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CORPORATE GOVERNANCE OF LITHUANIAN LISTED COMPANIES

NADZÓR KORPORACYJNY NAD FIRMAMI NOTOWANYMI NA GIEŁDZIE NA LITWIE

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Streszczenie. Niniejszy artykuł analizuje kwestię wiarygodności informacyjnej i dostępu akcjonariuszy do informacji dotyczących nadzoru korporacyjnego nad litewskimi spółkami akcyjnymi, uwzględniając również dostępność popularnych teorii ładu korporacyjnego (teoria agencji, dobrego gospodarza i zależności zasobowych). Autorzy przedstawiają obowiązujące uregulowania prawne w zakresie nadzoru korporacyjnego oraz zwracają uwagę na deficyt badań naukowych w tym obszarze i brak funkcjonalnych modeli dostosowanych do realiów kraju. W artykule przedstawione są wyniki badań empirycznych, opartych na analizie porównawczej dominujących modeli nadzoru korporacyjnego litewskich spółek akcyjnych w latach 2006 i 2010. Ocenie poddano cechy charakterystyczne spółek i zmiany, jakie zaszły w przedziale czterech lat w jedynym z obszarów systemu ładu korporacyjnego jakim jest zarząd.

Key words: accessibility and reliability of information, agency theory, corporate governance, corporate governance theories, public listed companies, resource dependency theory, tewardship theory, the board.
Słowa kluczowe: dostępność i wiarygodność informacyjna, nadzór korporacyjny, spółki notowane na giełdzie, teoria agencji, teoria dobrego gospodarza, teorie ładu korporacyjnego, teoria zależności zasobowych, zarząd.

INTRODUCTION

Under conditions of market economy in order to make appropriate investment decisions, guarantees that the invested capital will bring returns or steadily increase the shareholder value are necessary. Practical investigations (The McKinsey Quarterly 2002, ECGI, ISS, 2007, Heidrich & Struggles 2006, 2007) show that the risk of losing invested capital decreases when a corporation distinguishes itself by good corporate governance and having effective control mechanisms in action. It is the corporate governance which defines how vision, mission, and strategic goals of the corporation will be implemented, what place the corporation will take in the competitive market, and what conditions will be created for increasing financial capacities, capital and market share. According to scientists Zahra, Pearce (1989), Bauer et al. (2003), Fahy et al. (2004), Čerka (2004), Adams, Ferreira (2005), the better the corporate governance of a company is, the more probability there is of profitability of activities and growth in market value and return on investments of such a corporation. The importance of corporate governance is emphasised by such international organisations and professional associations as International Institute of Internal Audit, the

World Bank, International Organisation for Economic Cooperation and Development, European Corporate Governance Institute, and International Federation of Accountants.

During the recent decades the importance of corporate governance issues has been increasing. Over the last 20 years special Corporate Governance Codes were adopted; now more than 60 countries all over the world have them. In 2005 the European Commission adopted an action plan for modernisation of corporate law and enhancement of corporate governance. After the world financial crisis of 2008 the issues of corporate governance started being analysed more intensively by practitioners and scientists not only in the framework of the banking sector, but also public listed companies, state owned enterprises and even small and medium sized business. Ruud (2003), Hermanson, Rittenberg (2003), experts at International Institute of Internal Auditors, speak about reasons that fostered the whole world paying greater attention to corporate governance and internal audit of corporate governance.

Firstly, the number of scandals (most known – MicroStrategy, Cendant, Enron, WorldCom) caused by the management of big corporations and their bankruptcies is not declining. The most recent scandals in Lithuania related to companies AB “Alytaus tekstile”, AB “Ekranas”, bank “Snoras” also showed that due to a bad corporate governance each year companies risk going bankrupt. As a result, financial problems are faced not only by the employees and creditors of such companies, but also municipalities and governments having to appoint donations or even increase tax rates to mitigate the consequences of bankruptcies and social problems. Secondly, changes in ownership composition of corporations, especially large ones, are observed. According to Huse (2005), after scandalous events shareholders became much more active and express an obviously greater interest in corporate governance and its quality of companies in which they chose to invest their capital. Thirdly, requirements by regulatory institutions of stock exchange markets became more stringent. Seeking to ensure compliance to corporate governance practice with these regulations, corporations are forced to improve their risk management procedures, corporate governance quality and audit. It is of paramount importance for the public interest companies, for its stakeholders to know on time if the governance of a corporation is appropriate, reliable and ensuring the implementation of corporate goals, achievement of good financial results, efficiency in activities, and promotion of its development.

The main problem examined in the article is the problem of reliability and accessibility of information about corporate governance of Lithuanian listed companies to stakeholders and the shortage of scientific research and practical solutions on this issue in Lithuania. The data officially published in annual financial statements of Lithuanian corporations does not present the full situation of corporate governance quality or risk areas related to corporate governance, and, therefore, does not enable defining reliably if the corporations are able to achieve their goals and strategies in the future.

The topic of corporate governance in scientific literature from foreign authors has been analysed since 1932. Meanwhile in Lithuania, there is lots of scientific work being done in the areas of strategic and operational management, internal audit; however, the investigation of the topic of corporate governance is tenuous. Over the last decade the topic of corporate governance was discussed by such Lithuanian scientists as Belickas (2004), Čerka (2004), Stačiokas, Rupšys (2005), Vazniokas, Darškuvienė (2007).

Starting from 2007 Lithuanian public listed companies are obliged to prepare and officially publish a report on how they followed the principles of Corporate Governance Code of Lithuania as a part of annual financial report, a major part of which is composed of questions directly or indirectly related to activities of the board performing the functions of corporate governance. Company reports of 2006 and 2010 revealed that they were not fully informative and did not allow the formation of a reliable opinion about the real quality of corporate governance and, at the same time, hindered the reliable evaluation and forecasting of perspectives and results of a company's activities that are highly dependable on the quality of corporate governance. As Nausėdaitė and Saladžienė (2007), the experts of Lithuanian Securities Commission claim, there is an obvious shortage of information about the real quality of governance of corporations.

Purpose of the study – to perform an analysis of scientific literature on corporate governance and based on the results of it, implement an empirical study in order to find out the prevailing corporate governance model of Lithuanian listed companies as well as to find out and evaluate the main characteristics of their boards which are one of the areas of corporate governance system.

The object of the study – the board of a Lithuanian listed company, its size and composition as well as the quality of presentation of all this information in the annual report about how a company complied with the guidelines of Lithuanian Corporate Governance Code.

Research methods used:

– Content analysis, logical analysis, quantitative and qualitative analysis of scientific literature, legal acts, Corporate Governance Codes of Lithuania and other foreign countries.

– Reconnaissance investigation about the prevailing model of corporate governance system and the main characteristics of the boards of Lithuanian listed corporations.

The concept of corporate governance

The concept of *corporate governance*, or *enterprise governance*, by Lithuanian scientists, legal and audit experts can be translated into Lithuanian in several ways: „korporatyvinis valdymas" (Vazniokas, Darškuvienė 2007), „organizacijų valdymas" (Stačiokas, Rupšys 2005), „organizacijų valdomumas" (Dičpetris 2003), „bendrovių valdymas" ir „įmonių valdomumas" (Belickas 2004). In 2007 the board of Vilnius Securities Exchange approved a

Corporate Governance Code of Lithuania, where the concept of corporate governance in the title of the Code is worded as *bendrovių valdymas*.

In search of scientific solutions to the problem, first of all it is necessary to reveal the essence of the concept of corporate governance. As Huse (2005), the author of numerous research, claims, there is no single globally acknowledged definition of corporate governance and points out that every corporate governance definition is biased. Each period and changing business environment dictates new forms and models of governance as well as determining new theories to be created and applied for the examination of corporate governance, so concepts of corporate governance *per se* are being adjusted.

Many world scientists, national and international organisations tried to define corporate governance. For a long time the notion was popular that corporate governance is the interaction among internal, external stakeholders and members of the board which is oriented towards the creation of value within a company. Later Monks, Minow (2001) pointed out that the main participants in corporate governance are shareholders, administration and the board. They treated corporate governance as relationships among all these participants while defining the activities of a company and trends for its development.

Representatives of institutions regulating securities markets looked at corporate governance from the perspective of regulation and risk management in their activities. Levitt (1999), the chairman of the US Securities Commission, described corporate governance as processes that are essential for the existence of effective market discipline. By highlighting the element of financial reporting he claimed that corporate governance is a link connecting the management of a company, its board and the system of financial reporting. The concept of corporate governance, as approved by the Council of Corporate Governance at Australian Securities Exchange (2003), means a system due to which a company is managed and which impacts how the goals of the company are set and implemented, risk is evaluated and managed, and activities of the company are optimised. In 1998 Corporate Governance Commission of *Belgium* (1998) defined corporate governance as a set of rules related to governance and control of a corporation. The board of the corporation is responsible for governance to meet the interests of the corporation and its shareholders as well as in compliance to laws, legal acts and agreements that the corporation is engaged in. Corporate governance, as approved by the *Japanese* Corporate Governance Committee (2001), is a scheme having to ensure that the executive directors responsible for the company perform their functions appropriately; the essence of the board activity, the majority of which is composed of independent members, is a proper oversight and motivation of executive directors and employees.

The most acknowledged concepts of corporate governance are defined by the Organisation of Economic Cooperation and Development (OECD) and International Institute of Internal Auditors (IIA). From the point of view of OECD (2004), good corporate governance has to ensure an appropriate remuneration of the board, directors and managers in order to

achieve the corporate goals the implementation of which is important to shareholders, the board, and other stakeholders as well as to enhance an effective oversight of activities seeking economic utilisation of resources. OECD states that corporate governance is a set of relationships among the management of the company, the board of directors, shareholders and other stakeholders. Corporate governance is grounded on the structure enabling one to define the goals of the company, means in order to achieve these goals, and to describe the oversight of activities of the company.

International Institute of Internal Auditors emphasises that the oversight of organisational risks and assurance that these risks are properly controlled and managed have a positive impact on the achievement of the goals of the company as well as preserving the market value of the company. The Institute of Internal Auditors claim that corporate governance is a system of processes and procedures that stakeholders of a company are directly or indirectly related to in order to ensure risk management and control processes administered by the heads of the company [*International…*].

Referring to the report of International Federation of Accountants (IFAC) prepared in 2004, the essential feature of corporate governance is that in search of successful activities a merely good leadership is not sufficient. IFAC points out two main dimensions based on which corporate governance of a company shall be evaluated – it is conformance and performance (Fig. 1). While evaluating the board which is one of the areas of the corporate governance system, it is necessary to examine not only how ethics, actions, work procedures, structure of the board and each its member complies the laws and codes, but also how the activities, efficiency and contributions of the board are creating added value in the company.

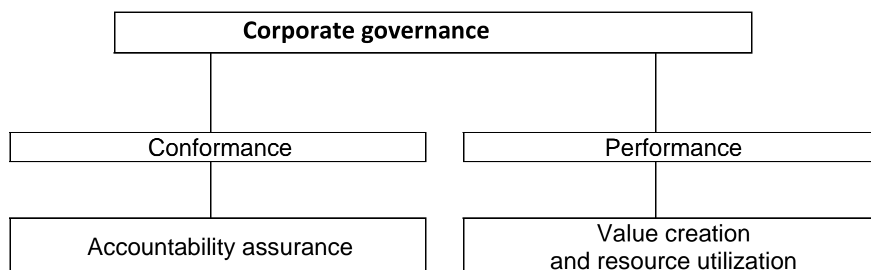


Fig. 1. Corporate governance
Source: IFAC, 2004.

In addition to the dimensions pointed out by IFAC, scientists Fahy et al. (2004) defined a third one – the dimension of the corporate responsibility concerning the issues of protection of intellectual capital of the company, motivation of employees, productivity, management of environmental, social, cultural aspects, ethics, risk management, supply chain management and assurance of supply of resources. In addition, the scientists explain the dimension of conformity as the one that examines internal control, risk management, activity and compo-

sition of the board, organisational culture. Performance dimension, according to them, is related to the system of performance management and processes, indicators and methodologies describing it.

Key theories of corporate governance and their development

Such a variety of concepts of corporate governance and their development was impacted by changing external and internal business environment, corporate governance research performed and theories created under the influence of these changes. British and American scientist were the first to examine the governance of big corporations. In the book "The modern corporation and private property" written by US scientists Berle, Means (1932), attention is paid to the strict division of property and the management in US corporations. The phenomenon was defined by the fact that big corporations were owned by lots of small shareholders, and for this reason, direct management by these shareholders was not possible. New effective management solutions and models were needed.

From the 1970s till the 1990s due to the strengthened positions of chief executive officers in corporate governance, there was lots of dissatisfaction over the extremely high and increasing salaries and other forms of remuneration of CEO's. As noticed by Fahy et al. (2004), the number of cases of dishonest behaviour and malpractice of CEOs increased highly in the US and other countries around the world. Scandals of such corporations as Enron, World.com, Tyco, Xerox, Global Crossing, HIH, Parmalat made experts pay attention not only to shareholders, but also other stakeholders – employees, customers, suppliers, local communities. This enhanced the search for new effective governance solutions and the growing importance of the role of the board – the institution for constraining the powers of chief executive officers as well as oversight and control of their activities. A notion became predominant that the board shall be not a mere "Christmas tree decoration", but shall be active in defining corporate goals, hiring, firing and evaluating a chief executive officer and assigning a salary level to him, in the process of the creation of corporate value and representing the interests of shareholders. In 1992 a commission headed by Sir Adrian Cadbury endorsed a special document "The Report of the Committee on the Financial Aspects of Corporate Governance". One of its main ideas was that a precondition for effective corporate governance is not only a separation between functions of the chief executive officer and a chairman of the board, but also assurance that the majority members of the board are independent. Later, based on this document, lots of countries legitimised the concept of separation of duties of a chairman of the board and a chief executive officer of a corporation.

The end of the 20th century distinguished itself by the processes of globalisation, development of information technologies, rapid changes in market environment, growth in securities markets. As earlier the main attention of shareholders was concentrated on the size of dividends, so from now on the market value of securities became most important for the shareholders. By joining efforts of stock exchange, national and international finance, audit

and other organisations, corporate governance codes were prepared in many countries around the world. Since then corporate governance has been interpreted as the oversight of a corporation that is exercised by its owners. In the 21st century a further development of corporate governance in market economies influenced by changes in their internal and external environment is observed. The main task for the corporate governance system became the constant creation of greater added value and not only the preservation of the present one.

Lots of theories examined corporate governance and other directly or indirectly related issues: stakeholder theory (Freeman 1984), Donaldson, Preston (1995), Friedman, Miles (2002), Phillips (2003), transaction costs theory (Coase (1937), Williamson (1981), information gap theory (Cheong et al. (2004), Ben-Haim (2006), McCarthy, Lindenmayer (2007), theory of the firm (Williamson (1981), agency theory Fama, Jensen (1983), Prendergast (1999), Eisenhardt (1989), stewardship theory (Huse (2005), resource dependency theory (Pfeffer (1972), Boyd (1990), Scot (2003), theory of friendly boards (Adams, Ferreira (2005). In the context of the study presented in this article the mostly important are: resource dependency theory, agency theory, stewardship theory and contingency theory.

Resource dependency theory is one of the classic theories examining corporate governance problems. In addition to the issue of corporate governance it had a great impact on the analysis of optimal organisational structure, selection of employees and board members, production strategy, structure of contracts, and external channels of the organisation. The originators of the theory are scientists Pfeffer and Salancik, who in 1978 published a book "External Control of Organisations: A Resource Dependence Perspective". According to the scientists, a corporation always takes into consideration the needs of external stakeholders, other participants of the market and their negotiating power, if the supply of resources is significantly dependent on them. Besides, the corporation will always try to decrease this dependency as much as possible. The strategy to be chosen by the corporation mostly depends on the external environment and decisions made by the board.

The Resource dependency theory allowed proving why corporations are often forced to create networks of cooperation with other organisations. If resources are rapidly diminishing, directors in order to assure the stability in activities and income earning are forced to increase the number of suppliers and (or) buyers. On the other hand, such networks of cooperation often inhibit the decisions of the management seeking to implement corporate goals. The solution of the resource dependency problem may lead a corporation towards the limiting of or even losing some powers. Success or failure of the company becomes dependent upon other organisations and the decisions of their managers. For example, in the case of a corporation being highly dependent on bank loans, it may choose the president of the bank to be a member of the board. In such a way the board would ensure that in case of need the bank grants a loan under more favourable conditions. However, there is a threat that the bank president being a member of the board may vote unfavourably if the

decisions of the corporation do not coincide with the interests of the bank. The resource dependency theory (Pfeffer 1972) points out the board as a means for co-opting, or including into their internal environment the necessary external organisations and their useful connections and related resources.

Agency theory is based on the concept of separation of roles between ownership and management. For the first time the idea that shareholders of a company are its owners and that the company and its managers, including the board, are the representatives, or agents, of the owners, was raised by Berle, Means (1932). Later Jensen, Meckling (1976) claimed that managers will try to increase the ownership of shareholders only if special corporate governance structures are implemented in the company. Tricker (1994) and other supporters of the agency theory proved that the most important role in corporate governance is played not by the chief executive officer, but by the board. In Tricker's view, the purpose of the board is while working with and through the chief executive officer to perform all four main functions – ensure the right and timely delivery of reporting to appropriate institutions, to create strategies for corporate development and performance, to perform the oversight of processes, systems and mechanisms active in the company, to form policies and monitor the implementation of them. The logical scheme of the board activities as made by Tricker (1994) is presented in Figure 2.

	Ensuring compliance	Implementation of activities
External communication	1. Delivery of reporting to appropriate institutions	2. Strategy creation
Internal communication	3. Stewardship and monitoring	4. Formation of policies
	Orientation towards the past and present	Orientation towards future

Fig. 2. Areas and directions of activities of the board
Source: Tricker 1994.

In difference to resource dependency theory, the agency theory was less focused on examining the relationship of the company and its board with the external environment of the company, but instead focused on one of the biggest internal problems of a corporation – the problem of remuneration of CEOs and their opportunistic behaviour. Williamson (1981), Donaldson, Preston (1995) claimed that in order to ensure the optimal corporate governance it is necessary to separate the functions of the chairman of the board and the chief executive officer as well as to implement special mechanisms to minimise agency costs. It was suggested to apply programs of financial motivation of the chief executives for their good work and to grant more authority to the board which shall control the opportunistic behaviour of CEOs in order to increase shareholder value and protect their interests. Empirical studies revealed that the problem of dualism, when the chief executive officer is heading the board, is much more prevalent in America than in other countries of the world, for example, Japan and Australia (Kesner, Dalton 1986, Hill 1994, Finch 2003). The trend of

increased shareholders' activity that came from the United States over the last twenty years gained the acknowledgement of the agency theory in many European countries. This is testified by Corporate Governance codes endorsed by many European states.

Stewardship theory tried to solve the shortcomings of the agency theory. Donaldson, Preston (1995) stated that research he performed did not support the merits of application of agency theory in corporate governance practice, but rather convinced that the application of principles of stewardship theory in corporate governance creates more benefits to the company and its shareholders. The scientist was convinced that shareholders would have much more benefit not by exercising a stricter oversight of chief executive officers, but by focusing their attention on the adequate remuneration of them. According to stewardship theory (Huse 2005), chief executive officers are not selfish and perform their duties honestly, take care that the assets of the corporation are used economically and effectively for the creation of products and increasing shareholders' ownership.

Burton (2000) noticed that the stewardship theory highlights not control, but active participation, not monitoring, but greater trust in the chief executive officer, supported more the development of activities rather than greater control of costs. Donaldson, Preston (1995) and McConvill (2005) claim that dualism, when the chief executive officer at the same time holds the position of the chairman of the board, is not a weakness but a strength, because this way it is possible to optimise the process of decision making and governance of all the corporation. Obvious differences between agency and stewardship theories are summarised in Table 1.

Table 1. Comparison of agency and stewardship theories

Theory	Agency	Stewardship
Managers as	Agents	Stewards
Approach to governance	Economic	Sociological and psychological
Model of man behaviour	Individualistic Opportunistic Self-serving	Collectivistic Pro-organizational Trustworthy
Managers motivated by	Their own objectives	Principal's objectives
Manager's and principal's interests	Diverge	Converge
Structures that	Monitor and control	Facilitate and empower
Owner's attitude	Risk aversion	Risk propensity
Principal – Manager relationship based on	Control	Trust
Management philosophy	Control oriented	Involvement oriented
How to deal with increasing uncertainty and risk	Greater control, more supervision	Training and empowering people, Redesigning jobs to be more challenging and motivating
Time frame	Short-term	Long-term
Cultural differences	Individualism, Large power distance	Collectivism, Small power distance

Source: Prepared according to Sanchez (2004).

Contingency theory. Both agency and stewardship theories, though being antagonistic, today are still very popular. As a rule, where there are two extremes, there is a niche for a medium solution. Contingency theory was developed which states that there is no one best

way to manage an organisation, and that the structure and sub-systems of it shall comply with the environment. Fiedler (1967), one of the founders of the contingency theory, in 1960–1970s analysed how organisational effectiveness is influenced by different styles of management. According to Fiedler, the main factors of management style are the level of employees' trust in their leader, the structure of tasks delegated to subordinates, and formal authority of the leaders. The scientist thinks that both relationship oriented leadership and corporate governance as well as strictly oriented to the implementation of goals of the company, can fit; however, in each situation a corporate governance style shall be applied to the specific situation in the company.

Based on the contingency theory, effective corporate governance is distinguished by the bodies of governance applying processes, systems and strategies of the company to specific circumstances, internal and external conditions and environmental factors. Huse (2005) points out 6 factors that are most often applied in corporate governance research. In his opinion, these factors are – national, geographic and cultural features, industry and its environment, ownership, size of a corporation, life cycle of the corporation, position and characteristics of a chief executive officer. For instance, by applying the criterion of national, geographic and cultural features, two major kinds of corporate governance can be determined. The first one is Anglo-American governance system, characterised by a flexible labour market, active securities market, domination of corporations having lots of small shareholders. Meanwhile, the second one – continental European governance system is defined by a more concentrated ownership, more settled labour market, a strong dependency on long term loan financing. Accordingly, in the latter one, where large shareholders are dominant, they have a stronger voice in strategic decision making. If there are no managers among these shareholders, the power of the board will probably be strong; and on the contrary, if at least one the controlling shareholders is the chief executive officer, the power of the board decreases.

Forbes and Milliken (1999), the supporters of this theory, do not define the direct correlation between the composition of the board and the financial results of the company, however, they suggest examining boards by analysing their composition, each single member of the board (their experience, competencies), work style, work results, and not as a closed, but rather open, system. They suggest examining the board from four perspectives: board characteristics, board processes, board level outcomes, and firm-level outcomes. However, according to Huse (2005), the activities of the board should be analysed based on how it performs the following functions: production control, behaviour control, strategic control, creation and maintenance of cooperation networks, consulting role, and the role of strategic management.

Recently one of the mostly examined and scientifically discussed research models for activities of the board is the one created by Zahra and Pearce (1989). The model distin-

guishes itself for integrating several different perspectives of corporate governance – agency theory, resource dependency theory, and legal approach (Fig. 3).

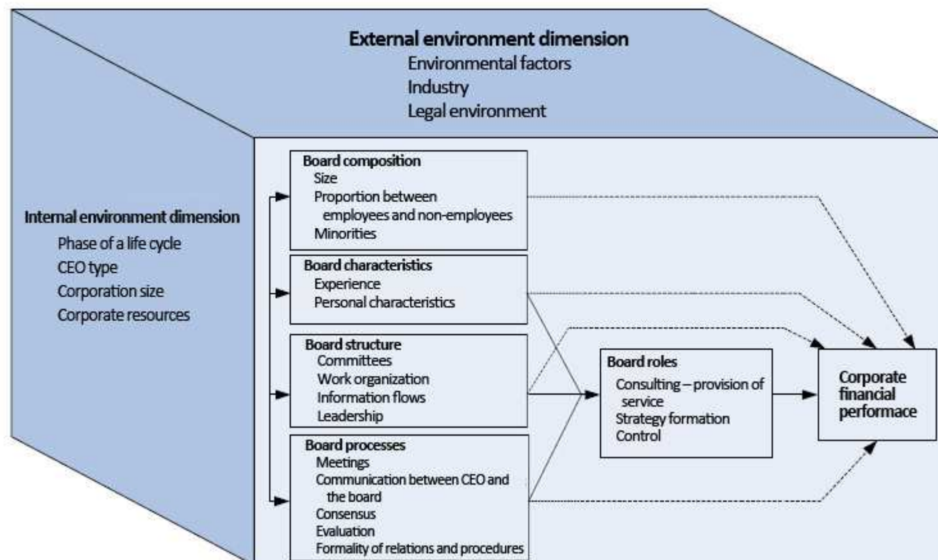


Fig. 3. Model for examination of the board of directors performance
Source: Zahra, Pearce 1989.

The model holds value due to several reasons: first, the qualities and performance of the board are examined from the perspective of various factors of internal and external environment. Second, the model made a distinction between the characteristics and roles of the board and the performance of the corporation, and, singled out their elements. Third, the model enabled the evaluation of the performance from the multidimensional perspective.

Corporate governance codes and empirical studies

Many countries around the world chose the preparation of Corporate Governance Codes as a way to solve corporate governance problems in their corporations. During the last 15 years Corporate governance codes have been prepared more than in 40 European countries. Today the codes are used by more than 60 countries around the world. As Jean-Nicolas Caprasse, the head of Deminor Rating agency performing different corporate governance research stated, "companies try to emphasise the transparency of their activities; this is seen from the increased number of corporate codes in Europe from 44% in 2002 till 74% in 2003. The same trend is noticed in the disclosure of mission of a corporation, when 77% of the investigated companies disclosed it in 2003, while it was only 53% in 2002".

The codes appeared to have had a direct impact not only on corporate governance, but also the market value of a corporation. The research performed on the opinion of Deminor, McKinsey and other investors (2002, 2004) showed that the majority of investors shall pay a bonus for corporations distinguished by a good corporate governance. The McKinsey research revealed that such an added value of premium amounts to 12–14% in North Amer-

ica, 20–25% in Western European countries, and more that 30% in Eastern European and African countries of the value of a company. Even 15% of investors from Western European institutions give priority not to such financial results as profits or growth potential, but to the factor of corporate governance quality. At present the best known documents in Europe and all over the world are OECD Principles of Corporate Governance (2004), Statement on Global Corporate Governance Principles of the International Corporate Governance Network (2005), and Euro-shareholders Corporate Governance Guidelines (2000). Organisations that on a constant basis perform research about corporate boards are Norwegian School of Management and a consulting company „Heidrich and Struggles" (2007) annually performing corporate governance research together with Marshall School of Business of the University of California (USA). Table 2 presents the overview of corporate governance principles, functions and characteristics of the board which are examined in order to evaluate the quality and effectiveness of the board as they are suggested by Lithuanian and other international organisations.

Table 2. Functions and characteristics of the board

Functions and characteristics of the board	Corporate governance code of Lithuania	ICGN	OECD	Euro-share-holders	Norwegian School of Management	Heidrich & Struggles
Board structure	X	X	X	X	X	X
Board elections	X	X	X	X	X	X
Independency of the board members	X	X	X	X	X	X
Functions and committees of the board	X	X	X	X	X	X
Competence, knowledge and experience of the board members	X	X			X	X
Ethics and management philosophy of the boards	X	X	X		X	X
Board decisions	X	X			X	X
Role of the board in strategic management	X	X	X	X	X	X
Board and risk management	X	X		X	X	
Relations of the board with CEO	X	X	X		X	
Relations of the board with shareholders	X	X	X	X		
Relations of the board with internal and external auditors	X	X	X		X	
The board and its financial policy		X	X	X	X	
The board and its HR policy	X	X		X	X	
Motivation and incentives of the board	X	X	X	X	X	X
Spread of information about the board and the company		X	X			
Evaluation of the board and its members	X				X	X

Source: Table prepared by Asta Aleliūnaitė.

As is seen from the summary table, most often examined characteristics of the board are:

1. Structure and elections of the board;
2. Independency of the board members;
3. Committees of the board;
4. Knowledge, skills, experience and time availability of the board members;
5. Ethics, philosophy and management style of the board.

Regulation of corporate governance in Lithuania

Foreign practice shows that in case of a large number of big corporations, a one-level corporate governance system, composed of the chief executive officer (CEO), the shareholders' meeting and the board, is possible. In the model presented by International Institute of Internal Auditors (Fig. 4) the bodies of corporate governance system are the CEO, the board of directors, and committees accountable to the board – Audit Committee, Nomination Committee, and Remuneration Committee.

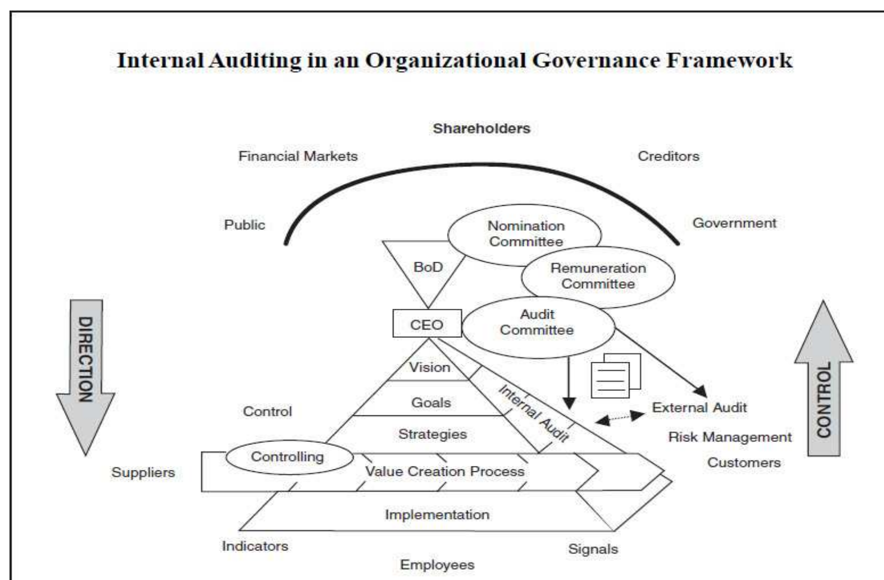


Fig. 4. Corporate governance system
Source: Ruud (2003).

In the case of large global corporations the dual system of governance is more often, when the corporation has not only CEO, the board of directors, shareholder meeting, but also the Steering board.

The present Lithuanian legal basis builds conditions for the existence of companies having as one-tier as two-tier corporate governance system. One of the main legal acts regulating the establishment, management, activity, reorganisation, restructuring, division, merger, liquidation of a company, rights and obligations of its shareholders, also the establishment of branches of foreign companies is the Law on Companies of the Republic of Lithuania.

Article 19 of the law defines two mandatory bodies that each company must have – The General Meeting of Shareholders and a single-person management body – the director of the company. Based on the law, a collegial supervisory body – the Supervisory Board, and a collegial management organ – the Board *may* be formed in the company, which means that they are not mandatory bodies.

Legal regulation in Lithuania enables the establishment and activity of stock companies the shareholder of which is one person, the written orders of whom are of the same legal power as the decisions made by the General Meeting of Shareholders. The exclusive right to select and depose members of the board of Lithuanian companies is granted to the General Meeting of Shareholders. In cases when all the stock of the company is owned by one legal or physical person, the board is selected and deposed based on the written order of the sole shareholder.

By 2008 neither the Law on Companies, nor other Lithuanian legal acts regulated what committees shall or may be established in a company. The audit, nomination, and selection committees were not mandatory at that time. However, in 2008 based on the changes in Lithuanian Law on Audit (2008, No. 82-3233) and decision No. 1K-18 made on 12 August 2008 by the head of Lithuanian Securities Commission, public interest companies (including but not limited to listed companies of Lithuania), have an obligation to establish an Audit committee.

The Civil Code of the Republic of Lithuania defines that "each legal person must have a single-person or a collegial managing body and the general meeting of members, where incorporation documents and laws regulating the activities of a legal person fail to provide a different structure of managing bodies. Laws regulating individual juridical forms of legal persons may establish that an managing body and the general meeting of members may be considered to be the same body of a legal person" (2.82).

Analysis of legal acts revealed that none of them obliges nor prohibits a Lithuanian stock company in addition to the general meeting of shareholders and the chief executive officer to have additional management bodies, special committees or functions, for example, function of internal audit.

Based on the Civil Code of Lithuania, members of *management* bodies of a legal person in Lithuania can be only physical persons, while other bodies may have as physical, as legal personas as their members (2.81). Despite this, recently it is often discussed that not only physical but also legal persons shall be allowed to be selected as the chief executive officer. According to the Civil Code, in Lithuania disclosure of information about members of the management bodies in the Centre of Registers (name, surname, personal code, address of residence) is required (2.66.1).

Following the examples of good practice of older European Union countries and experience in implementing the requirements of their Corporate Governance codes, similar documents were prepared in Lithuania. In 2004 the board of Vilnius Securities Exchange aiming

to improve the governance of stock companies and to disseminate the best practice of corporate governance among the listed companies, approved the *Corporate Governance Code of Listed Companies of Lithuania*. Later on the code was amended and on 21 August 2006 a new edition of it was endorsed. Finally, on 23 January 2007 in the meeting of the board of Vilnius Securities Exchange the Form of Disclosure of how companies followed the principles of Corporate Governance Code was approved. It was for the financial statements of the financial year of 2006 that this form was applied for the first time by Lithuanian listed companies.

It is important to mention that despite the fact that the principles and rules of the Corporate Governance code are of the nature of recommendation, all Lithuanian listed companies are obliged to present the report on how they observed the recommendations of the Corporate Governance Code together with their annual financial reports. In case of a company not complying with some of the recommendations, it has to provide the reasons for that; the principle “comply or explain” is to be followed.

Empirical study of corporate governance of Lithuanian listed companies

The goal of the study – based on financial reports of Lithuanian listed companies that are publicly available on their web sites to find out the prevailing model of a corporate governance system, the main characteristics of the collegial management body – the board of directors, and to evaluate the problem of availability and thoroughness of information about the governance of listed companies in Lithuania.

Objectives of the study

1. To define what models in 2006 and 2010 and compositions of the collegial management bodies (the boards of directors) and collegial supervision bodies (the supervisory boards) were prevailing of Lithuanian listed companies.
2. To examine the number of chief executive officers who held a position of a chairman of the board.
3. To find out and evaluate thoroughness of publicly available information about competence and education of the members of the boards of these companies.
4. To define the number of companies that have at least one member in their board of directors having a degree in the area of finance, banking, accounting and (or) audit.
5. To investigate how Lithuanian listed companies in 2006 and 2010 followed the recommendations of Lithuanian Corporate Governance Code and to evaluate the level of informativeness of the reports on the subject of the board of directors.

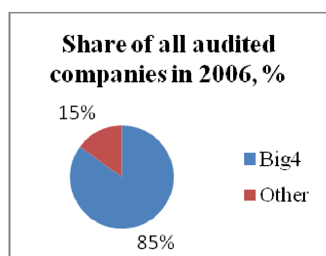
The scope of the research – 46 companies in 2006 and 45 companies in 2010. During the research content analysis of the following documents was performed:

– Audit Conclusions of financial reports of 2006 and 2010,

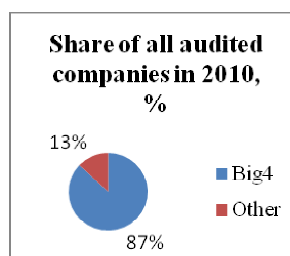
– Annual Reports of 2006 and 2010 and their annexes “Report on compliance with Corporate Governance Code of Lithuanian Listed Companies”.

RESULTS OF THE EMPIRICAL RESEARCH

The empirical research showed that the audit of financial reports of 46 companies in 2006 was performed by 10 different audit companies, while in 2010 the list of audit companies had decreased to 8. It is interesting to observe that the Big4 companies in Lithuania (UAB “PricewaterhouseCoopers”, UAB “Ernst & Young”, UAB “KPMG Baltics” and UAB “Deloitte Lietuva”) in 2006 performed the audits of 85 per cent of all Lithuanian listed companies; meanwhile in 2010 the share had increased to 87 per cent. Auditing of the remaining companies in 2006 was performed by other 6 different audit companies UAB “Auditorių biuras” – 2; UAB “IDG auditoriai” – 1; UAB “Moore Stephens Vilnius” – 1; UAB “Auditas” – 1; UAB “Revizorius” – 1; UAB “Tezaurus auditas” – 1; and in the year of 2010 – 4 audit companies: UAB “Rimess” – 2; UAB “Nepriklausomas auditas” – 2; UAB “Auditorių biuras” – 1; UAB “Revizorius” – 1.



Source: Prepared by Asta Aleliūnaitė.



Source: Prepared by Asta Aleliūnaitė.

The analysis of structure and composition of the management bodies of 46 companies in 2006 revealed that:

– all 46 companies had the General Meeting of Shareholders, collegial management body (the board of directors) and a chief executive officer (CEO);

– though a two-level corporate governance system (composed of the oversight and management collegial bodies) in Lithuania is possible as defined by the law, only 21 companies, which is less than half (46%) of the researched companies, had a supervisory board;

– the boards of 5 companies (11%) had audit committees;

– 1 company (2%) had a common audit-selection committee;

– remuneration committees were formed only in 2 (4%) of the companies;

– in 14 companies (30%) the chairman of the board was also the chief executive officer of the company;

– 314 persons (including CEO, a steering board members, and the members of the board of directors, but not including the General Meeting of Shareholders) participated in the governance of these 46 companies;

– the number of persons in steering boards fluctuated from 3 to 9;

– the tenure period in a steering board fluctuated from 1 to 4 years (usually it was 4 years);

– the number of persons in the boards of directors fluctuated from 2 to 10;

– the tenure period in the board of directors fluctuated from 2 to 5 years (usually it was 4 years).

Based on the same criteria the analysis of the structure and composition of 45 companies in the year 2010 was performed and it was found out that:

– all 45 companies had the General Meeting of Shareholders, the board of directors and CEO;

– a Steering board was found in 19 companies, which is less than half (42%) of the companies in the research scope;

– even though since 2008 listed companies in Lithuania are obliged to have an Audit committee, the results of the research revealed that only 32 companies (71%) had them. It is also important to notice that there is no unique practice concerning the members of audit committees: in some companies these were selected by a Steering board, in others – made by dependent members of the board of directors and independent external specialists;

– as in 2006, a Selection Committee was not found in any of the companies;

– a separate remuneration committee was formed only in one company, while 3 companies had a common Selection-Remuneration committees;

– in 13 companies (29%) the chairman of the board of directors was also CEO. Additionally it was defined that in 2010 there were 20 companies, where CEO was not a chairman, but a member of the board of directors;

– the number of persons (including CEO, a steering board members, and the members of the board of directors, but not including the General Meeting of Shareholders) participating in the governance of 45 companies was 386, or increased by 20% in comparison to the year of 2006;

– the number of persons in steering boards fluctuated from 3 to 7 (the maximum number decreased);

– the tenure period in a steering board fluctuated from 2 to 4 years (the minimum tenure increased);

– the number of persons in the boards of directors fluctuated from 3 to 9;

– the tenure period in the board of directors fluctuated from 2 to 4 years (usually it was 4 years).

The results of examination of the **composition of the boards of directors** showed that on 31 December 2006:

– 205 persons were the members of 46 listed companies in Lithuania;

– some of these 205 were members of the boards of directors of more than one listed company in 2006;

– there were 30 women and 175 men in the boards. Women made up 15%, and men – 85% of all the members on the boards.

On 31 December 2010:

– 253 persons were the members of 45 listed companies in the scope of research;

– 31 of these were members of the boards of directors of more than one listed company;

– there were 48 women and 205 men in the boards. Women made up 19%, and men – 81% of all the members on the boards.

The examination of information about **education of the members of the boards** disclosed that in 2006 only 2 companies in their annual reports declared full information about the education of their boards members (science institution and degree gained). Only 10 companies (22%) had a member or several in the board with education in finance, banking, accounting and (or) audit.

Based on the situation as on 31 December 2010, 19 companies (42%) in their annual reports disclosed information about education of their board members, whereas full information on the subject was disclosed by 11 companies (24%). 13 companies (29%) had at least one member on the board with a degree in finance, banking, accounting and (or) audit.

The fact of the occupation of the members of the boards in managing an extremely large number of companies was determined. In 2006 among those 205 who were the members of the 46 companies investigated:

– 42 (20%) members participated in the management of 5 or more companies, including not listed ones, and (or) owned more than 25% of capital of different companies.

– 30 (15%) persons participated in management of 7 and (or) owned more than 25% of capital of different companies, including not listed ones;

– there were 7 persons who participated in the governance of 15 or more companies.

To compare, in 2010 out of those 253, who were on the boards of 45 companies in the research scope:

– 20 (11%) persons participated management of 5 or more companies (including not listed ones) and (or) owned more than 25% of the share capital;

– 17 (7%) persons participated in management of 7 and (or) owned more than 25% of capital of different companies, including not listed ones;

– 4 persons participated in the governance of 15 or more companies.

To summarise, it is necessary to highlight that Lithuanian listed companies do not pay sufficient attention to full disclosure about the corporate governance in the reports about how they complied with the recommendations of Lithuanian Corporate Governance Code. Half of the investigated companies did not follow the obligation endorsed by the law starting from 2008 to form an audit committee in the company.

Table 3. Summary of findings

Specification	2006	2010
The number of companies in the research scope	46	45
Including:		
Companies, having a steering board	21	19
Companies, having the board of directors	46	45
Companies, having a separate Audit Committee	5	32
Companies, having a separate Remuneration Committee	2	0
Companies, having a separate Selection Committee	0	0
Number of persons, being members of the governance bodies	314	386
Number of persons, being members of the board of directors	205	253
Share of women, being members of the board of directors	15	18
No. of companies, where CEO is also a chairman of the board of directors	14	13
No. of companies that disclosed information about at least one member of the board of directors having an education in economics, finance, or audit	10	13

Source: Table prepared by Asta Aleliūnaitė.

In addition, the results showed an obvious problem of dualism, when chairman (member) of the board is also a chief executive officer of the company, which means that the chairman of the board was involved not only in strategic management, but also production and operational management.

In the opinion of the authors of this article, a positive trend is the number of persons participating in the governance of the investigated companies which increased by 20%, the share of women in the boards grew as well.

Analysis of the reports on how the companies in 2006 and 2010 complied with the recommendations of Lithuanian Corporate Governance Code, revealed that:

– The comments of the majority of companies, in case they did not comply with some recommendation, are redundant and usually not concrete and informative.

– Companies, the boards of directors of which have no audit, remuneration and (or) selection committees, indicated that questions which shall be solved in these committees are being solved by the Steering board, the board of directors and CEO.

– Article 3 of Lithuanian Corporate Governance Code recommends that in case a company chooses to form only one collegial body, it is recommended that this shall be the Steering board. In such a case the Steering board is responsible for the effective oversight of functions performed by the chief executive officer. However, the empirical study disclosed that in cases when only one collegial body is created, this is not a Steering board, but the board of directors.

– It is defined in the Corporate Governance Code that the remuneration committee shall evaluate the structure, size, composition and performance of the steering and management bodies, provide recommendations to collegial body on how to seek the necessary changes, regularly evaluate the skills, knowledge and experience of each member of the board of directors, and to inform the collegial body about this. It means that if there is no Selection committee, the Steering board performs the evaluation of itself, the board of directors and CEO, and if there is not Steering board in the company, this function shall be performed by

the General Meeting of Shareholders, CEO or the board of directors. It follows that the board of directors shall evaluate its own structure, size and competences. However, the analysis of annual reports revealed that very few companies indicated that the board of directors evaluates its own performance on a periodical basis. There is no information about how this evaluation is performed and what criteria and results of such evaluations are.

– In the reports of 2006 and 2010 none of the companies disclosed that they applied the practice of evaluation and disclosure of the independence of the members of their boards of directors. Also, none of the companies officially disclosed the Remuneration report, even though it is recommended in the Corporate Governance Code.

CONCLUSIONS

The empirical study disclosed that US, British, Australian and Norwegian scientists and such international organisations as International Institute of Internal Auditors, European Corporate Governance Institute, Organisation of Economic Cooperation and Development, International Federation of Accountants, and the World Bank had the greatest contribution in creating and development theories of corporate governance as well as performing corporate governance empirical studies. Meanwhile in Lithuania there were no sound scientific empirical studies on corporate governance or audit of corporate governance performed. The analysis of scientific literature and practical studies showed that Lithuania did not participate in research implemented by international organisations, though information about the neighbouring countries (Latvia, Estonia, Poland) is present. This testifies to low activity of Lithuanian scientists and practitioners in sharing information with international partners, low interest in legal standardisation of corporate governance audit of public listed companies on a national level.

Content analysis of Lithuanian legal acts revealed that the evaluation of the compliance with Corporate Governance Code performed by Lithuanian companies does not guarantee that the principles of a recommendable nature will be followed in the corporate governance for certain. Content analysis of the annexes of annual reports prepared Lithuanian companies disclosed that in case a company does not comply with recommendation of Corporate Governance Code, it is sufficient to indicate the reasons for non-compliance. In addition, the reasons that are indicated are often too abstract and do not allow the formation of a clear opinion about the governance of a company and its internal control mechanisms in action.

The empirical study, the goal of which was to find out the corporate governance peculiarities and main characteristics of their boards of directors, enables the claim that a one-level governance model prevails in Lithuanian listed companies. The fact that a very large number of their chief executive officers also hold the positions of members or even chairmen of the boards implies that the problem of dualism is highly relevant in Lithuania, and may have serious consequences if not solved in time.

The examination of characteristics of the boards of directors of Lithuanian listed companies exposed that the board of directors in 2006, as in 2010, was the main body of strategic

management. All the companies in the scope of this research had boards of directors. Study results, having shown that audit committee, selection committee, or remuneration committee is very rare in Lithuanian companies, mean that the functions of these committees are performed by the board of directors itself, therefore, CEO and the board hold the full responsibility for the quality of corporate governance, corporate performance results, and satisfaction and meeting the expectations of shareholders and other stakeholders.

An obvious shortage of the board members' competence and education in audit, accounting and finance as well as the problem of non-compliance with independent criterion in many of the boards mean the existing risk of poor Lithuanian listed companies' corporate governance in the period of 2006–2010. The members of the boards shall actively participate in raising their qualifications in accounting, finance and audit, attending special training. It is advisable to amend legislation enforcing the Lithuanian listed companies on a periodical basis as well as each time there is a change in the composition of the boards, to provide information to Lithuanian Bank that would approve the new composition of the board only under the condition the board has at least one member with an education and (or) significant experience in audit and accounting.

Watching the trends of globalisation and mergers and growth of Lithuanian companies, the suggestion to simplify the present corporate Governance Code would be premature. Therefore, it is possible to recommend the application of special corporate governance internal audit methods allowing the examination of the real situation of corporate governance and enabling more full and reliable disclosure of it in the reports on compliance with Corporate Governance Code. The companies shall conceive that corporate governance recommendations – are not the bureaucratic burden, but help for companies trying to make their governance more effective and to gain more trust of stakeholders in the quality of management and governance.

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