ResearchLEAP

Journal of International Business Research and Marketing
Volume 1, Issue 6, September 2016
journal homepage: www.researchleap.com

Corporate Governance and Development: The case of Uzbekistan

[1]Rasulov Nodir Madrahimovich, [2]Amonboyev Mukhammadsidik

[1] *Tashkent State University of Economic, O'zbekistan street, 49, Tashkent, Uzbekistan, 100003*
[2] *University of Las Palmas de Gran Canaria, Calle Juan de Quesada, 35001 Las Palmas de Gran Canaria, Las Palmas, Spain*

ABSTRACT

DOI: 10.18775/jibrm.1849-8558.2015.16.3005
URL: http://dx.doi.org/10.18775/jibrm.1849-8558.2015.16.3005

Keywords:
Corporate Governance
Corporate governance principles
Legislation of corporate governance
Uzbekistan

This paper discusses the concept of corporate governance and its application as well as its development in the case of Uzbekistan. The paper briefly focuses on the history of the corporate governance and provides different approaches, which were used to explain the underlying concept of corporate governance. This review of main definitions is followed by necessary regulations adopted for improving the practice of corporate governance in Uzbekistan. The paper also mentions important steps taken in order to develop corporate government principles. Moreover, the legislation of corporate governance is also thoroughly discussed through the paper. Finally, the paper discusses the application of corporate governance principles of developed countries including Germany, USA and UK.

I. Introduction

Corporate Governance historical overview

Corporate Governance is known as a system which is used to control and direct the company. Calder (2008) described corporate governance term as being "holy trinity" which includes the rights of shareholders, transparency, and accountability of board of directors. The evolution of the corporate governance can be traced back to the period of the collapse of Roman Empire. Precisely, after the downfall of the Roman Empire, the entrepreneurial activities of the Church members and baronial robbers noticeable improved at a higher level compared to business people. It was reported that the nature of business activities carried out at that period was simple, and there was a separation between the Church and its members. This can be explained by the fact of long existence and presence of the church through the period of wealth development; therefore, churches are considered to be the ancestor of today's modern corporations (Calder, 2008).

Corporate governance is defined

There are many definitions which explain the concept of corporate governance. The definitions of corporate governance can be explained by dividing them into two main categories. The first category of corporate governance definition is mainly related to a group of behavioral patterns (Siebens, 2002). Particularly, it is related to the actual behavior of corporations, interactions between corporations and members of stakeholders. Another category of corporate governance definition is particularly concerned with the legal framework. To be more precise, it is more about normative framework according to which firms are operating. It can be stated that first category of the definition related to corporate governance is more applicable for the cases of studying the firms or group of firms that operate within a specific country. Therefore, the first category of definition deals with the structure of the board of directors, the responsibilities of stakeholders, the link between employees and firm performance. The definition of corporate governance from a broader perspective reveals that it is regarded as the set of mechanisms which separated the ownership from the management (Claessens, 2006). Therefore, the corporate governance represents the system through which companies and firms can be controlled and directed. Based on the definition of corporate governance it can be stated that objective of the good corporate governance is to maximize the contribution of the company to the whole economy, particularly to all stakeholders. That is to say, the concept of corporate governance can be described in terms of the relationship between firm stakeholders, precisely creditors, and company or shareholders and corporations.

The review of the relevant literature shows that importance of corporate governance can become even more crucial when there is a separation of ownership and management in today's modern corporations. Precisely, the interests of managers are expected to contradict with the interests of shareholders. Therefore, due to the difference in the interest of company's stakeholders, most of the corporations are facing the principal-agent problem, which can be observed in the management, and direction related issues of the company. Therefore, there is no single definition which can be applicable for the understanding the underlying definition of corporate governance from different perspectives. According to La Porta (2000), corporate governance directly impacts on the decision-making process of top-level managers. In accordance with Shleifer (1999), corporate governance is the system that helps finance corporations to ensure the safety of their return on investment. The description provided by Pei (2004) mentioned that corporate governance is the system, which controls and directs the corporation. Precisely, corporate governance stipulates main rights, duties and responsibilities of the stockholders and board of directors and assists them in terms of decision-making.

Why is corporate governance important?

Recently, the importance of corporate governance has increased. Precisely, the critical aspects of the corporate governance are believed to have a positive impact on economic development of the countries. One of the reasons that have triggered the increase of the importance of corporate governance is the privatization. Nowadays, most firms are turning to the public sector in order to obtain capital, and most of the partnerships are converting their type of business ownership to corporations. The second prominent reason which explains the development and critical importance of the corporate can be related to the technological progress. This can be explained in more detail by liberalization and openness of more and more countries to international trade (Siebens, 2002). As a result, allocations of resources have become quite common and difficult to control which lead to the formulation of the corporate governance. The last but not least, the increasing popularity of corporate governance can be explained in relation to the increasing importance of financial intermediaries, which were formulated due to the mobilization of capital from the principal owner (Shleifer, 1999). Moreover, the critical review of the literature led to the identification of various channels that can influence the growth and development of the corporate governance (Claessens, 2006; Calder, 2008; Onuorah, 2016). Firstly, the increasing access and availability of the options for the external financing by firms results in greater investment and growth. Also, it can lead to the creation of more employment opportunities. Secondly, lower cost of capital and high valuation of the firms is considered as a next important aspect which can be explained as a result of increasing popularity of corporate governance. Improved conditions for operational performance, which leads to better resource allocation and lead to creation of more wealth. The good practice of corporate governance is believed to reduce the risk of the financial crisis that is considered important for economic growth of the country.

The contribution of corporate governance towards economic growth of the country

Nowadays, a number of large corporations are continuously dominating the economic activities not only at the local level but also in global level as well. In this regard, the corporate governance systems used within these corporations are also different from each other. In this respect, it is worth to mention that corporate governance is reported to have an impact on economic growth of the country. Considering the case of banks, which play a significant role in the economy of each country, it can be stated that their strength and continuous stability are the most important points, which result in the matter of general public interest.

Therefore, the practices of effective corporate governance system are found to be closely related to the increasing level of public trust and confidence in the banking system. This, in turn, is considered as the critical elements, which ensure the proper functioning of the banking and economy as a whole. Otherwise, bank failures are likely to increase due to the poor functioning of the banks (Ibrahim et al., 2006)

Nowadays, most of the researchers are interested in studying the phenomenon of corporate governance (Dabor, et al., 2009; Siebens, 2002). The importance of corporate governance can be observed in the social and economic development of the countryMoreover, the topic of corporate governance has been widely discussed among the researchers of highly industrialized and developed countries (Abdul Rahman, et al., 2005; Claessens, 2006). However, the state of corporate governance is not studied in a sufficient manner especially in developing countries such as in Uzbekistan.

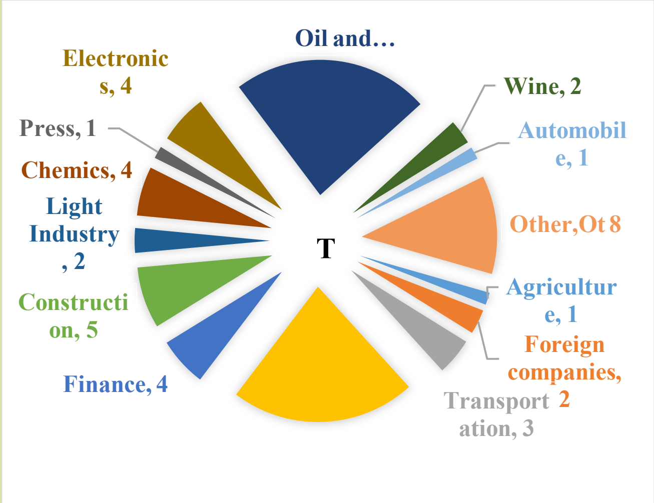
Nowadays, most of the manufacturing organizations are formulated based on the principles of corporate governance. In order to improve the efficiency of joint-stock company operations and to create favorable conditions for investment environment, a number of new regulations have been adopted. For example, Decree by the President of the Republic of Uzbekistan in 2015, April 24 is focused on the measures to improve the modern corporate governance application principles for the operations of joint stock companies.Some of the outlined points are following:

- To learn the international practices of companies operating based on the principles of corporate governance
- To establish joint-stock companies based on foreign direct investment and to improve the conditions of operations in order to attract the attention of investors
- To implement strategic management of joint stock companies, to establish effective monitoring system for the personnel of the corporation
- To educate young specialists on effective measures of strategic management in close cooperation with leading international universities.

The creation of favorable conditions for investment and increasing focus on attraction of foreign direct investment in Uzbekistan is considered as one of the crucial issues that are continuously discussed and supported in government level. Therefore, it is important to consider a number of regulations adopted by the Uzbek government in order to have a close look at the implications of the adopted regulations.

Corporate Governance In Uzbekistan

Following the Decree, shares of governmental organizations have been transformed to the shares of private organizations. Precisely, shares of 1856 companies were privatizied and 68 out of 1856 were offered for foreign investors.



Source: Ggk.uz (2016) (information on privatization)

Based on the pie chart above, we can conclude that food, oil and gas industry constitute the largest share offered for foreign investors. Moreover, foreign investors have been offered some preferences and incentives; exempt from paying dividend and profit taxes, which creates favorable condition for their businesses.

The process of introduction and implementation of corporate governance principle in Uzbekistan can be studied by dividing them into seven steps that are critically important in order to understand the uniqueness and peculiarities of the each phase of development.

Table 1: The steps of corporate governance development practice in the case of Uzbekistan

Steps	Period	Symptoms	Concept	Result
1	1990-1992	Formulation of property relations	Formulation of legal aspects of property relations	Research has begun to understand the underlying assumptions of corporate governance
2	1993-1997	Reforming property relations	Evolution of the first joint stock companies	"Adoption of law on measures of protection of legal rights of joint stock companies
3	1998-2002	Reforming of corporate governance relations	Complete execution of corporate governancereforms in Uzbekistan	Application of corporate governance principles to joint stock companies. Establishment of stock exchanges
4	2003-2007	The improvement of Corporate Governance System	Evolution of different approaches towards corporate governance. The importance of corporate governance has maintained due to the increase in the class of property owners	The operations of joint stock companies has significantly expanded
5	2008-2010	To apply the principles of international corporate governance characteristics	The establishment of system which provides incentives for local and foreign investors	The impact of world financial crisis was eliminated, which increased the attractiveness of investment environment
6	2011-2014	To create healthy competition and to eliminate the means of property owners	Corporate governance with government shares have developed their infrastructure	To ensure the security of investors capital
7	2015	To establish ways of Improving conditions for corporate governance	Codex of Corporate Governance is executed	To learn the corporate governance principles of foreign companies

2. The state of the corporate legislation in Uzbekistan

The history of the formation of corporate governance in Uzbekistan can be traced back to the number of legislations. One of the first two laws on this matter is the Law on Joint-Stock Companies and the Las on Protection of Shareholders Rights (adopted 1996, revised in2014). These laws state official steps need to be taken for establishing corporations, identify the principles of management and operations of companies and the principles of communication between executive bodies and stakeholders. They also outline the principal rights of shareholders, determine securities market players and provide measures for the protection of the rights of businesses and investors, therefore, formulates the legal structure for corporate governance in Uzbekistan.

The core principles of corporate governance in Uzbekistan are stated in the Law on Joint-Stock Companies and Protection of Shareholder rights (2003). This legislation sets the specific principles by taking specificity of a nation, governance and control into account. The adoption of this legislation leads to a positive development of market relations in Uzbekistan. Precisely, this legislation strongly stipulated the specific cases of joint stock company operations, their reorganization, liquidation, governance of the company and its activities, securities of joint stock, profit and dividend distribution. Some amendments have been introduced into the following legislation in 2014 (Ashurov, 1994).

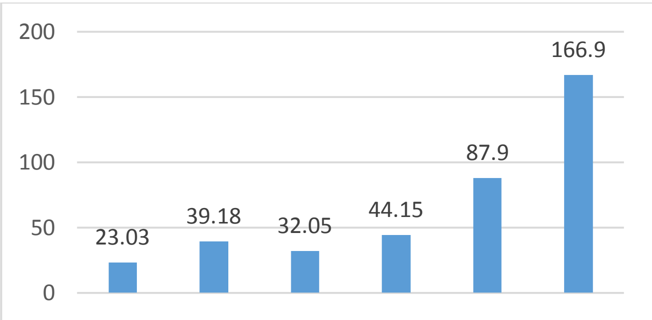
The uniqueness of operations of corporate governance can be characterized by the role of different stakeholders involved in the process, which include the following mentioned in table:

Table 2: The responsibilities and benefits of corporate governance participants

Participant groups in corporate governance	Responsibilities	Benefits
Shareholders	Considered as company investors	Benefits when there is a need to sell or buy dividends
Hired managers	Accomplishes all necessary functions of management	Benefits from the high status given within their responsibilities
Company personnel	Responsible for production	Benefits from the high status given within their responsibilities
Governance bodies	Establishes legal framework of corporate governance operations	Benefits from the stability of the company, and its ability to create employment opportunities
Creditors	Participates in financing production	Benefits from the stability and after tax profits

Based on the table, it can be concluded that the participants of corporate governance are separated from each other and different in terms of their responsibilities and benefits they receive (Karimov, 2010). Most of the measures taken to improve the state of corporate governance will be useless if the necessary investment opportunities are not created. In order to improve the corporate governance effectiveness in Uzbekistan, the government is paying attention for the democratization of rules regarding the transition of state-owned stocks into the private sector.

The inflow of money acquired through selling government companies



Period 2011-2015

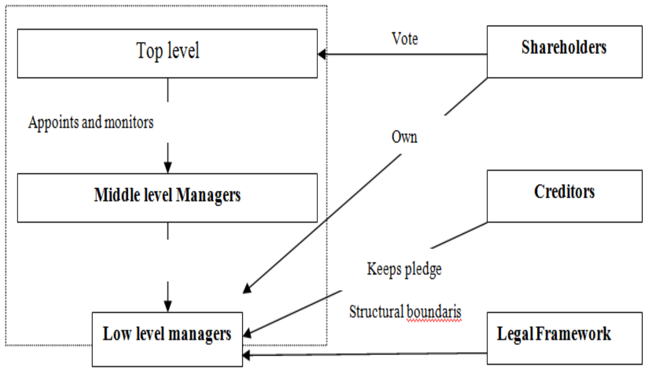
Source: Worldbank.org

As table shows, the companies owning government share have considerably benefited from the sale of state-owned stocks especially during 2015.

3. Discussion

The importance of applying corporate governance principles to the operations of companies

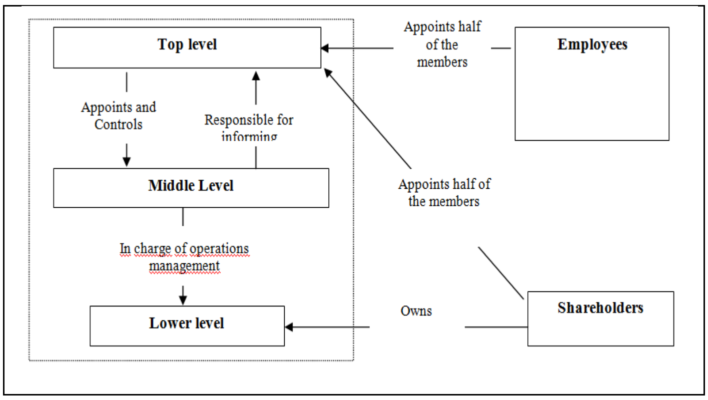
There are two theories which can be used to explain the corporate governance. The first theory is known as the shareholder theory. Shareholder theory states the role of the shareholder as the principal and the role of the manager as an agent, being similar to agency theory. The prosperity of the shareholder is the main goal of agency theory. Thus, agents are expected to perform in the best interests of the shareholder. In turn, shareholders control and direct the actions of the managers by introducing different rules and obligations that are relevant to the operations of the company (Radigan, 2008). The second theory underlying corporate governance is the stakeholder theory, which can be used to explain the relationship between corporate and stakeholders. Stakeholders consist of the group of people who can internally and externally influence on the operations of the company (Bank of International Settlements, 2006). However, governments are becoming increasingly concerned with the fostering the application of corporate governance principles into joint stock companies. Therefore, in order to foster the application of corporate governance principles into joint stock companies, the modern government practices should be carefully analyzed and implemented. In this regard, already developed companies with the strong expertise in corporate governance can be taken as a benchmark by considering our local economic conditions. The corporate sector of developed countries has already confirmed the process of convergence of current legislation and corporate governance forms. Global financial crisis in 2008 can be regarded as one of the important reasons leading to the process of worsening corporate governance principles in many countries. For example, one of the leading companies in the USA in the sphere of energetic "Enron" was bankrupted, and some executive members were judged as a result of preparing fake financial statements. This was the reason for the USA government to reconsider the regulations related to corporate governance. However, despite the bankruptcy of "Enron", later corporate governance principles of USA have become the strongest in all over the world. It is said that bankruptcy of "Enron" was the accelerator for reformulation corporate governance principles that can be observed from the diagram below.



American model of corporate governance

Source: N. M. (2015)

Social-economic model of the USA provides an opportunity to outside parties to be involved in regulating company activities to increase their private wealth.



German model of Corporate Governance

Source: N. M. (2015)

Corporate government principles of the USA (Business Roundtable system) and Germany (two-tier board system) are considered as two main international standards accepted all over the world. According to American regulations, Business Roundtables (Worldbank, 2016) regulate the activities of the company. The principal responsibility of the board of directors of a public corporation is to choose a chief executive officer and to supervise the CEO and senior management in day-to-day operations. The statistics for the latest years show that the number of executive directors is decreasing while the number of independent directors is increasing. The American system of corporate governance is directly related to the characteristics of American property system. This can be explained due to the absence of strong investors in corporate government.

In Germany, the activities of Supervisory board is carried out based on Aktiengesets- German Company Act (1965). In the case of companies with more than 2000 employees, employees are given right to elect half of the members of the Supervisory Board (One third participation Act, 2004).

As it is mentioned in German Company Act, only representatives of shareholders have a right to be part of Supervisory Board of stock corporations. However, there might be some changes based on the type of Stock Corporation. Act of Supervisory Board stipulates that shareholders and employees can act as a part of Supervisory Board. Compared to Germany, in Uzbekistan, there is no such limitation as only shareholders should be part of Supervisory Board. Moreover, employees in Uzbekistan are not given the right to be selected as a part of Supervisory Board.

Corporate Governance in the UK

Considering the perspective of UK, the economy of the country is largely dependent on the efficiency of the firm. Therefore, the implementation of one board allows the board members to run the company with the high degree of freedom. The Joint Stock Companies Act (1844) was adopted to stipulate the cooperation among different forms of companies. However, in 1855, new Limited Liability Act was adopted in order to formulate the rights of owners and company. Previously, the bankruptcy of the company was considered as the bankruptcy of the owner, which was the main motive to sign Limited Liability Act (OECD, 2004).

Corporate Governance in EU

Application of company management is not particular to the European Union, therefore, there are one or two board systems. The countries including France, Spain, Switzerland and Italy use one board system while countries including Germany, Sweden, Austria and Netherlands use two board systems. In this type of corporate governance, the function of the manager is considered to be separated from the function of supervisor. That is to say; supervisors are only responsible for giving advice for directors; however, they are not in charge of managing company (Barca, 2001). A strong set of criteria should be met by the members of the board while being selected. In the context of EU, employees are given a place on the board; however, they do not have a voting right.

Recommendations and Suggestions

This research has provided the analysis of key literature findings in the area of corporate governance and its development. Particularly, the key elements of corporate governance structure have been discussed using the case of mainly developed countries both in Europe, USA, and UK countries and relating them to the principles of developing countries such as Uzbekistan. In this regard, the number of steps that have been taken to develop the path of corporate governance principles has been discussed with the support of various regulations.

Limitations

However, the future research can extend the scope of the current research by focusing on available empirical evidence, which could not be found within this research. Therefore, lack of available and reliable data can be considered as one of the limitations of the current study.

In summary, we can observe the influence of globalization not only in the social and economic spheres but also in transforming the way of the property sector. Therefore, upcoming young generation should be educated based on the practices of modern international practices which will prepare them well enough to understand the ongoing issues. This, in turn, will contribute to maintaining the strong position of Uzbekistan among economically developed countries.

Reference

- Abdul Rahman, R., &Haniffa, R. M. (2005), “The Effect of Role Duality on Corporate Performance in Malaysia. Corporate Ownership and Control”, Vol. 2 No. 2 pp40-47.
- Asaul, A, Pavlov, V, Beskier, F, Mishko, O, (2006) Management and Corporate Governance, Journal of Corporate Governance, p. 86
- Ashurov, Z (1994). THE CORPORATE GOVERNANCE IN UZBEKISTAN: A
- Bank of International Settlements (BIS). 2006. Enhancing Corporate Governance for Banking Organisations. Basel: BIS.
- Barca, Fabrizio, and Marco Becht, eds. 2001. The Control of Corporate Europe. Oxford: Oxford University Press.
- Begmatov, A., Hamidulin, M (2007). Corporate governance. Journal of Corporate Governance, 224.
- Claessens, S., (2006). Corporate Governance and Development the World Bank Research Observer, Vol. 21, No. 1. pp. 91-122, CrossRef
- Core, J. E., Holthausen, R.W. and Larcker, D. F. (1999), "Corporate governance, chief executive officer compensation, and firm performance", Journal of Financial Economics, vol. 51, no. 3, pp. 371-406, CrossRef
- Dabor, E. L. and Adeyemi, S. B. (2009), "Corporate Governance and the Credibility of Financial Statement". Journal of Business Systems, Governance and Ethics. Vol. 4 No.1.
- Economics.uz (2016) Economics and innovative technologies, scientific online journal
- Gkk. Uz (2016) The state committee of the republic of Uzbekistan for privatization, demonopolization and development of competition.
- Ibrahim A., and Ali, B, (2006) Corporate Governance and Concentration in the Arab Banking Sector and Economic Growth: The Case of GCC Countries. Abu Dhabi, UAE

- Karimov, I., (2010), The Concept of the Further Deepening of the Democratic Reforms and the Formation of the Civil Society in the Country, Uzbekistan, Tashkent
- La Porta, R., Lopez-De-Silanes, F. and Shleifer, A. (2000), "Investor protection and corporate governance", Journal of Financial Economics, vol. 58, no. 1-2, pp. 3-27, CrossRef
- N. M (2011). Principles of formulating basis of corporate governance, Economics and Education 65-69
- N.M (2015) The practice of corporate governance in Uzbekistan, Business daily, p.3
- N.M (2015) The practice of corporate governance. National and International practice, Economic and innovative technologies, online journal,
- N.M (2015) The steps of corporate governance development practice in the case of Uzbekistan, Conference Proceedings, p 31-35
- OECD (2004), *OECD Principles of Corporate Governance*, OECD Publication Service, Paris.
- Onuorah, A (2016) Corporate Governance and Financial Reporting Quality in Selected Nigerian Company. International Journal of Management Science and Business Administration Volume 2, Issue 3,
- Pei Sai Fan (2004), “Review Of Literature & Empirical Research on Corporate Governance”, Financial Services Group Training Unit Monetary Authority Of Singapore.
- Radigin, A., Entov, R, Mejeraups, I (2008) Specialties of formulating national model of Corporate governance, p. 86
- Siebens, H., (2002) Concepts and Working Instruments for Corporate Governance
- Sodikov, Z (2013). The influence of modern technologies on economic development. Conference Proceedings: principles of Corporate Governance, Tashkent, Uzbekistan, 25-26.
- SPECIAL FOCUS ON THE BOARD’S SUPERVISORY ROLE COMPARED WITH GERMAN PRACTICE. *Corporate Board: Role, Duties & Composition / Volume 10, Issue 3, 2014*
- Suyunov, D, (2007). The mechanism of corporate governance: The problems and solutions, Journal of Corporate Governance.
- Tara, Sh., and Sadri, S (2015) Corporate Governance and Risk Management: An Indian Perspective. International Journal of Management Science and Business Administration Volume 2, Issue 3, 7 – 16
- Troschke, M. and Zeitler, A. (2006), Privatisation and corporate governance in Kazakhstan and Uzbekistan: insights from a corporate survey in food and light industries, Osteuropa-InstitutMünchen, Working Paper No.256
- Worldbank. Org (2016). Uzbekistan statistics