6.3. Transactions that are important to the company and its shareholders, such as transfer, investment, and pledge of the company's assets or any other type of encumbrance should be subject to approval of the general shareholders' meeting. All shareholders should be furnished with equal opportunity to familiarize with and participate in the decision-making process when significant corporate issues, including approval of transactions referred to above, are discussed.

6.4. Procedures of convening and conducting a general shareholders' meeting should ensure equal opportunities for the shareholders to effectively participate at the meetings and should not prejudice the rights and interests of the shareholders. The venue, date, and time of the shareholders' meeting should not hinder wide attendance of the shareholders. Prior to the shareholders' meeting, the company's supervisory and management bodies should enable the shareholders to lodge questions on issues on the agenda of the general shareholders' meeting and receive answers to them.

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⁶⁷ NASDAQ OMX BALTIC Stock exchange, Corporate Governance Code for the Companies Listed on the Vilnius Stock Exchange. Available at: http://www.nasdaqomxbaltic.com/files/baltic/VSE_CGC.pdf (2009-01-20);

Appendix no. 6. Changes in share ownership structure of listed companies in Lithuania in 1996 - 2007 year period. (FESE report on Share ownership structure in Europe, 2007)

LITHUANIA: OMX Vilnius Stock Exchange (1996 – 2007)

Figures are shown in percentages.

	Year	2007	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997	1996
FOREIGN INVESTORS	A	34,7	37,5	38,9	55,2	51,8	52,3	46,4	54,9	44,3	48,6	49,3	34,1
DOMESTIC INVESTORS	B=D+E+F+G+H	65,3	62,5	61,1	44,8	48,2	47,7	53,6	45,1	55,7	51,4	50,7	65,9
<u>Private Financial enterprises</u>	D=I+J+K+L	3,9	16,6	6,9	3,0	4,1	10,7	11,1	11,2	10,8	5,8	6,0	4,9
Collective Investment	I=S+T+V	0,4	2,3	1,2	1,5	2,0	6,2	8,5	9,2	1,8	0,8	0,7	3,8
Insurance & Pension Funds	S=W+X+Y	0,4	2,3	1,2	0,3	0,2	0,2	0,4	0,3	1,3	0,1	0,2	0,8
General Insurance	W												
Life Insurance	X												
Pension Funds	Y												
Investment Companies	T				1,2	1,8	6,0	8,1	8,9	0,5	0,7	0,5	3,0
Mutual Funds	V												
Banks & Savings Banks	J	2,4	12,8	4,1	1,3	1,8	4,1	2,2	1,6	8,5	4,3	4,3	0,3
Bond Issuing Mortgage Companies	K												
Others Not Identified	L	1,0	1,5	1,6	0,2	0,3	0,4	0,4	0,4	0,5	0,7	1,0	0,8
<u>Private Non-Financial companies/ organisat.</u>	E=M+N+O	19,4	13,9	16,4	28,6	29,9	24,4	26,7	17,8	21,1	27,4	28,8	45,8
Limited Companies	M	19,4	13,9	16,4									
Private Organisations & Trusts	N												
Others Not Identified	O												
<u>Individual Investors/ Households</u>	F	15,5	11,3	10,5	11,4	11,3	10,6	12,4	11,0	16,2	15,0	13,5	10,4
<u>Public Sector</u>	G=P+Q+R	26,5	20,7	27,3	0,2	0,3	1,4	2,4	4,6	5,8	2,9	1,0	0,8
Central and Local Government	P	19,6	15,3	21,4									
Companies Owned by Government (incl bank&post)	Q	6,8	5,5	5,9									
Others Not Identified	R	0,0	0,0	0,0									
<u>Not Identified domestic investors</u>	H				1,4	2,6	0,6	1,0	0,5	1,8	0,3	1,4	4,0
NOT IDENTIFIED	C												
Total	A+B+C=100%	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0
Reply based in all listed companies? (Yes/No)	Yes/No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
If No....Number of companies	number												
% of total number of listed companies	%												
% of total market capitalisation	%												

Source: Central Security Depository of Lithuania