Competitiveness and Corporate Governance – The Case of Montenegro

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This paper provides results of theoretical and practical researches obtained by the authors on the notion of competitiveness and corporate governance, as well as monitoring the creation and development of a corporate governance model in Montenegro in the period between 2002 and 2012. Furthermore, the authors have analysed the element of the corporate governance system in the reports on competitiveness of renowned international organisations. The purpose of this paper is to point out the influence of corporate governance quality on the improvement of the competitiveness level of firms and the country as a whole. Basic conclusion reached by the authors in the conduct of their research is that the reform implementation in Montenegro affected positively the corporate governance in the period between 2002 and 2012, as proven through better ranking reported by relevant international institutions.

Keywords: corporate governance, regulation, competitiveness, economic regulation, Montenegro.

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1. Introduction

Alternating periods of accelerated economic growth and big crises at the global, regional and national level in the last decade reopened the debate on the quality of corporate governance as one of the factors that influence competitiveness of national economies. The goal of this paper is to point out weaknesses and advantages in competitiveness of the corporate governance system in Montenegro. It is paid equal attention to the issue of corporate governance both by the developed markets countries with long established practice of protecting the shareholders rights, developed institutions of the system and significant experience in running businesses that separate the ownership from management, as well as by the underdeveloped countries that are building the institutions of market economy through a transition process. On the other hand, competitiveness has become one of the most frequently analysed economic concepts in the last thirty years.

The paper is based on two starting hypotheses. The first hypothesis is that competitiveness of the entire economy significantly depends on the quality of corporate governance. The second hypothesis is that the reforms in the corporate governance system in the period 2007-2012 were manifested in influence on the improvement of the position of Montenegro on the competitiveness lists of the relevant international organisations.

Although the classic papers in corporate governance, such as (Means & Berle, 1932) and (Jensen & Meckling, 1976) appeared much earlier, the problem of corporate governance in Montenegro became topical in the early nineties with the beginning of the privatization process. The reason lies in the fact that there was no separation of ownership from management. Moreover, similar problems in corporate governance may be found in most European countries (Henrich, Lis

& Pleines, 2007). However, the contradiction of corporate governance model in Montenegro has arisen from adopted regulations which are not practical. Specifically, Anglo-American model of corporate governance is adopted in company's law in Montenegro, which corresponds to dispersed ownership (Enriques & Voldin, 2007), while in practice ownership is not dispersed, but in most cases there is a dominant shareholder who makes all the important decisions, which is a characteristic of the continental model of corporate governance (Jocovic, 2011).

The Law on Companies ("Law on companies," 2002) has formally initiated the process of creation of its own company law and corporate governance system in Montenegro. In the last period a great deal of factors influenced the model of corporate governance in Montenegro. Some factors are related to an underdeveloped business environment in which this model has been created and developed, while other factors are an integral part of the institute of corporate governance. The obstacles for development of corporate governance in the previous period are related to the following facts: 1. incomplete and contradictory legal system in the beginning of privatisation, 2. insufficiently developed company law with the vast number of new institutes whose existence were imposed by the new conditions for running business, 3. lack of shareholders culture, 4. lack of human resources in this field and lack of individual and collective awareness on the significance of corporate governance, 5. existence of different forms of property, 6. presence of the Government in the ownership and governance of joint stock companies.

The mentioned Law created a significant number of legal institutes that had not existed in the Montenegrin legislation. Especially, it has been expressed occurrence of new institutes in the field of corporate governance. Consequently, there was a strong need for the education of the public about their contents, manner of application, etc. The implementation of the new legislation in the practice confirmed the concerns of certain critics that a significant number of issues in this field have remained incompliant with the international standards, but also with the existing legislation and that there is a certain number of unclear provisions and doubtfulness that should be amended as soon as possible. The special problem in the functioning of the corporate governance system was the lack of appropriate court and business practice in this field.

In the period between 2007 and 2012, along with the amendments to the company law there was a change in the improvement of corporate governance. At this stage, the changes emerged at all levels in development of corporate governance. First, the changes of company law paid special attention to the reform of corporate governance. Second, the awareness of key entities of corporate governance about its importance has significantly matured. Third, the shareholder culture started developing and it was the prerequisite for development of good corporate governance. Fourth, the development of the capital market significantly influenced the improvement of the corporate governance system. Fifth, in privatisation companies the corporate governance elements, that are present in market developed countries, were applied. Sixth, the institutional framework for development of corporate governance was significantly enhanced. Seventh, the signing and coming into force of Stabilisation and Association Agreement with the EU, in formal and legal terms implies the obligation of Montenegro to harmonise its law with that of the EU, which had positive reflections on corporate governance. In the end, the candidacy for membership in the EU and opening of the negotiations in 2012 for the chapter of company law, the prerequisites for further improvement of this field and compliance with the EU law have been created.

2. Theoretical background

For the needs of this paper it is necessary to provide answer to three questions. First of all, what is competitiveness? The second, to whom the notion of competitiveness refers – solely to the forms of conducting economic activities (competitiveness of businesses) or we can also talk about competitiveness of a state. In the end, how are the competitiveness of the national economy and corporate governance linked?

Over the time, the concept of competitiveness has undergone significant changes. The development of the notion starts with the classical economists Smith and Ricardo who identified the production factors such as land, capital, natural resources and labour as the basic determinants of comparative advantages. In addition, Weber (Weber, 2002) explains the differences in economic results of certain countries with social and economic factors such as the value and religion system, which he defines as social and cultural capital. Schumpeter (Schumpeter, 1934) particularly emphasises the role of entrepreneurship innovations and technology. Drucker (Drucker, 1999) develops the concept of governance as the basic factor of competitiveness. Solow (Solow, 1956, p.65-94) points out the role of education and technological innovations for long-term economic growth. Porter (Porter, 1990) brings together all those ideas in a model known as "Porter's diamond of competitive advantage". In defining competitiveness at the micro level, or at the level of countries, the frequent starting points are the surveys that sum up the up-to-date theoretical views on competitiveness, and which, in general, have not significantly changed even today. Trabold (Trabold, 1995, p.169-183) elaborates on the views of the afore mentioned authors, and also the views of other authors, he analyses four important aspects of competitiveness: possibility of sale at the international market (export), possibility of attracting investments, possibility of adapting economy and possibility of creation and increase of available earnings. Trabold concludes that those different aspects comprise a certain hierarchy. Thus the possibility to create and increase the available earnings, that is most frequently measured by the growth of GDP, which is the most general indicator of competitiveness of different countries. Even though they are different according to their basic roles, the public and the private sector are related in the creation of a productive and competitive economy. No matter how good the fiscal and monetary policies are, how efficient the legal system and stability of democratic institutions, that is not sufficient. In the end, wealth is created at the microeconomic level of economy, which is based on the quality of the microeconomic business environment and operational practices and strategies at the level of firms (Porter, Delgado, Ketels & Stern, 2012). Furthermore, competitiveness is a multidimensional phenomenon – indispensably present at the level of firms, sectors, and the country as a whole (Enright, Frances, 1996).

Doubtlessly, the efficient system of corporate governance presents the condition for increase of competitiveness of the national economy. Empirical evidence which are contained in corporate governance research, support the idea that poor corporate governance prevents the efficient allocation of resources, reduces the ability of the company to be a competitor in the free market and hinders the investment inflow and economic development (Chi – Kun, 2005). Also, the success of developed and developing countries to integrate on global market depends on the quality of corporate governance (Mallin, 2007). After all, strengthening of the competitiveness and competition between countries, according to a group of authors, are the main reasons that will lead to convergence of different models of corporate governance (Karmel, 1991).

Moreover, the competitiveness indexes of the most prestigious international institutions (World Economic Forum, World Bank, Heritage Foundation, etc.), that empirically measure the competitiveness of the national economy in a number of elements, assess the corporate governance issues. Furthermore, the last surveys on competitiveness in the light of financial crisis and corporate scandals, draw the attention of the academic public on the influence of good corporate governance at the level of national economy. For example, according to the Porter and Rivkin (Porter & Rivkin, 2012), analyse the competitiveness of the American economy from the aspect of business trend and corporate governance in national companies. In the past few years, the United States of America, as the leader in the world in terms of competitiveness are losing the leading position, and one of the reasons are evident financial scandals that caused the beginning of the global financial crisis. For these reasons, the authors believe that the above issue deserves attention and should be investigated from the perspective of the potential benefits to the national economy.

3. Methodology and data

The World Economic Forum has based its competitiveness survey on the Global Competitiveness Index (GCI), the overall index that measures the microeconomic and macroeconomic foundations of national competitiveness. The GCI comprises 12 individual pillars (sub indexes) that are divided into three units: basic requirements, efficiency enhancers and innovations. Each of the individual pillars refers to one of the aspects of the complex concept that is called competitiveness. The concept *Stage of development* is integrated in the Index, and emphasises the pillars that are relevant for the country and its current development level. Furthermore, although there are all 12 pillars individually for every country, the importance of certain pillars depends on the stage in which the country is. Each country, included in the survey is ranked in relation to other countries: on the scale from 1-7 where 7 is the maximum amount or rank that places the country in developed countries in accordance with a certain sub index or pillar.

The observation of individual pillars of competitiveness is of great importance for the subject of the survey and linking of achieved level of corporate governance and competitiveness of the overall economy. Two pillars are relevant for this survey: the first pillar - *Institutions*, within this pillar there are 22 individual sub indexes, and the eighth pillar -*Development of financial market,* with 8 individual sub indexes. Presentation of these pillars and individual sub indexes for Montenegro are given in the tables and explanations.
World Bank researches and uses 10 indicators or phases in the cycle of enterprise: starting a business, obtaining construction permits, electrical supply, electricity, registering property, getting credit, protecting investors, paying taxes, foreign trade, enforcing contracts, resolving insolvency. These indicators are used to analyze the business environment in the context of administrative regulations that burden business enterprise, primarily through three aspects - the duration, number of trials and direct material cost of paying dues for each of the procedures. In order to achieve the objectives of the survey, the data of the World Bank has been presented with special reference to the measurement of the quality of the business environment and investor protection in Montenegro.

4. The Global Competitiveness Report - Position of Montenegro

The institutional environment is set by the legal and administrative capacity within which the individuals, companies and governments generate revenues and wealth in the economy. The importance of the appropriate institutional environment is particularly emphasised in the existing conditions of the world economic crisis, as it shows the direct role of the government and the presence in the economy in the most of the countries. The quality of the institutions has the great significance on the competitiveness and the economic growth (Milović, 2012, p.200-212). The institutions influence the investment decisions, organisation of production, and have the central place in the manner in which the company is conducting the distribution of costs and benefits of developing strategies and policies. The role of institutions accompanies the legal framework. The views of the Government on the market and freedoms as well as the efficiency of own business running are important in the conditions in which there is a big administration, unnecessary paperwork, corruption, lack of adherence to agreements, lack of transparency and trust, dependence on the political and judicial system which imposes significant economic expenditures on business entities and causes slowdown of economic development. Furthermore, the proper governance of the public finances is crucial for ensuring the trust in the national business environment.

Although the economic literature is more focused on the public institutions, the private entities are also important element of the process of creation of wealth in the society. The global financial crisis with numerous company scandals emphasised the influence of the good corporate governance and creation of trust between the investors, individual participants and the Government. The business that is based on the mutual trust with high corporate ethical standards in the domain of leading companies and accuracy of financial statements, is a reliable partner in leading economy on the way of economic development and economic prosperity (Monti, 2007). The private entities that are observed within this pillar are related to the following sub indexes: 1) ethical behaviour of firms, 2) strength of auditing and reporting standards, 3) efficacy of corporate boards, 4) protection of minority shareholders' interests, 5) strength of investor protection. All the listed elements comprise the institute of corporate governance at the level of national economy. When observing the value of indexes for Montenegro within the private entities the following indicators are related to the time framework 2007-2012 ("The global competitiveness," 2012).

Table 1

Pillar 1: Institutions, position of Montenegro 2007-2012.

Indicator	2007 /131	2008 /134	2009 /134	2010 /139	2011 /142	2012 /142
Ethical behaviour of firms	107	76	53	52	47	50
Strength of auditing and reporting standards	88	73	68	85	82	95
Efficacy of corporate boards	75	70	65	75	82	93
Protection of minority shareholders' interests	106	88	82	87	71	65
Strength of investor protection	19	19	24	27	28	29

Source of data: *The global competitiveness report from 2007-2012.*

The best result in the observed period Montenegro achieved in the field of strength of investor protection in 2007, being at the 19th place. In the report from 2012 Montenegro is in the 29th position, but it is important to mention the fact that compared to 2007 more economies have been observed (131/142). Montenegro is among 50 most competitive counties in the world according to the sub index of ethical behaviour of firms. This sub index analyses ethical behaviour of firms in relations with government officials, politicians and other firms. The elements of the protection of minority shareholders' rights, with the economic growth that also marked development of the capital market, have the increasing trend. Compared to 2007 when Montenegro was at the 106th position, in 2012, a significant leap was made, from position 41 to 65. For the remaining two sub indexes in the table the results are not that good: strength of auditing and reporting standards

95th place, and efficacy of corporate boards at 93rd place, which is deterioration compared to 2007 when that result was 75th position.
The appropriate legal regulations and development of capital market influence the improvement of the corporate governance quality in firms (Bainbridge, 2010). Furthermore, in the corporate governance models with dispersed ownership, the joint stock companies with good corporate governance at the capital market can find available finances. Shleifer and Vishny (Shleifer & Vishny, 1997) confirm the mentioned view and point out that for appropriate financing of the firm at the capital market, in addition to level of its development, good quality corporate governance system is necessary as a security signal for the investors. In the end, with the corporate governance some authors explain the decrease or increase of competitiveness of the national capital market. For example, Bainbridge, (Bainbridge, 2010) explains that for the decreases of competitiveness of the capital market in the USA the problem was not bad corporate governance, but inappropriate regulations of this institute. The global economic crisis brought the attention to the good functioning of the capital market. The efficient financial sector conducts the best allocation of resources, particularly for the foreign investors. The allocation of resources and the use of funds go to those segments that have the highest rate of return for the invested capital. The risk assessment for investment in these markets is crucial for the successful activities of the investors. The economies require efficient capital market, which is oriented to private investors, with the regulated securities market, strong banking system and appropriate model of corporate governance. In the crisis conditions, all these elements are emphasised through decrease of liquidity and efficiency of capital market, both in the developed and developing countries. The next table shows the sub indicators that are observed within the pillar 8 - efficiency of the capital market for Montenegro for 2007-2012.

Table 2

Pillar 8: Development of the capital market, position of Montenegro 2007-2012

INDICATOR	2007 /131	2008 /134	2009 /134	2010 /139	2011 /142	2012 /142
Development of capital market	43	35	17	28	35	40
8.A Efficiency, 1-7	53	38	23	44	52	51
Availability of financial services	n/a	n/a	n/a	76	80	84
8.02. Affordability of financial services	n/a	n/a	n/a	62	64	69
8.03 Financing through local equity market	55	30	23	50	67	64
8.04 Ease of access to loans	68	29	9	25	37	39
8.05 Venture capital availability	61	44	22	24	29	29
8.B Reliability and trust	38	34	22	27	22	30
8.06 Soundness of banks	60	54	72	94	107	108
8.07 Regulation of securities exchanges	57	49	42	48	47	54
8.08 Legal rights index	17	16	5	6	1	1

Source of data: The global competitiveness report from 2007-2012.

The eight pillar of competitiveness is divided into two groups of sub indexes: 8.A – E*fficiency,* and 8.B – *Reliability and trust.* The best position for the Efficiency, Montenegro had in 2009 when it was in the 23rd place, and in the current survey it is almost in 50 most competitive countries of the world. The Reliability and trust for the 2012 survey, ranks Montenegro on 30th place, and the best result in six years was achieved in 2009 when Montenegro was on 20th place. The results of this survey and the achieved practice of the corporate governance development, imply the conclusion that there is a contradiction between the adopted model of corporate governance and the practice in the functioning of the capital market, because a small percentage of joint stock companies in Montenegro is financed by emission of securities.

5. Doing Business Indicators for Montenegro

According to Doing Business Index of the World Bank, Montenegro is ranked on the 56th place out of 183 economies that were included in the survey for 2012 ("Doing business 2007-2012," 2012). The position of Montenegro (56), shows that there is more room for improvement of administrative procedures related to economic operations, and that, if Montenegro wishes to remain attractive destination for FDI it will have to do much more, in order to have a better business environment.

Observed from the point of view of corporate governance, it is important to measure the level of business environment quality. If the results presented in the table 3 are analysed in detail, it can be concluded that according to the most of the indicators Montenegro is in the zone of acceptable or in the good zone. As regards protecting investors, Montenegro has good ranking on the high 29th place. The best marks were awarded for easiness of taking loans for legal entities – 8th position, which implies the high degree of reforms implemented in the financial sector.

Table 3

Ranking of Montenegro according to the quality of business environment

Indicator	**2011**	**2012**
Ease of doing business	56	56
Starting a business	46	47
Dealing with construction permits	170	173
Getting electricity	68	71
Registering property	117	108
Getting credit	8	8
Protecting investors	28	29
Paying taxes	125	108
Trading across borders	35	34
Enforcing contracts	134	133
Resolving insolvency	48	52

Source of data: Doing Business database

The protection of investors is dealing with the possibilities of the firms to get the capital they need for growth, innovations and competitiveness. The availability of information, participation in decision making through the ownership in companies protection of shareholders as well as the obligations and solid regulations in the field of insiders are necessary for better ranking in this field. According to this indicator Montenegro has been ranked on high 28th position and is the second in the region. Better ranking has Macedonia, it is ranked as 17th in 2012.

Table 4

Protecting investors in Montenegro 2011-2012.

Protecting investors	**2011**	**2012**
Rank	29	28
Extent of disclosure index 0-10	5	5
Extent of director liability index 0-10	8	8
Ease of shareholder suits index 0-10	6	6
Strength of investor protection index	6.3	6.3

Source of data: *Doing Business database*

Company related legislation in Montenegro in the field of shareholders' rights accepts the developed countries standards to the greatest extent. However, the most expressed problem in this area is the existance of prescribed norms and their application in practice. The shareholders in Montenegro are entitled to file an appeal in the court in the same way as the shareholders in developed countries and culture. However, the positive answer cannot be provided wheather the same effectiveness of the appeals as an instrument is achieved both in Montenegro and other countries where shareholder's appeal is an option. In addition, the Company Law of Montenegro should further regulate matters in relation to the composition of the board of directors, the structure of members, the issue of responsibilities of board of directors, the transparency of work of this body etc. The best evidence for mismatch between practice and regulatory framework is the position of Montenegro regarding the protection of investors where the area of the board of director's work and the protection of minority rights in practice have been particularly negatively evaluated (Table 4).

The results presented in the Table 4 show that regarding the elements that comprise the institute of corporate governance and which are analysed in this report, there is room for further improvement and reduction of competitiveness weaknesses. Undoubtedly, the commenced reforms, in the course of financial crisis, in the legislative framework of corporate governance and their implementation in the business practice will contribute to improvement of this field in the future period.

6. Discussion and conclusion

On the basis of the analysis of corporate governance model in the period 2002-2012 and the position of Montenegro in the analysis of corporate governance system elements in the reports on competitiveness of renowned international organisations, the general conclusion is that the corporate governance system is in the development stage. Based on the conducted work analysis, the following areas can be stated as the signals of corporate governance promotion in Montenegro: 1. gradual maturing of the corporate governance awareness; 2. enhancing shareholder's rights; 3. gradual improvement of business environment to perform commercial activities and 4. company law reform. To support the above mentioned, the authors point out to the standing of Montenegro in the sub-index of the WEF Report of corporate socially responsible institutions, where Montenegro is among 50 most competitive countries in the world. In the stated period, Montenegro improved its ranking from the 107th position in 2007 to 50th in 2012 (Table 1). Also, in the field of the protection of minority rights, Montenegro progressed significantly, as shown in the same report, from 106th to 65th position within the observed period (Table 1). According the Ease of Doing Business Index in 2012, Montenegro occupies the 58th position among 183 economies (Table3).

The authors believe that, in addition to the positive amendments in the legal framework and functioning of elements of corporate governance, it is necessary to improve certain fields in order to make the corporate governance system in Montenegro more competitive with respect to the appropriate models in the developed countries.
The authors identified the most important failures as to the existence and appliance of the corporate governance system in Montenegro over the past period, based on their research, to be the following areas: 1) inappropriate protection of shareholder's rights, particularly the rights of minority shareholders; 2) insufficiently regulated the area of audit; 3) incomplete and inefficient regulations in the area of the board of directors; 4) insufficient legal arrangement as to the transparency of work of joint stock companies. Thus, in the World Economic Forum Report on the global competitiveness within the pillar 1: Institutions, Montenegro noted the significant fall in relation to the sub-index of audit strength and reporting standards i.e. from 88th position to 95th and efficiency of the board of directors from 75th position to 93rd position (Table 1). Although a certain improvement was made with regard to protection of shareholder's rights in the observed period, this area can be identified as one of the shortcomings of the corporate governance system. Period in which the shareholder's rights have been shadow violated and without appropriate legal remedies to act against the said are behind us. Minority shareholders in Montenegro are increasingly joining in order to facilitate the realisation of their rights, which is a new dimension in the development of shareholding practices and corporate governance systems and has a direct impact on the level of economic competitiveness of Montenegro. In the forthcoming period in corporate governance development, greater attention must be paid to the rights and legal protection of shareholders, especially minority ones. To that end, equally important are the rights assigned to shareholders and efficient implementation of mechanisms for their legal protection in practice.

The research presented has confirmed the starting hypotheses of the paper. Undoubtedly, on the basis of the aforementioned, in the circumstances of financial crisis and corporate scandals, the improvement of corporate governance presents imperative and necessary condition for raising the level of competitiveness of the national economy. Furthermore, this paper also confirmed the starting hypothesis, that the implemented reforms in the corporate governance system in Montenegro in the period 2002-2012 reflect its better position in the reports on competitiveness of the relevant international organisations.

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