

CORPORATE GOVERNANCE IN FORESTRY

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Abstract:

Corporate governance is a key element in improving economic efficiency and growth, and in increasing investors' confidence. It provides a structure through which company objectives are set, the means for achieving the goals and methods of monitoring results. Corporate governance provides a framework for managing and monitoring companies. Subsequently, it can be said that corporate governance is one of the key elements in improving economic efficiency and market economy. The European model of corporate governance finds its application in the EU and all other countries which harmonize their legislation with EU directives regulating corporate governance and with the OECD recommendations relating to corporate governance. The issue of corporate governance in Croatia is imposed simultaneously with the privatization and institution building of market economy. As a result of privatization, there is a large number of small shareholders. Croatian Forests Ltd established a European (two stage) model of management and control functions on the principles of two-tier corporate governance structure where the functions of management and leadership are strictly separated and contained in the management and supervisory board. Earlier analysis of the management structure of the company Croatian Forests Ltd indicated the need for changes in certain segments of the action. This paper presents a study of corporate culture in the company Croatian Forests Ltd, and proposes changes in its organization.

Key words:

forest economics, corporate governance, organization, Croatian Forests Ltd.

1. Introduction and problem matter

Corporate governance affects legal, regulatory and institutional environment. Basic rules of corporate governance are defined by appropriate legislation, primarily of the Law of Trade Company¹ and Constitutional Court Decision² and other regulations governing capital markets, accounting and auditing issues. However, beside consistent application of regulations, international practice has shown the need for development of good corporate governance practices through adoption and implementation of codes of corporate governance. Considering these facts and the importance of responsible and ethical behavior of businesses subjects within the economy, and as recommended by the Organization for Economic Cooperation and Development (OECD)³, Croatian Agency for Supervision of Financial Services (HANFA)⁴ and Zagreb Stock Exchange, developed the Code of Corporate Governance in 2007. The Code aims to establish high standards of corporate governance and

¹ Official Gazette No. 111/93, 34/99, 121/99

² Official Gazette No. 118/03, 107 / 07, 146/08, 137/09

³ OECD-(Organisation for Economic Co-operation and Development): Principles of Corporate Governance. Paris: OECD, 2004. 65pp. ISBN 978-92-64-05597-1

⁴ HANFA-(Hrvatska agencija za nadzor financijskih usluga): Kodeks korporativnog upravljanja. Zagreb: Hanfa, 2007

transparency of business activities. Also, Croatian Government in 2010 made the Decision on the adoption of Code of Corporate Governance⁵. The Code aimed to upgrade corporate relations arising from existing legislation and internationally accepted principles and experiences on the best corporate governance practices. Objectives of the Code are to establish, maintain and further improve high standards of corporate governance and transparency responsible for the effective management of capital and jobs. Fundamental principles of the Code are legality, transparency, clearly defined procedures for supervisory board, management and other bodies and structures that make important decisions, prevent conflicts of interest, effective internal controls, strengthening personal responsibility and corporate social responsibility⁶.

OECD promotes the policy aimed at achieving sustainable economic growth and employment, and increasing living standards in member countries, ensuring financial stability and thus contributes to the development of world economy on a multilateral basis in accordance with international obligations⁷. OECD guidelines for corporate governance represent the criteria for policy makers, investors, corporations and other interested parties. It promotes a program of corporate governance and provides specific guidance for legislative and regulatory initiatives. The guidelines are an instrument that provides standards, guidelines and best practices for corporate governance. It is adaptable to specific legal, economic and cultural circumstances. Policy makers can use them while creating legal and regulatory framework for corporate governance that respects their own economic, social, legal and cultural circumstances. Good corporate governance is a significant factor in attracting investment as well as in investor protection⁸.

Corporate governance in a country has certain specific features or elements that set it apart from other countries, while some common principles can be detected^{9,10}. This method of management is determined by ownership structure and has some general characteristics, such as excessive state ownership, the instability of its structure, small influence of workers' participation¹¹. The differences such as historical heritage, legal and institutional framework, structure and functioning of financial markets influence the formation of different models of corporate governance, which determine the model of corporate governance. Two most popular models of corporate governance are:

- Anglo-Saxon (open, single-level) model
- European (closed, two-level, continental) model

Although they are both useful and in many ways similar, the models differ significantly in the organizational structure, management authority and decision-making procedures.

⁵ Official Gazette No. 112/10

⁶ Tipurić, D.: Nadzorni odbor i korporativno upravljanje. Zagreb: Sinergija, 2006. 365pp. ISBN: 953-6895-30-7

⁷ Račić, D., Cvijanović, V., Aralica, Z.: The Effects of the Corporate Governance System on Innovation Activities in Croatia. Vol.9 No.1-2. Zagreb: Revija za sociologiju, 2008. 101-114pp.

⁸ Veršić Marušić, M.: Zašto kodeks korporacijskog upravljanja?. Zagreb: Hrvatska pravna revija, 2004. 31-39pp.

⁹ Barbić, J., Čolaković, E., Parać, B., Vujić, V.: Korporativno upravljanje - osnove dobre prakse vođenja društva kapitala. Zagreb: Biblioteka Kaleidoskop, 2008. 608pp, ISBN: 978-953-98558-5-5

¹⁰ Tipurić, D.: Korporativno upravljanje. Zagreb: Sinergija, 2008. 420pp. ISBN 978-953-6895-36-6

¹¹ Čengić, D.: Problemi korporacijskog upravljanja u postprivatizacijskom razdoblju. Zagreb: Društvena istraživanja Zagreb, godina 7 broj. 6 (38), 1998. 767-792pp. ISBN 953-97410-1-7

2. Materials and methods

The issue of corporate governance in Croatia is imposed simultaneously with the privatization and institution building of market economy. As a result of privatization, there is a large number of small shareholders - both at the beginning of the 1990's, and in the coupon privatization in 1997. However, slow development of capital markets and a relatively bad position of small shareholders have had an impact on the shares neutralization and/or quick sales. Privatization has created conditions for restructuring of companies and consolidation of equity shares. Still, its course was marked by slowness and by significant inconsistencies and arbitrary decisions. Establishment of legal and institutional framework for corporate governance was also slow and insufficiently effective¹². The results of these conditions were frequent unregulated takeovers (usually through loans) and the dominance of concentrated ownership structures that were partly supervised by management and employees, and partly by the bigger shareholders. All of the above slowed the establishment and expansion of good practices of corporate governance, which was additionally influenced by the lack of knowledge, and only partial recognition of the importance of corporate governance by the business community and experts. This had a negative impact on corporate transparency and protection of shareholder rights and consequently on the interest of investors and capital market development. Since domestic companies mainly depend on bank loans for the long-term financing and very rarely on issuing of shares or bonds, capital market could not have had impact on their corporate governance. Privatized companies had kept concentrated ownership structure and were therefore in many cases beyond the reach of the capital market.

2.1. Research object

Dissemination of good practices of corporate governance implies recognition of the importance and usefulness of corporate governance by the business community. Law on commercial companies, regulations on capital market governing, law on accounting and auditing and other relevant laws include rules relevant for corporate governance. Croatian forests Ltd was established on January 1st 1991, as a public company for management of forests and forest lands in the Republic of Croatia, in Zagreb, 2002. Based on Law on Amendments to the Law on Forests¹³ and Decision of the Government from March 7th 2002, the former public company was transformed into the company Croatian Forests Ltd. The founder and sole shareholder is the Republic of Croatia. The company's equity is a fundamental interest, invested in things, which corresponds to the proportion of the business. The Republic of Croatia has assumed the underlying shares and the entry in the register became 100% owner. Governing bodies of the company are the Assembly, the Supervisory Board and the Management Board.

2.2. Methods

In research were applied scientific and research methods: descriptive method, normative method, deductive method, comparative method, the survey method and the analysis of the strategic plan method.

12 Račić, D., Cvijanović, V.: Stanje i perspektive korporativnog upravljanja u Republici Hrvatskoj: Primjer javnih trgovačkih društava. Vol. 4 No.1, Zagreb: Ekonomski fakultet, 2006. 205-216pp.

13 Official Gazette No. 13/2002

The work is based on the descriptive method, meaning that it begins with the general description of activities, estimation of the forest district office system and its impact on a company's organizational structure, explanation of rights and duties of everyone present in this interactive correlation, as well as with procedure description on how to act in order to achieve the best final results. To evaluate the current state of the forest district office structure it is necessary to use some aspects of normative methods, especially statistical data regarding the number and structure of employees, their qualifications, years of experience, level of education, way of functioning of the district system, as well as responsibilities and necessary work supplies of the forest district officer. Based on these data, it is possible to get a picture of the real situation in the forest district system in Croatian Forests Ltd. In order to obtain conclusions about the situation in forest district systems of the Croatian Forests organization deductive methods of comparison and analysis were used with the aim to show the research results in the observed period in relation to the size of the sample.

Survey method allows us to determine the possible strategic changes in the existing organizational structure with emphasis on the importance and significance of the district officer role, district structure of the forest offices and business culture in the overall structure of the organization. Research of characteristics of organizational culture included a survey of company employees with wide-ranging questions on management and operations of the Company. The questionnaire on employee attitudes was applied on 98 respondents – (49 forestry engineers and 49 district officers). Survey included their attitudes on organizational characteristics, management practices, decision making practices and priorities of the Company. It also included obstacles and advantages in governance and management, other indicators which indirectly indicate perception and level of organizational culture in the company. The aim of the survey is to obtain results which will through determining the characteristics of management practices and operations of the company enable better understanding of overall organization of the company, as well as of the forest district working model. The intention is also to emphasize the importance of organizational culture and highlight the need for its promotion and development as important advantages of the company.

3. Research results

Research shown in this paper was conducted on two samples or two observed groups – employees of Croatian Forests Ltd. Research of the forest district office system and the organizational culture in 2003 encompassed forest district officers and forest office managers, while the later survey on assessment of district system in 2004 encompassed forest managers and their deputies, Management Board members and heads of expert services in the Directorate or expert departments in Forest Administration.

3.1. The attitudes of employees

Respondents were asked to allocate 100 points among the listed options and thereby assess the organizational characteristics of the Company. Table 1 shows the results with the average number of points that allocated to particular characteristics.

Results show that the highest score on all three levels of the company (30.8 - 52.3 to 62.7), is assigned to setting of standards, hierarchy and bureaucratic ways of functioning. Respondents recognized them as main features of Croatian Forests Ltd. On the other hand, the lowest total score (forest district officers and managers together) at all three levels is assigned

to creativity, adaptability and innovation (16.9 to 13.3 - 9.7). Between forest district officers and forest managers there is a high degree of compliance in "highlighting the common values, goals and active participation" as the characteristics of companies (- 28.56, R - 27.03 at the Forest Office), and "enterprise and creativity "(U - 12.6, R - 6.62 on the company level). In other characteristics, the results among forest managers and district officers are divided.

Table 1: Properties that best describe Croatian Forests Ltd. (Average score for each property)

Properties		On the level of Forest Office	On the level of Forest Administr.	On the level of CF Ltd.
1. Emphasis on common values and goals, active participation, cohesion, family	U	28,56	14,49	10,9
	R	27,03	12,16	9,86
	x \square	27,82	13,36	10,39
2. Emphasis on rules, hierarchy, schematisation, birocratic way of functioning	U	22,4	42,31	55,77
	R	39,5	62,89	70
	x \square	30,8	52,33	62,7
3. Emphasis on dynamics, goal orientation, client orientation, efficiency orientation	U	27,3	26,79	20,64
	R	21,6	14,86	13,51
	x \square	24,6	20,99	17,17
4. Emphasis on entrepreneurship, creativity, flexibility, dedication to innovation and to task management	U	21,7	16,41	12,69
	R	11,8	10,08	6,62
	x \square	16,9	13,33	9,74
Total Forest Administration	\sum U	100	100	100
Total Forest District	\sum R	100	100	100

3.2. Analysis of factors that influence decision making and priority setting in the company

Respondents determine the main factors that influence decision making and priority setting in the company. For each listed factor they chose one out of five offered importance intensities. The results are displayed separately for each level of Company. Table 2 shows that on the level of forestry office there are no factors that stand out. Replies of forest district officers and managers are evenly distributed over all five grades of intensity and impact. For almost all of the factors most frequently assigned rating score is "3". In conclusion, the majority of respondents considered that these factors at the level of forestry office "neither influence, nor not influence" the decision-making and priorities.

Table 2: Appraisal of factors which have considerable influence on decision making process and priority at the Forest office level (1- factor without influence, 5- factor with strong influence on decision making)

Decision-making factor		Share of grades in %				
		1	2	3	4	5
1. Authorities responsible for financial policy and distribution of income	U	32,56	25,58	30,23	11,63	0,00
	R	37,50	5,00	35,00	10,00	12,50
	Σ	34,94	15,66	32,53	10,84	6,02
2. Professional and ethical business standards companies in natural resources economics	U	25,58	6,98	23,26	25,58	18,60
	R	20,00	7,50	40,00	22,50	10,00
	Σ	22,89	7,23	31,33	24,10	14,46
3. Expectations of future generations (bringing back to the grand children)	U	6,98	9,30	32,56	25,58	25,58
	R	15,00	20,00	27,50	20,00	17,50
	Σ	10,84	14,46	30,12	22,89	21,69
4. Market and competitiveness of goods and services	U	20,93	13,95	32,56	25,58	6,98
	R	15,00	17,50	27,50	17,50	22,50
	Σ	18,07	15,66	30,12	21,69	14,46
5. Employer expectations (Government RH) and state (national) economy	U	16,28	23,26	32,56	18,60	9,30
	R	12,50	20,00	27,50	10,00	30,00
	Σ	14,46	21,69	30,12	14,46	19,28
6. Expectations from international community due to the binding international criteria's in forestry	U	27,91	16,28	34,88	13,95	6,98
	R	17,50	22,50	32,50	7,50	20,00
	Σ	22,89	19,28	33,73	10,84	13,25

The influence of individual factors on the decision-making at the level of forestry office is the same for managers and district officers. Among their answers significant differences can only rarely be found. The factor 6 (impact on the international community) respondents have somewhat different views. Directors consider that there is no influence (27.9%), while district officers believe it has strong influence on decision making (20%). There is a similar situation in the market and competition for goods and services (factor 4).

4. Conclusion

Corporate governance implies a system of management and control of commercial operations. Quality of corporate governance should aim at company's business transparency, effective and efficient use of its resources and at establishment of relationships among the

stakeholders that will help achieve the strategic goals of society. Relevant laws contain basic rules for management of companies, while in the international corporate governance practices corporate management is determined by the code corporate governance. Legal regulations and codes form the framework to which the company adjusts partially or entirely, complementing it with its own practices according to its needs, interests, and the socio-economic environment in which the company is present.

Corporate governance conditions in the Republic of Croatia are gradually improving. Legal framework of capital market governing established the rules for corporate governance. As an extension of corporate relationships, and with recognition of internationally accepted principles and practices, the national code for corporate governance has been adopted. Most companies at least formally apply relevant regulatory mechanisms, but there is still considerable scope for improving and accelerating the process of corporate governance.

Through the analysis of the management structure of the Croatian Forests Ltd.¹⁴ the need for changes in certain segments of the governance actions was identified. Within the Supervisory Board it is necessary to establish special subcommittees as the Committee for the appointment, remuneration committee and audit committee. Deficiencies in the system of corporate governance have indicated the need to establish special committees within the supervisory board. Particular emphasis is placed on the independence of members of these committees, which should guarantee the impartiality and objectivity. Objectivity in decision making, supervision of financial reports and selection of external auditors are determined as most important for management and supervisory boards.

Based on the presented results it is possible to make the following conclusions:

- Croatian forests' employees considered standardized rules, strict hierarchy and bureaucratic way of functioning as a main feature of the company. The process of decision making is centralized and has the political characteristics (level of Forest Administration and Directorate), while the decision-making at forest office and district office level is perceived as a friendly and participatory process.
- Management practices in forestry offices are found satisfactory by most of district officers and office managers
- The disadvantages and limitations of district office system arises from internal weaknesses of the company's organization (high degree of centralization in decision making, employment without criteria, insufficient education, frequent job changes, lack of creativity and innovation, lack of clear criteria for the size of district and insufficient funds for district officers' operations).

Possibilities of improvement of the district ranger system and company's business activities are: establishing clear criteria for determining the size of district office and district ranger employment, defining responsibilities, permanent education, decentralization of decision making, upgrading control systems, setting performance benchmarks and setting clear criteria for employee awarding system.

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¹⁴ Tipurić, D.: Poslovno upravljanje i organizacijsko strukturiranje Hrvatskih šuma d.o.o. Zagreb: Hrvatske šume, 2009. 144pp.

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