

# Problems of Corporate Governance in the Practice of Machine Building Enterprises of Ukraine

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## SUMMARY

*This paper presents an analysis of the current state of corporate governance for mechanical engineering in Ukraine, and the main problems and features of corporate governance. It focuses on the current situation with corporate governance machine building enterprises in the Kharkov region. The objectives of the study are to identify the basic problems in the activity of corporate governance machine building enterprises in the region, as well as the features and limitations of corporate governance.*

*Keywords: Ukrainian machine building, corporate governance*

*Journal of Economic Literature (JEL) code: M21, M38*

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## INTRODUCTION

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The transition of Ukrainian enterprises to a market economy was accompanied by the processes of privatization and corporatization. The most common form of business organization has become shareholder, due to its many advantages over other forms (the ability to transfer property rights and, at the same time, control of the company; capital increase through an additional share issue, while maintaining the financial stability of the company, etc.).

This process did not pass over engineering industries. Thus, the most common form of ownership in the modern engineering industry is corporate. This is attested to by statistics. According to the State Property Fund of Ukraine, between 1998 and 2012, the number of joint stock companies in Ukraine has increased markedly. Overall, since the beginning of the privatization process, and as of July 1, 2012, 127901 enterprises in Ukraine changed ownership. With the development of the market environment, the functioning of these units has been directed towards the search for a niche market. Companies that were weak, usually unable to compete, ceased to exist.

However, the current state of corporate governance in the Kharkov region of Ukraine is characterized by a low level of corporate culture, a discrepancy between the existing corporate governance practices and generally accepted principles, lack of coordination of government in the regulation of corporate relations, poor management

of state corporate law, etc. "On Joint Stock Companies" (2008).

Therefore, in the present conditions the development of corporate relations, especially in the machine-building industry, is important in order to attract investments to the Ukrainian economy, stock market development and the growth of national wealth.

Until recently, the privatization and corporatization in Ukraine was aimed at promoting the effectiveness of the individual entities and the revenue of the state budget. Now the emphasis should shift towards an integrated, systemic solution for how to increase the competitiveness and efficiency of basic industries and the economy in general, and on this basis people's livelihoods.

## METHOD

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Studies of corporate governance of enterprises in Ukraine conducted by the example of machine-building enterprises of Kharkov region. Among them, OJSC "ROSS" (OJSC "Kharkov plant modular machines"), OJSC "Plant Frunze", OJSC "Kharkov plant dies and pressform", OJSC "Kharkov Bearing Plant", OJSC "Kharkov Tractor Plant. S. Ordzhonikidze", OJSC "Turboatom", OJSC "Light Miner", OJSC "Potential", OJSC "Hidropryvid Kharkov Plant", OJSC Factory "Index", JSC "HZEMI", JSC "Electric machine", JSC "Ukrelectromash HELZ", OJSC "Teploavtomat", OJSC "Tochprybor", OJSC "Volchansky aggregate Plant", OJSC "Lozovskii forging-Mechanical Plant", OJSC

"Avtramat", CJSC "Finprofile" ("Stock market infrastructure", 2012).

The main directions of research and implementation of corporate governance in selected enterprises include reorganization, the election of the chairman and members of the Supervisory Board, the decision to terminate their mandate as possible reasons for convening the extraordinary meetings of the past in 2012, the availability and variety of committees of the supervisory board, the competences of shareholders in the definition of the strategy, the existence of the internal documents of the company, including its own corporate code, etc. ("Stock market infrastructure", 2012) (Figure 1).

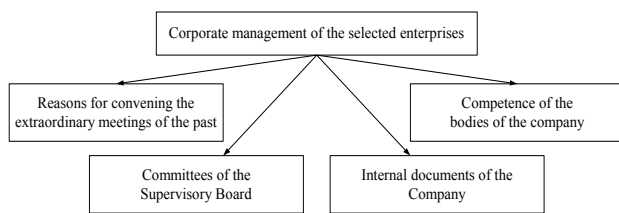


Figure 1. The main directions for studying corporate management of the selected enterprises

## RESULTS

Analyzed companies is not a classical company created by combining capital and the privatization of the practice of their development as a joint-stock companies. It is this fact that determines the characteristics of corporate governance in Ukrainian enterprises. One such feature is the combination of management and ownership. However, among the studied companies the tendency is to reduce the share of management in equity.

The most effective form of corporate governance is provided by enterprises owned by foreign investors. Scientists of the Institute for Economy in Transition "Russia" conducted research in enterprises in the Czech Republic, Hungary, Russia, and Bulgaria, and found that the transformation of the enterprises with foreign capital is the best way, but the share of foreign capital should not be less than 30%.

In research conducted in Ukrainian enterprises, foreign investors are present in manufacturing plants in a small amount (less than 35%). This result means that the enterprises studied here have low attractiveness to foreign investors. In addition, none of the companies quotes its shares on the stock market. This means that the management of enterprises is not trying to go for external financing through the sale of their shares.

Another important issue is the concentration of ownership in enterprises. The presence of a shareholder (or group of shareholders) in the company owning 70% of shares or more may mean a lack of mutual respect in the decision-making capabilities of minority shareholders to participate in management (decisions on all issues,

including those which require a qualified majority, are taken by one person or a group of related persons). In fact, the minority shareholders become passive investors, and their shares essentially cease to be voting. This reduces the motivation of minority shareholders to participate in enterprise management, the effectiveness of management decisions and, consequently, the efficiency of the company. On the other hand, the greater the share of the largest shareholder-manager in a company, the less advantageous to him to withdraw the company's resources for personal consumption ("Industrial of Ukraine", 2013).

A significant lack in corporate relations in the engineering sector in Ukraine is the almost complete absence of committees of the supervisory board, although the Ukrainian and international principles of corporate governance consider it appropriate to consider the existence of such structures, and recommend implementation of the supervisory board of the Corporate Secretary. Up to the end of 2012 the Committee had been established in none of the studied companies, in the structure of the supervisory board of other engineering enterprises of Ukraine, along with the corporate form of governance there are such committees as the committee for strategic planning, audit committees, the appointment and remuneration and investment committees, but the position of corporate secretary has been not enough implemented.

Among the requirements for the members of the Supervisory Board, as shown in internal documents, in the researched companies the most common are industry knowledge and experience in the area (47% of surveyed companies) and personal qualities such as honesty and responsibility (46% of surveyed companies). In addition, there are claims for knowledge in the field of finance and management, and it is specified that there must be no conflict of interest. Requirements as to the age of members of the Supervisory Board were not detected. Of the enterprises, 13% did not have any requirements set in their documents. This low set of requirements for the members of the Supervisory Board indicates a lack in the level of development and implementation of corporate relations in the engineering sector in the Kharkov region (Figure 2).

Not enough attention is paid by the management of companies to internal corporate documents. However, these documents are often a means of resolving disputes and internal conflicts. Such documents may include Provisions on the General Meeting of Shareholders, the Supervisory Board of the executive body (Management Board) of the company officials, the audit committee, the company's shares, reports on the distribution of profits, etc. But among the studied companies domestic regulation documents are not used, which indicates the underdeveloped corporate relations.

Another important aspect of the activities of Ukrainian joint stock companies is the disclosure of information about their activities. The essence of the

disclosure is to ensure access by interested parties, including the shareholders, to complete and accurate information about the industrial, economic and other activities of the company.

Almost all of the financial statements and the results of activities of the investigated engineering companies extend to the general meeting published in the press, as well as a public information database of the Securities Commission on the Securities Market. In addition, for the documents available for inspection joint-stock company, a copy may be obtained on the request of the shareholder, and the information made available on the website of the company.

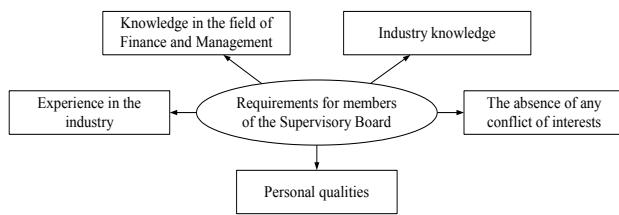


Figure 2. Requirements for members of the Supervisory Board

Furthermore, they published information on shareholders holding 10% or more of the authorized capital, the composition of management bodies, the charter and by-laws (in their own web page on request of shareholders), minutes of general meetings of shareholders after meetings. Information on the remuneration of company officers is not made public.

Among Ukrainian joint stock companies it is not common to refer to consultants in the field of corporate governance and financial management. The enterprises surveyed have not received paid services of such consultants within the last few years, reflecting stagnation in the development of domestic corporate relations ("Industrial of Ukraine", 2013).

Recently, many foreign companies have corporate governance codes. The practice of multinational corporations suggests that the availability of its own code provides help in dealing with a wide range of applications. Corporate codes have been widely used in developed countries since the 1980s. Now 80% of the companies on the list of the 500 best companies in the world have such codes. But among the studied domestic engineering companies with the corporate form of management, there is no enterprise that has set up its own corporate code.

Thus, as the results of the study it can be concluded that the main problems of the corporate engineering enterprises in the Kharkov region associated with ownership are:

1. Low corporate culture;
2. Lack of investment attractiveness of enterprises;
3. The need to increase capitalization;
4. The need to improve the access of joint stock companies to the capital markets and reduce the cost of their involvement;

5. The poor reputation of the company in the domestic and international markets, as well as of its directors and managers;
6. Complicated control systems for corporate rights;
7. Lack of balance between the interests of the minority and majority shareholders;
8. Vague definition of the objectives of the corporation and how to motivate its owners;
9. The choice of organizational structure, inadequate goals;
10. Incompetent directors from the joint Soviet era;
11. Weak legal framework (particularly in the context of the interaction between business entities);
12. Low rate of market infrastructure facilities (stock and commodity exchanges, consulting and design firms, developed infrastructure of the labor market, etc.);
13. Conflicts of interest in government;
14. Low awareness of entrepreneurs and managers of the basic elements of corporate governance;
15. Ability to manipulate the composition and content of internal regulations;
16. Insufficient degree of transparency.

## CONCLUSION

Thus it is clear that the current situation in the corporate sector of engineering enterprises in Ukraine requires the implementation of specific measures at the level of corporate enterprises. The quality of corporate governance is an important factor in the effectiveness of a company. During the financial crisis the cost of debt remains high, and outsourcing by the issue of shares is virtually nonexistent. Therefore, improving the level of corporate governance can provide a quick and significant financial effect, reducing the cost of capital to ensure the company and the growth of its market capitalization.

One source of constraints on the effective implementation of corporate management in engineering enterprises in Ukraine, as in other countries, is that the interests of shareholders and, for example, those of managers disagree. Despite recent interest in increasing the size of the corporation, its power and prestige, managers are often paid by a fixed salary (company income has no effect on the salary), thus the fate of the manager depends on the stability of a company and he/she aims to minimize risky investments in order to avoid bankruptcy and layoffs. But the majority of shareholders want to take risks in order to obtain large dividends. On the contrary, lenders may not be particularly interested in the high profits of the company – they are much more interested in the presence of these revenues. Therefore, they are skeptical of what they perceive of as very profitable but very risky operations. The topic chosen for this article is relevant to large complex corporate enterprises in Ukraine and requires further research.

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