

Development of corporate governance in Lithuania

Juozas Bivainis

Profesorius socialinių mokslų habilituotas daktaras
 Vilniaus Gedimino technikos universitetas
 Ekonomikos ir privatizacijos institutas
 Gedimino pr. 38/2, 2600 Vilnius
 Tel. (370-2) 62 10 26
 Faks. (370-2) 22 67 40
 El. paštas: sekretepi@po.ekm.lt

This paper provides the research of corporate governance mechanisms in Lithuania together with their legal and regulatory underpinnings. Building proper corporate governance is interpreted as an integral part of developing a sound private sector basis for economic growth of country. Public and private sector decision-makers have attach great importance to issues, such as property protection, and rights and responsibilities of different participants in the governance of corporation. This interest arises from a broader concern for efficient allocation of resources and the development of capital markets.

Key words: corporate governance, joint-stock company, company law.

Introduction

The Lithuanian economy experienced a period of essential changes during the years 1990–1999. It featured rapid changes in the GDP, the structure of the economy, orientation of foreign trade, as well as in an overall system of economical activities. Creation and development of forms of economical activities, typical for a market economy, are one of the most important changes in this context. A very important part of this process is the development of corporate governance.

The importance of corporate governance development is reinforced by some of the most pervasive contemporary trends in the global economy, notably the growing role of the pri-

vate sector, increased internationalisation, and rapidly changing competitive circumstances for investors and producers [17]. Despite the fact that Lithuanian have achieved substantial progress in enacting essential economic legislation and establishing relevant institutions [2, 3, 19], future efforts can be made to improve the corporate governance framework and practices. This task defined the principal objectives of our research:

- 1) to examine the main characteristics of the corporate governance framework and practices in Lithuania as well as identify the main players shaping the corporate governance environment;
- 2) to assess the role shareholders, employees, creditors and other corporate governance agents, to consider the protection of share-

holders, with particular emphasis on minority shareholder protection;

3) to provide an overview of the legal framework and the practical functions of the board, focusing upon its responsibility and accountability to the company and shareholders;

4) to highlight the significance of transparency and disclosure for advanced corporate governance as a powerful tool both for influencing the behaviour of companies and for protecting investors.

Economic Environment of Corporate Governance

During the period of 1991–1999 Lithuania's economy has undergone essential changes in all its sectors. There were two distinct stages in the economic development of the country: the period from 1991 to 1994 was a period of a dramatic decline typical of postcommunist states, the second period from 1995 to 1998 was a period of recovery marked not only by the stabilisation of the economy but also by its growth.

In spite of the unfavourable macroeconomic conditions, great efforts were made to lay the foundations for market economy in order to transform the country's centrally planned economy into a functioning market economy [19]. The privatisation of small and medium companies, housing and agricultural land was sufficiently fast [1]. The prices of almost all products and trade conditions were liberalised, new laws were enacted to promote the establishment of new private companies and to create favourable conditions for investment. The exchange rate of the domestic currency was fixed. An important factor contributing to the economic growth was the political stability of the country.

1995 saw the beginning of the economic recovery. Macroeconomic stability was achieved in 1997–1998, the inflation rate went down, the deficit of the national budget was reduced considerably (Table 1).

In the past few years, Gross Domestic Product (GDP) has been growing fast, in 1998 it stood at 5.1%. The largest part of value added was created by industry (together with the supply of electricity, gas and water): in 1997 – 25.2%; agriculture and forestry created respectively 11.7 and 10.6 per cent of value added, transport and communications – 9.6 and 9.7 per cent; construction – 7.7 and 8.2 per cent of value added.

With the restructuring of industry and the expansion of services performed, the share of the services sector in value added was rapidly increasing: in 1997 it accounted for 55.4%. The expansion of the services sector has been the main driving force in the development of Lithuania's economy. Especially efficient were the sectors of transport, car repairs and re-export, construction, the financial sector and other service sectors.

The evolution of GDP per capita (at actual prices, USD) has been the following: in 1992 this indicator stood at USD 489, in 1993 – USD 714, in 1994 – USD 1136, 1995 – USD 1622, in 1996 – USD 2128, in 1997 – USD 2587, in 1998 – USD 2888. However, GDP per capita according to the purchasing power parity has been considerably higher: in 1996 it was USD 5697, in 1997 – USD 6161.

Since 1992, the year of hyperinflation (1020.8%), the annual inflation rate has been going down steadily. In 1998, it was 5.1%. The inflation rate during the year (on the basis of comparison of data for the month of December) was even lower – in 1998 it was 2.4%.

Table 1. The Main Indicators of Lithuanian Economy

	<i>Economic indicators</i>	1993	1994	1995	1996	1997	1998
1	Annual change of GDP, % (at comparative prices)	-16.2	-9.8	3.3	4.7	7.3	5.1
2	Deficit of the national budget, % GDP	0.8	-1.8	-1.8	-2.5	-1.0	-1.3
3	Annual inflation rate, %	410.2	72.2	39.6	24.6	8.9	5.1
4	Inflation during the year, % (December)	189.0	45.1	35.7	13.1	8.4	2.4
5	Foreign trade (goods and services) balance, % GDP	-7.8	-6.0	-11.8	-9.8	-10.6	-12
6	Current account balance, % GDP	-3.1	-2.1	-10.2	-9.2	-10.2	-12.2
7	Foreign direct investments, % GDP	1.17	0.74	1.20	1.93	3.70	8.66
8	Foreign debt, % GDP	10.7	11.7	13.9	15.2	14.6	15.7
9	Annual growth of real wages, %	-39	14.2	3.2	4.1	13.9	14.7
10	Unemployment rate, %	4.4	3.8	6.1	7.1	5.9	6.4

Sources: Lithuanian Yearbooks of Statistics 1994–1995, 1996, 1997, 1998.

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Ministry of Economy. Vilnius, December 1998.

Table 2. Basic Characteristics of Lithuania Foreign Trade

	1993	1994	1995	1996	1997	1998
Exports, % of GDP	75.1	47.8	44.9	42.5	40.3	34.7
Imports, % of GDP	84.5	55.4	60.5	57.8	58.9	54.2
Exports	100	100	100	100	100	100
To the EU	16.9	25.8	36.4	32.9	32.0	38.0
To the CIS	57.1	46.7	42.3	45.4	46.4	35.7
Imports	100	100	100	100	100	100
From the EU	18.7	26.4	37.1	42.4	46.5	50.2
From the CIS	67.5	50.3	42.0	32.9	29.3	24.7

Sources: Lithuanian Yearbooks of Statistics, 1997, 1998;

The Economic and Social Development of Lithuania. Monthly bulletins. Vilnius: Department of Statistics under the Government of the Republic of Lithuania, 1994, 1997, 1998;

Internet page of the Department of Statistics under the Government of the Republic of Lithuania: <http://www.std.lt>

In 1997, the revenue of the national budget was higher than planned by 2.2%. In 1997, as compared to 1996, the revenue of the national budget increased by 22.6%, or 1.5 billion LTL. The budget deficit was 1.0% of GDP, in 1998 it was 1.3% of GDP.

One of the main features of the development of the Lithuanian economy during the years 1991–1999 is a change in its foreign trade. Data characterising trends in the Lithuanian foreign trade during the period of 1991–1999 are presented in Table 2; it clearly shows the re-orientation of the Lithuanian trade towards the West.

Positive trends have been observed in the composition of imports – the share of investment goods has been going up: in 1997, it accounted for 15.5% (in 1996 – for 13.5%). During 1997, imports of this kind of goods increased by 42%. The projection is that in 1999 the share of investment goods will account for 16.1% of total imports. Developments during this period were characterised by efforts to create favourable conditions for foreign trade using the means of free trade agreements with big number of countries and works related with accession to the WTO.

International integration of the Lithuanian economy is also characterised by trends of for-

eign investment in Lithuania. With the economic revival, the investment process has become more active. In 1994–1998, foreign direct investments (FDI) in Lithuania increased by more than 9 times, as of 1 January 1999 they totalled 6,5 billion LTL, FDI per capita being LTL 1756 (USD 439). The largest share of FDI has gone to manufacturing industries – 32%, trade – 25%, postal and communications services – 17%. Data characterising foreign investment in Lithuania during the period of 1991–1999 shows that the amount of foreign investment, especially of foreign direct investment, is constantly growing (Table 3).

In 1993–1998, the average monthly gross wages increased by 5 times, in 1998 they reached LTL 995 (including the private sector). Since 1994, wages have been increasing more than prices, although their purchasing power, compared to that in 1990, has remained low. The growth rate of real wages was comparatively great – in 1997, real wages grew by 13.9%, in 1998 by 14.7%, although from 1999, it is expected that the growth rate of real will slow down.

The unemployment rate has been increasing: it has increased from 4.4% in 1993 to 6.4% in 1998.

Table 3. Foreign Investments in Lithuania

	<i>At the end of</i>			
	<i>1995</i>	<i>1996</i>	<i>1997</i>	<i>1998</i>
Total foreign investments in Lithuania, mill. LTL		11253	15864	19714
Among them:				
Direct foreign investments	1408	2801	4162	6501
Portfolio investments		1227	1664	1473
Other foreign investment		7225	10037	11740

Sources: Foreign Direct Investment in Lithuania, 1999 04 01. Department of Statistics.

Internet page of the Department of Statistics under the Government of the Republic of Lithuania: http://www.std.lt/informacija/rodikliai/pagrindiniai_rodikliai_apie_sali.htm 1999.07.01

Development of the Lithuanian economy was not only a quantitative process related to output changes. Its deep characteristic is transformation of the economical system, featuring privatisation and changes in the character of economic relations. The results of privatisation have led to the definite consolidation of the private sector and its fast growth in the economy of Lithuania. This caused radical changes in the structure of Lithuanian economy – the totally dominant public sector has been replaced by the private sector functioning under the conditions of market economy [1].

The rise of the Lithuanian economy is not a process without some setbacks, though they may be characterised as temporary. The main events, which had inflicted damage for the Lithuanian economy during the period of 1995–1999, are the banking crisis in Lithuania, which occurred in autumn of 1995 and the crisis in Russia, which broke out in late summer of 1998. The main effect of the latter crisis was a sharp decrease in Lithuanian exports to Russia and other CIS countries, which still accounted for a significant part in Lithuanian exports at the time. The decline in trade with Russia is illustrated in Table 4.

The decline in exports itself expresses accumulated problems of particular businesses – decrease of sales, profits, issues related with cash flows; due to financial crisis in Russia, some Russian importers were unable to pay for good

purchased previously. Such events caused some strain in the financial system of Lithuania, too; banks that used to invest into the Russian government bonds faced especial problems, though the amount of such investments was lower than elsewhere in the Baltics.

The decline in exports to the East created a chain reaction in the Lithuanian economy, slowing down the GDP growth and even leading to decrease in the beginning of the year 1999. The worsening of results of companies' activities may be illustrated by the fact, that in average based on data of 100 largest Lithuanian companies, in the first half year of 1999 comparing with the first half year of 1998 sales decreased by 15.2% (the total sales of these 100 companies decreased from 6.37 billion LTL to 5.40 billion LTL), and net profits decreased by 14.8% (the total net profits decreased from 241 million LTL to 216 million LTL). Among these 100 companies 20 companies which were profitable in the first half of year 1998 suffered loss in the first half of the year 1999. The general picture reflecting issues in the financial situation of enterprises is shown in Table 5.

The largest problem caused by the crisis in Russia to the Government itself is a fall down of the budget revenue; revenue from customs duties decreased most significantly. The Government of Lithuania possesses not many means to influence the process of overcoming troubles

Table 4. Russia's Share in Exports and Imports of Lithuania

	1996	1997	1998	1999, first half-year
Russia's share in exports from Lithuania, %	24	24.5	16.5	6.7
Russia's share in imports to Lithuania, %	29	25.3	21.2	19.6

Source: Ministry of Economy of the Republic of Lithuania

Table 5. Financial Indicators of Non-financial Enterprises in 1998, in total, mill. LTL

	<i>I quarter</i>	<i>II quarter</i>	<i>III quarter</i>	<i>IV quarter</i>
Equity	30406	31372	3198	34000
Liabilities	20918	21969	22854	22238
Long term financial liabilities	5659	6279	6692	5286
Long term trade credits	209	238	255	336
Operating profit, loss	562	737	868	687
Net profit, loss	373	541	622	–

Source: Financial Indicators of Enterprises, I–IV quarters, 1998. Lithuanian Department of Statistics

created by the last crisis in Russia. Recovery from the consequences of crisis in Russia and the extent to which the economy has recovered from it actually depends mainly on the ability of enterprises to re-arrange themselves, and to re-orient trade. The Government made some steps in response to the crisis in Russia: the Centre for monitoring and analysis of consequences of the crisis in Russia was created. The Centre was constantly monitoring the situation and was preparing proposals to overcome the problems. It was decided by the Government to provide some financial support to a few enterprises, which were facing financial difficulties and were unable to pay wages to their employees, due to the Russian crisis.

It is possible to foresee now that the Lithuanian economy shall start to recover in the second half of 1999. Signs indicating a potential for this recovery may be seen: enterprises, which formerly exported to Russia, are finding opportunities to export to the West; the volume of retail trade has begun to grow.

Background of Formation

The major factors that have shaped the current corporate picture (the ownership and control arrangements for corporations) are:

- 1) methods of privatisation used;
- 2) developments after privatisation.

Privatisation of enterprises in Lithuania was carried out in two stages. The first one was privatisation of state property to the public with employment of a voucher system, the second one is commercial and which is currently being realised [1]. These stages are directly related with legislation, used in a respective stage. The main law regulating the process of privatisation in the first stage was the Law on Initial Privatisation of State Property [12], in the second stage – the Law on Privatisation of State and Municipal Property [11]. With reference to its impact on corporate governance, the first stage of privatisation may also be divided into sub-periods featuring different characteristics and offering different factors for further developments [15, 18].

During the first stage, before application of the Law on Initial Privatisation, enterprises were allowed to privatise to their employees up to 10% of state capital for cash at low prices, thus creating an initial stake of private capital. The main method of privatisation according to the Law on Initial Privatisation was public subscription for shares. It was rational to pay for subscribed shares by using vouchers, however paying in cash was also possible. In its initial stage application of the Law on Initial

Privatisation of State Property featured absence of privileges for employees of a company. The situation changed later. From June 1991 until April 1992, employees had a priority right to subscribe for shares of the enterprise being privatised. From April 1992 they had a right to subscribe in addition to shares held previously for shares up to 30% of a company's capital at the price equal to nominal value disregarding their subscription price fixed for other persons which was always higher. From February 1993, this share was increased to 50% (20 % of this amount had to be subscribed for a higher price, but from June 1994, conditions for subscription of these 20% were made the same as for the rest part) [3]. Employees of an enterprise had one more opportunity to privatise it: according to the Law on State and State-Stock Enterprises it was possible to increase a share capital (capital which did not belong to the state) by using profit of such an enterprise and to transfer the respective shares to employees.

Another factor is to be taken into account – participation of investment stock companies in voucher privatisation. It was allowed to create them from October 1991; from January 1992, their investments into enterprises being privatised by public subscription for shares were restricted to not more than 50% of the statutory capital of an enterprise.

The facts disclosed above are related with the initial composition of ownership in privatised companies. In enterprises privatised under the Law on Initial Privatisation of State Property during the beginning of its application, privatisation usually resulted in initial structure of ownership that featured a big impact of “outside” shareholders (not employees) and invest-

ment stock companies. Later the share of employees increased, “outside” persons become inactive. It is also necessary to mention, that investment stock companies (more than 300 of them were created) were used not only to accumulate vouchers from public. Very often they were created by persons, who wished to privatise enterprises for vouchers purchased (by using other formal types of contracts as circumvention) from public.

In cases of privatisation of large companies under the Law on Privatisation of State and Municipal Property [11], a big stake in an enterprise is sold to a single investor offering the best price or the best certain conditions usually; practically this investor is foreign very often. According to this law, small stakes remaining in the state ownership are privatised by applying the method of public sale in the Stock Exchange. In practice these stakes, as a rule, are purchased also by a single investor, who already participates in the company usually. It is necessary to mention that concentration of ownership took place mainly as over-the-counter trade. Very important players here were managers of companies: managers used to purchase shares owned by other employees. This is an important reason, why ownership of companies where a great part of capital stock belonged initially to employees, is more concentrated now. Besides, stock exchange transactions were employed in the process. Increases in subscribed capital were also used. Foreign investors who purchased shares usually bought them from persons who had already concentrated them in their own hands (sometimes these persons constituted quite numerous groups).

Finance and Restructuring

The rate of return (before tax) on equity in Lithuanian companies may be characterised as average; there are profitable (some – of high profitability) and loss-making industries. Data on the average rate of return (before tax) on equity in the whole Lithuanian economy and in industries chosen as an example, which may be characterised by prevalence of quite big enterprises, in the year 1998 is presented in Table 6.

Lithuanian companies showing satisfactory financial results, have a tendency to invest much and expand their business. Funds for distribution in the form of dividends usually are modest (of course, there are exceptions). The main external source of funds for large companies is loans from banks. Some large enterprises were laying efforts to issue bonds.

The role of the equities market in financing of corporations as well as in corporate finance

may be evaluated as moderate. Well-developed and successfully operating companies use to solve issues of renovating of equipment by means of issuing new emissions of shares.

The debt/equity ratio in Lithuanian companies is rather low. The debt/equity ratio in the whole Lithuanian economy and in some industries chosen as an example in IV quarter of 1998 is presented in Table 7.

The main part of corporate debt is constituted by loans from banks. According to creditors, the structure of companies' debt may be characterised by the following data: in the whole Lithuanian economy in IV quarter of 1998 financial debts constituted 37% of all liabilities of non-financial enterprises, trade credits – 32%, and other liabilities – 31%. Companies enjoy rights to take loans from banks in both local and foreign currency, and they have the right to borrow from foreign banks. Actually, the largest companies have successful experi-

Table 6. Average Rate of Return (before Tax) on Equity in Lithuanian Economy in 1998

	<i>Whole Lithuanian economy</i>	<i>Industry of manufacture of machinery and equipment</i>	<i>Industry of manufacture of refined petroleum products</i>	<i>Industry of manufacture of medical, precision and optical instruments</i>	<i>Industry of manufacture of chemicals and chemical products</i>
Average rate of return (before tax) on equity, %	7.6	-7.4	-10.7	26.2	8.6

Source: Financial Indicators of Enterprises, I-IV quarters, 1998. Lithuanian Department of Statistics

Table 7. The Debt/Equity Ratio in Lithuanian Companies in IV Quarter of 1998

	<i>Whole Lithuanian economy</i>	<i>Industry of manufacture of machinery and equipment</i>	<i>Industry of manufacture of refined petroleum products</i>	<i>Industry of manufacture of medical, precision and optical instruments</i>	<i>Industry of manufacture of chemicals and chemical products</i>
Average short/equity ratio	0.65	0.59	2.55	1.46	0.39

Source: Financial Indicators of Enterprises, I-IV quarters, 1998. Lithuanian Department of Statistics

Table 8. The Short/Long Term Debt Ratio in Lithuanian Companies in IV Quarter of 1998

	<i>Whole Lithuanian economy</i>	<i>Industry of manufacture of machinery and equipment</i>	<i>Industry of manufacture of refined petroleum products</i>	<i>Industry of manufacture of medical, precision and optical instruments</i>	<i>Industry of manufacture of chemicals and chemical products</i>
Average short/long term debt ratio	2.32	6.91	3.45	0.54	2.44

Source: Financial Indicators of Enterprises, I–IV quarters, 1998. Lithuanian Department of Statistics

ence in obtaining loans from foreign banks too. Lithuanian enterprises have more short term debt than long term. The data characterising situation in the whole Lithuanian economy and in a few particular industries, chosen as an example, in IV quarter of 1998 reveals this situation (Table 8).

The composition of companies' debt was not influenced by the Russian crisis to the rate which could be treated as significant, but it is possible to notice that companies' trade debts increased, and debts to financial institutions decreased (the latter decrease is more significant than the former increase) in the IV quarter of 1998. It may be supposed that banks restricted their loans making to business companies as a result of the Russian crisis.

An excessive risk taking, as well as almost all other mismanagement issues, may be linked to failures in the corporate governance via inability of the corporate governance to establish and ensure an effective management practice. In some cases it was possible to notice a purposive excessive risk taking with the aim to gain benefit for particular persons/groups at the expense of a company.

Corporate restructuring is an intensive process at present. The most widely used form of restructuring during the years of 1992–1995 was formation of new companies, usually private

companies. Currently evidence of significant realignment of ownership structures through demergers and mergers and acquisitions by outside investors (including foreign) is also present.

Corporate restructuring which volume could be treated as significant and which could be attributed to the crisis in Russia of 1998 is not taking place. Corporate restructuring is going on as a natural process. The influence of the mentioned crisis ought to be more evident in future. Meanwhile, there exist new ideas which were inspired by the crisis about restructuring of companies in trouble: a new draft law is prepared. When adopted this law will regulate rehabilitation (restructuring) of companies having problems in those cases when the need to apply bankruptcy procedures is still absent at the given moment. A possibility to restructure debts of a company is provided in this draft of law.

The major actors in corporate restructuring are investors/owners. As everywhere else, conflicting interests of creditors and debtors converge due to the need to preserve both the creditors' and debtors' property. This need requires to keep running a company which has problems, but operation of which can be retained.

Resources of failed firms are re-allocated according to the bankruptcy legislation; effectiveness of these processes may be evaluated as

low due to the fact, that the demand for these resources is quite low. This may be illustrated by the fact, that in those enterprises, whose bankruptcy procedures were started after October 1, 1997, during the second half of 1998, property was sold for the total amount of 5.018 mill LTL, while the total accounting value of this property was equal to 11.275 mill LTL [3]. Bankruptcy proceedings are initiated currently only at a stage of development, when a company has no remaining net assets. It is difficult to find possibilities to revitalise such firms, and their assets are to be sold or distributed separately. This low effectiveness of re-allocation may be related with structural changes in the economy: companies' going bankrupt is related to their operation in industries which have no perspective for further successful development; thus their assets are not marketable. The problem is that there is also quite low demand for assets of firms, which are bankrupt due to mismanagement issues.

The Company Law of the Republic of Lithuania provides that shareholders have the major role in a company; power of a particular shareholder in control of a company is proportional to the number of votes he possesses [2]. According to legislation [2], risk shall be equally spread among shareholders of the same class and returns shall be equitably distributed among them in proportion to a number of shares owned by a shareholder.

Corporate groups play an important role in the Lithuanian economy. They are formed by means of ownership of an equity stake in a company by another company; the latter company then participates in formation of managing bodies of the former company. Meanwhile it is necessary to say, that some very negative experience related with corporate groups was present

in the past years. Namely, controlling companies or persons related with them in corporate groups created after privatisation or take-overs used to "ump out" property of subsidiary companies. Seeking for external financing, it is important to assure now, that such practice will not be present.

Existence of major shareholders is perceived usually as positive when seeking for outside investment, because financial institutions regard this situation as contributing to effective management of a company and hence to financial reliability of a firm. Possible investors also usually regard this situation as making it easier to deal with a company.

Take-overs are perceived as an important corporate governance factor, as in most cases they result in re-formation of a company's managing bodies and changes of executives. There are no special provisions in the legislation [2] limiting take-overs except for that contained in legislation on competition and rules contained in securities public circulation regulations. However, companies (their shareholders) use to exercise measures against take-overs being carried out in their respect.

Commercial banks do not own a considerable part of industry, and their shareholding in non-financial institutions is restricted by the banking legislation. Commercial banks providing financing have some other means to exercise corporate control; the pattern of such control usually is defined on case-by-case basis.

Investment companies were extremely important during the period of initial privatisation; they were being created with the purpose of participation in the initial privatisation. At this moment their number diminished sharply, but their role in governance of Lithuanian compa-

panies is still noticeable [3]. Foreign financial companies are increasing their participation in equity of Lithuanian companies.

The role of local institutional investors such as private pension and mutual funds in corporate ownership and governance is minimal, as such institutions are not still being created in Lithuania. However, steps are made to encourage creation of private pension and mutual funds: the Law on Investment Companies is in force, which allows creation of controlling investment companies, close investment funds and investment funds (investment companies with variable capital). Only controlling investment companies (created after re-organisation of investment stock companies, which were formed during the first stage of privatisation) are actually operating. However, some steps of private structures are observed that are related with efforts to create investment companies of other kinds, including investment funds. The Law on Pension Funds was adopted in June 1999 and did enable creation of private pension funds.

According to the Law on Insurance [10], Lithuanian insurance companies may invest their funds of technical differences (within the limits to be established by Minister of Finance) into shares listed on a stock exchange, and upon authorisation of the Board of the Supervisory Council - into unlisted shares and into shares of foreign companies. According to the same Law, insurance companies may not invest into equity funds, which correspond to their statutory capital. These restrictions on insurance companies' investment into equity are legally binding.

The state participates in control of companies in those cases when the state participates in ownership of a company. According to partial data, in the value of total investments into com-

panies' shares, investments of Lithuanian residents into these shares equal to 49.5% of the total value of Lithuanian companies' shares; private firms account for 26.7 % and natural persons – for 15.2 % of the total value of Lithuanian companies' shares. Share of investors of other kinds, including state and municipalities – 7.6 % (shares of these kinds of investors in the total value of domestic shareholding are respectively 53.9 %, 30.7 % and 15.4 %) [3].

The state's as a shareholder's behaviour may be regarded as different during the time. A very loose control of companies in which the state had a share, in the beginning, was tightened later, while ministries and other state institutions still performed the role of representatives of the state as a shareholder. These arrangements were expressed by decrees of the Government (adopted in March 1995 and in July 1997). The main principles of these Decrees are as follows: representation of the state in a company (mainly in the way of participation in the general meetings) through an officer empowered by the respective institution. Decisions to be implemented by the empowered officer representing the state are to be made, according to their importance, by the empowered officer himself, head of the institution representing the state or the Government. State representatives also, according to the number of shares held by the state, propose candidates into the supervisory (or managing) board and vote for them. The last tendency is to concentrate functions of representation of the state as a shareholder in the remaining companies with state's participation in equity in a separate institution – the State Property Fund, which was created in the beginning of 1998.

Foreign investment is a major factor in the Lithuanian economy. This is confirmed by fig-

ures describing the composition of ownership in public companies. According to the Lithuanian Central Securities Depository, on June 30, 1999 among the total value (equal to 2.12 billion LTL) of shares accounted by securities' circulation intermediaries, on which information regarding their ownership was available, the value of resident investments was equal to 1.05 billion LTL and the value of non-resident (foreign) investments was equal to 1.07 billion LTL, that makes 49.5 % and 51.5 % respectively [3]. According to the Department of Statistics, the main countries providing foreign direct investment to Lithuania were Sweden, USA, Finland, Germany, Denmark and the Great Britain. They accounted for 17.3%, 15.3%, 10.3%, 8.1%, 8.0% and 6.3% of the total foreign direct investment respectively [5].

Increase of foreign investments into shares, decrease of investments by residents into shares of companies and concentration of ownership, when the number of shareholders is decreasing due to purchase of shares from shareholders by other persons including other current shareholders, due to increases of statutory capital are typical for current situation.

Role of Shareholders

In accordance to Company Law [2], shareholders have such rights in a company, as shares held by them entitle them to, and are treated equitably. Shares in public companies may be both registered and bearer. Actually registered shares totally prevail.

“One share-one vote” rule is established in the Company Law for common stock: if all shares of the company, which bear a voting right, are of the same face value, each share except for

special shares provides one vote in a general meeting; if shares, which bear a voting right, are of different face value, one share of the lowest face value provides one vote to its holder. The number of votes provided by other shares is equal to their face value, divided by the lowest face value. It is possible to provide in the statute of a company different rules for determination of the number of votes, but in each case the number of votes provided by a share shall be proportional to its face value. Any differences in treatment between foreign and domestic shareholders are absent.

Shareholders can voice their concerns in a general meeting freely. According to the Company Law, a shareholder or shareholders, possessing at least 1/20 of the total number of votes, may propose to include into the agenda of the general meeting an additional item or may propose their decisions. They must be included into the agenda, in case they are submitted not less than 15 days before the meeting. It is possible to provide a lower number in the statute of a company. Besides, in order to protect a minority shareholders there is another provision (Article 16, Part 8 of the Company Law): shareholders who possess at least 1/10 of the share capital have the right to appoint an expert (a group of experts) to examine operation of the company and its accounting documents, to identify presence of facts, indicating insolvency or deliberate bankruptcy and of facts of squandering of the company's property, loss-making contracts, violation of shareholders' rights. There is another, practical issue: major shareholders usually tend to ignore these concerns, when they are expressed by minor shareholders.

Shareholders are required to approve such transactions, as selling, transfer, leasing or pawn-

ing of long-term assets, whose value exceeds 1/20 of the statutory capital of the company. Such provisions were needed because of the demand to prevent such cases, when property of a company is disposed while it is needed by the company or when property is sold at too low price; these cases may be related both with non-competence and dishonesty of managers of the company.

The Company Law provides some issues that are possibly related with conflict of interests between company's shareholders and the company. The Law allows a company that has not more than 50 shareholders to receive loans from its shareholders for the interest defined by a contract. Furthermore, the annual interest rate for such a loan may not be higher than the average interest rate for the securities (bonds), issued by the Government of the Republic of Lithuania during the last quarter before the day of conclusion of a contract.

Provisions for the protection of shareholders in cases of take-overs, such as special disclosure thresholds, the obligation to extend a tender offer to all shareholders, etc. are provided under securities legislation [13]. Namely, according to the Law on Securities Public Circulation, if a person acting individually or together with other persons has acquired shares of an issuer registered in Lithuania, conferring more than 1/10, 1/5, 1/4, 1/3, 1/2, 2/3 or 3/4 of votes, he shall inform the Securities Commission and the issuer about the total number of shares bearing a voting right and the number of votes held by him within 7 days. The same obligation to report is applied in cases, when the indicated thresholds are passed due to decrease of share of votes possessed. Persons acting together are defined as:

1) a person who issued a power of attorney, and its holder, if the holder of the power of attorney has a right to vote according his own mind;

2) persons being controlled and persons in position to control;

3) persons, who have concluded a written contract regarding co-ordinated voting on issues of the issuer's management;

4) a person, who transfers to another person the right to vote according his own mind and the transferee;

5) members of managing board and supervisory board, chief executive and his deputies, chief financier, persons, empowered to conclude transactions in the name of the enterprise;

6) spouses.

According to the Law on Securities Public Circulation, if a person acting individually or together with other persons has acquired more than 50 percent of votes in the general meeting of an issuer of securities for public circulation, he shall submit an official proposal to purchase the rest part of securities conferring a voting right as well as securities confirming the right to acquire securities bearing voting rights of the issuer for the price of the proposal which may not be lower than the average price of securities which were purchased by the person submitting the proposal during 12 months before exceeding the 50 per cent limit.

Shareholders can be protected against abuses or infringements of their rights by the way of application to the court or, in cases related with public securities turnover, to the Securities Commission. Cases of application of a shareholder to courts whenever infringements of their rights occur are quite numerous. It is complicated to assess the effectiveness of courts' processes related with abuses or infringements of shareholder

rights, because information possessed on this issue is too fragmented, but in general, the situation is improving in the course of time.

According to the Lithuanian Company Law, a shareholder upon submission of a request shall be allowed by the company to get acquainted with and to make copies of annual and intermediary financial statements, reports of the managing board on operation of the company, minutes of general meetings and the list of shareholders. A shareholder, who presents an obligation in a written form on non-distribution of confidential information, may also get acquainted with minutes of sittings of supervisory and managing boards, if these minutes do not contain information about essential events in the company which was not publicised (information is confidential, when the managing board designates by its decision it as being such; information, defined by the law as public, may not be designated as confidential).

A shareholder, owning shares of the company whose total face value is equal to or exceeds 1/20 of the statutory capital of the company or a representative of shareholders, together owning shares of the company whose total face value is equal to or exceeds 1/20 statutory capital of the company upon submission of a written promise on non-distribution of confidential information may get acquainted with all minutes of supervisory and managing boards, transactions of the company, as well as warrants, contracts regarding pawning of long term tangible assets. Such shareholder may get acquainted with all documents of the company.

The need to protect shareholder rights is properly balanced with the need to guarantee the smooth and efficient running of the everyday business of the firm: in cases unrelated with viola-

tions of the law or infringements of their rights by a company bodies (in opposite cases they are entitled to court protection) shareholders can not influence (excluding unofficial influence) actions and decisions of managing bodies of the company. On the other hand, shareholders constitute the supreme body of a corporation and adopt most important decisions; they have the right to obtain information and may monitor the way these decisions are implemented.

Management's liability towards shareholders is limited: according to the Company Law, the head of administration (chief executive) and a person empowered by him (a manager) may be declared by a court on the grounds of an application of a shareholder liable to cover losses inflicted on a shareholder or shareholders only in those cases, when the head of administration or a person empowered by him has concluded a transaction illegally or performed other unlawful acts, which caused a loss to the company or resulted in direct or indirect benefit for these persons in the cost of the company or its other shareholders. In other cases managers are not liable for losses which were inflicted on a company by their decisions.

The Role of the Board of Directors

Management bodies in Lithuanian companies pursuant to the Company Law are the following: general meeting of shareholders, supervisory board, managing board and head of administration (chief executive) [2]. In a public company supervisory board or managing board may be not formed; in this case functions of the body being not formed are to be transferred to other bodies. A typical size of a board of directors of a public company is 5 persons.

There does not exist a requirement to represent interested parties other than shareholders, such as employees, creditors or major clients/suppliers, in boards. According to the Company Law, boards are formed entirely by shareholder's voting; shareholders have full freedom of decision in selecting their candidates and voting. In practice inclusion of employees, creditors or clients/suppliers into boards may happen, though it is not common. The law does not include a provision in obliging a board to give special consideration to the interests of minority shareholders; they shall act in the interests of the company as a whole.

Provisions in the Company Law or other rules limiting possibility of a person to be elected as a member of managing board or supervisory board of more than one company are absent. Practice, when one and the same person is a member of managing board or supervisory board in several companies, is usual. Information on "cross-membership" in boards of two companies unrelated by ownership links is absent.

Members of managing board shall jointly cover losses inflicted on the company due to decisions of managing board contradicting the statute of the company and the law. A member of managing board is exempted from this duty, in case he voted against such decisions or did not participate in a respective sitting of managing board, on condition that he within 7 days after the moment, then he learned or should learned about such a decision, handed to the chairmen of the sitting a written protest. Dismissal or retirement of a member does not exempt him from the duty to cover losses. A member of managing board may be exempted from coverage of losses, if he acted on the basis of documents of the company or other informa-

tion, when there was no reason to distrust it, or acted not exceeding the usual degree of production or economic risks. Disputes regarding coverage of losses shall be taken to court. There are penal provisions applicable to head of administration also.

Members of managing boards are elected by supervisory boards, and members of supervisory boards are elected by general meetings. Currently a managing board or a supervisory board (but not both) may be not formed in a public company; the last proposed amendments to the Company Law provide for a possibility not to form a supervisory board, but not a managing board.

When managing board is elected by a supervisory board, it is elected by simple voting. When supervisory board or, in case supervisory board is not formed, managing board is elected by general meeting, a cumulative voting is used: in this voting each shareholder has such amount of votes, which is equal to number of voting shares held by him multiplied by number of members of the respective board being elected. These votes may be distributed by a shareholder at his own discretion – votes may be given to one or several candidates.

The main rules on corporate governance and the role of boards are included in the Company Law. During the drafting, discussing and adoption of the current Company Law in 1994–1995, an intensive joint work with representatives of the business spheres was performed, intensive consultations were held with them with the purpose to find the best solutions for issues of regulation of operation of companies. The some approach is used now, in the course of adoption of the new version of the Company Law. There were some initiatives shown by industrial associations

to establish voluntary corporate governance guidelines. However, usually separate companies determine the precise definition of the role of supervisory and managing boards themselves, subject to their particular needs. Self-regulation in the British sense, performed by associations, is not traditional in Lithuania, though there are some thoughts about possibilities to encourage its usage.

The Transparency and Disclosure

The basis for accounting standards is the Law on Fundamentals of Accountancy [9]. It establishes, that financial statements of a company are the Balance Sheet, the Profit and Loss Statement, the Cash Flow (Changes of Financial Position) Statement and the Explanatory Note.

Lithuanian financial accounting standards are sufficient for market participants and for the purposes of governance. Present disclosure channels allow users who have some deeper interest in operation of a company to obtain information on its financial situation. Accounting standards shall be evaluated as sufficient for operation and control of companies. Improvements related with their approximation with the EU legislation are being prepared.

There are some issues related with asset valuation: due to inflation in former years the assets value was redefined several times. There existed rules established for this re-valuation of assets, and enterprises had a possibility to perform these re-valuations properly. The legal basis for this was established by a Decree of the Government.

Mandatory disclosure of companies' non-financial information is provided by accountancy regulations (applying to the contents of the Explanatory Note), regulations of securities pub-

lic circulation and regulations of operation of register of enterprises. Information, which can be obtained from these sources is important not only to shareholders, but to other parties as well: an Explanatory Note shall contain information on general situation of the enterprise, conditions of operation of the enterprise, activities of the enterprise in the field of research and development, changes of capital and reasons for that, main events in the enterprise.

There are especially great debates about improvement of disclosure through improvement of operation of the register of enterprises (or creating the register of economic entities on its basis). Work in this field is related with harmonisation of Lithuanian law with that of the EU also.

According to the Law on Audit of the Republic of Lithuania [8], the external auditor is responsible for inspection of financial statements of a company and making conclusion regarding the correct reflection by financial statements of financial situation of a company, results of activities and cash flows, compliance of financial statements with legal acts regulating financial accountancy and working out of financial statements, as well as with the general principles of accountancy, applied in the Republic of Lithuania. Thus, an external auditor improves possibility of shareholders and other interested parties to rely on financial statements of a company. There is a penalty for an auditor, who issues a misleading opinion on veracity of financial accountancy of a firm, if such opinion led creditors, stockholders, state or other institutions, enterprises or persons to great material losses – up to 3 years of imprisonment and a fine or a fine only – provided in the law (Article 313 of the Penal Code of the Republic of Lithuania).

The disclosure of ownership links is arranged under the legislation on public securities. This disclosure is provided in the Law on Securities Public Circulation [13] and organised by the Securities Commission pursuant to legal acts adopted by it. Companies-issuers of securities are required to submit to the Securities Commission annual prospectus-report, semi-annual and quarterly reports; they shall contain a list of largest shareholders, who own or possess more than 5 per cent of share capital of the issuer. It shall be indicated, how many shares each such shareholder has or possesses, what is his share in equity and share of votes held. It is necessary to disclose in an annual prospectus-report also long-term investments, including investments into subsidiary companies and related enterprises. The issuer shall inform the public in the media, where and when it is possible to become acquainted with the above mentioned reports. The Securities Commission monitors ownership links.

Current standards do allow for appropriate disclosure of off-balance sheet transactions, cross-guarantees of credits, contingent liabilities and other similar risks. Legal regulation of this sphere is still insufficient, there is a general requirement to disclose in the Explanatory Note (one of company's financial statements) "all large amounts accounted in off-balance sheet accounts".

The crisis in Russia of 1998 was not directly related with transparency and disclosure issues of Lithuanian financial institutions. There was a major crisis in the financial sector in Lithuania in 1995, which was subject to poor and dishonest management of banks, issues of disclosure of information regarding banks and issues of supervision of commercial banks by the cen-

tral bank. That crisis led to improvements in the field of transparency and disclosure.

Conclusions

1. The current system of corporate governance in Lithuania has formed to a great extent as a result of privatisation of state property. The first stage of privatisation was characterised by privatisation of state property to the public with employing a voucher system, the second one – by selling for money big stakes in larger enterprises to strategic investors. This reflects the initial composition of ownership in respective companies.

2. The largest groups of company owners are other private firms and natural persons. The fact of the group of other firms taking the lead in shareholding in companies also illustrates importance of corporate groups in the economy. The major role in governance of companies belongs to shareholders. Influence of the banking system, in which private banks prevail, as well as of other financial intermediaries, is of lesser importance in this sphere. Foreign shareholders are holding a great part of equity in larger public companies.

3. The Company Law of the Republic of Lithuania provides for completely equitable treatment of shareholders without regard for their being foreign or local or any other characteristics. A general meeting of shareholders is the ultimate organ of a company both, in law and in fact. Shareholders can obtain information from a company; their rights to information are differentiated according to amount of stock held by them currently. There are provisions in force being applied on conflict of interests between shareholders and the company, on

protection of shareholders in cases of take-overs, on court protection of shareholder rights, on insider trading.

4. The Company Law of the Republic of Lithuania provides for two boards: a supervisory board and a managing board. The supervisory board appoints the managing board. One of the boards may be not formed. There are no legal limits on shareholders in respect to their formation, including limits on ability of a member of a company board to take position of a member of a board in another company.

5. The crisis in Russia of 1998 did not cause significant changes in corporate governance itself. It caused a significant decrease of exports over a short period of time after brake-out of the crisis in Russia, necessity to redirect Lithuanian exports to even greater degree than during former years, a slow-down of economical growth.

6. The role of the state in corporate governance is not of such big importance in order the state would be able to make some steps to influence corporate governance subject to changes in external conditions of operation of the economy. The state responded to changes caused by crisis in Russia with some delay, mainly with actions in the field of fiscal policy. The main role of the state is to establish rational rules, according to which companies shall operate and which are the frameworks for structural changes. These structural changes are a natural processes that is characteristic to any market economy. It is a duty of the state to supervise the soundness and legality of processes, resulting in structural changes in the economy.

7. The system of corporate governance is developing in Lithuania. Its development does not depends so much on short-term processes and events, such as crisis in some other countries, though these events influence the economy, as on a long-term economic environment, traditions and the state's measures related to the regulation of corporate governance. Actually, the state institutions are working in this field. Part of this process is harmonisation of laws with the EU legislation, which will enhance the legal conditions for companies' operation; the new Company Law will be adopted in the 2000 year.

8. The new version of the Company Law, which is currently being discussed in the Government, will be harmonised with the EU legislation in the field of company law (i.e. directives, regulating protection of interests of shareholders and other parties by means of disclosure of information, formation and maintenance of capital of a company, mergers and divisions, single member's companies), encompassing all necessary provisions. Moreover, this new Company Law will contain different from that being applied currently provisions on establishment of a company, on the manner of formation of its bodies, expanded provisions on mergers and divisions, amended provisions on voting by qualified majority in a general meeting, etc. It will provide for the new order of participation of a shareholder in a general meeting, equality of rights of shareholders in obtaining information from the company notwithstanding number of votes held by them and it will contain a number of other new provisions.

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BENDROVIŲ VALDYMO PLĖTOJIMAS LIETUVOJE

Santrauka

1990 metais pradėta Lietuvos ekonomikos reforma per dešimtmetį iš esmės pakeitė visus ūkio sektorius. Sukurtas privatus sektorius, kuriame svarbus akcinių bendrovių vaidmuo. Šių bendrovių formavimosi, jų veiklos ir valdymo dėsningumai bei teisinio reglamentavimo klausimai straipsnyje aptariami remiantis atlikto tyrimo rezultatais.

Dabartinę bendrovių veiklos ir valdymo praktiką daugiausia lėmė valstybės turto privatizavimas: pirmu etapu vykdytas pagal Valstybinio turto pirminio privatizavimo įstatymą, antru – pagal Valstybės ir savivaldybių turto privatizavimo įstatymą. Susiformavusioje akcinių struktūroje dominuoja privataus kapitalo įmonės ir fiziniai asmenys. Dėl vertybinių popierių viešosios apyvartos pastebimas akcinio kapitalo koncentracijos didėjimas. Akcinių turtnes ir neturtnes teises griežtai nustato įstatymas, jų teisės priklauso tik nuo turimų akcijų ir nesusietos su akcininko kilme, statusu ar kitokiais požymiais.

Įteikta 2000 m. sausio 25 d.

Įstatymas nustato keturis bendrovės valdymo organus: visuotinį akcinkų susirinkimą, stebėtojų tarybą, valdybą ir administracijos vadovą. Jų formavimo tvarka ir funkcijos buvo tobulinamos, siekiant mažinti bendrovės ir valdymo organų, akcinkų daugumos ir mažumos konfliktų prieclaidas. Neblogai reglamentuotas informacijos sklaidimas, tik reikėtų paspartinti ūkio subjektų teisinio registravimo pagal šiuolaikines informacijos technologijas įteisinimą.

Bendrovių valdymo tobulinimą lėmia globalizacija, tarpvalstybinė integracija, politinė bei ekonomi aplinka ir, žinoma, teisinė praktika ir tradicijos. Atsitiktiniai trumpi reiškiniai, ypač tokie grėsmingi kaip valstybių kaimynių ekonominės krizės, daro įtaką ne tik operatyviai, bet ir strateginei bendrovių veiklai.

Parngtas naujo Akcinių bendrovių įstatymo projektas yra harmonizuotas su Europos Sąjungos teise ir akumuliuoja pažangią ne tik Lietuvos, bet ir kitų valstybių praktiką.