Institutions, Corporate Governance and Corporate Governance Institutions: The Case of Estonia*

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During the last ten years, Estonia has made strong efforts in terms of the transition to a market economy. This is particularly true with respect to the soundness and transparency of monetary and fiscal policies, the privatisation of former state-owned enterprises, the development of the financial sector and the institutional setting. This paper argues that strengthening the formal institutional setting, and in particular the corporate governance institutions, is crucial to further enhance the process of economic transition of the country. It describes the current state the corporate governance structures as compared to other countries in Central and Eastern.

In den letzten 10 Jahren hat Estland viele Anstrengungen in der Umwandlung in eine Marktwirtschaft unternommen. Dies trifft insbesondere auf die Stabilität und Transparenz der Währungs- und Finanzpolitik zu, der Privatisierung ehemaliger Staatsbetriebe, die Entwicklung im Finanzsektor und im institutionellen Umfeld. Der Aufsatz zeigt auf, dass die Stärkung des formellen institutionellen Umfeldes und im einzelnen auch die der Bereiche der Unternehmensorganisation essentiell wichtig für den weiteren Tranformationsprozess des Landes sind. Er stellt den heutigen Stand der Unternehmensstrukturen im Vergleich zu anderen Staaten dar.

Keywords: Institutions / corporate governance / Estonia / transition / Central and East European countries

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Introduction[*]

Estonia is among those countries in Central and Eastern Europe that has made strong efforts in terms of the transition to a market economy since the early 1990s. In particular, the Estonian government has made considerable progress with respect to the soundness and transparency of monetary and fiscal policies, reflected in relatively low levels of inflation and stability of the external value of the Estonian Kroon, the privatisation of former state-owned enterprises, the development of the financial sector (including the establishment of a stock market) and the accompanying formal institutional setting, such as regulatory institutions, bankruptcy laws and the establishment of property rights. The success of these efforts may perhaps best be described by the fact that the country has become eligible for joining the EU in 2004.

Yet, less is known about the extent to which corporate governance structures in Estonia have developed during the process of transition. The main aim of this paper is to provide a comparative analysis of the corporate governance structures in Estonia. The paper argues that strengthening of the formal institutional setting, and in particular the implementation of corporate governance institutions, is crucial to further enhance the process of economic transition of the country. Next, it describes the current state of Estonia's corporate governance institutions as compared to other countries in Central and Eastern Europe. It also provides policy conclusions with respect to which institutional reforms may be needed. In the paper, we focus on formal corporate governance institutions, leaving informal institutions outside the scope of the analysis. We have made this choice because data on informal corporate governance institutions are very difficult to obtain and compare between countries.

The remainder of this paper is organized as follows. Section 2 discusses theoretical aspects of corporate governance, arguing that corporate governance structures are embedded in the general institutional environment of a country. In particular, we argue that corporate governance can be considered as a form of institutional design. Subsequently, section 3 discusses the relationship between those institutions that are closely linked to corporate governance (corporate governance institutions), and the general institutional environment. In section 4, we analyse the current state of Estonia's corporate governance institutions, as well as its general institutional environment. Section 5 provides concluding remarks and draws policy lessons with respect to what institutional changes

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may be needed to improve existing corporate governance structures, so that they may become more supportive to the process of transition.

2. Institutions, corporate governance and corporate governance institutions

2.1 Institutions and corporate governance

Institutions matter. This is one of the core messages from the New Institutional Economics (NIE). NIE is concerned with the choice of a governance structure of economic actors under a given institutional environment, as well as with the effects that various institutional environments have on economic performance and development, and the change of these environments over time (Eggertsson, 1990; Voigt and Engerer, 2002). According to Nooteboom (2002:15) institutions *"enable, constrain and guide behavior, and are stable and engaging with respect to that behavior*". They are relatively inevitable and cannot be freely chosen. It is a multilevel concept, which means that institutions can be defined at the level of macro-conditions, at the level of markets, but also at the firm level. In this way they form an institutional hierarchy in terms of Aoki (2001). Institutions may be specified in both formal terms (e.g. laws, rules, property rights, guidelines) and informal terms (e.g. conventions, norms, codes of conduct). The difference between both indicates the extent to which institutions are formally written down and are generally accepted and/or legitimised. Institutions reduce uncertainty and extend time horizons of actors dealing with each other. They affect the costs of doing business; i.e. costs are increased if there are uncertain or poorly structured property rights, if contracts are weakly protected, if information is scarce and access to it highly skewed, and if corruption is endemic (Rowen, 1998:9-10). These conditions of what we see as 'weak institutions' lead to fewer transactions, to less capital investments, and to long-term agreements being avoided.

As described above, institutions, whether formal and/or informal, create a governance structure at different levels of interaction within an economy. One important level of interaction is the corporate level. Discussions about the nature of the instutional setting at the corporate level, *i.e.* discussions of corporate governance, have recently received much attention in both academic and policy making circles. From an academic point of view, much of the corporate governance discussion rests on the seminal work of Berle and Means (1932). These authors describe an image of the modern corporation, in which ownership and management are separated. This results in the well-known agency problem, in which management should be aligned to the needs of dispersed owners (shareholders). In more recent approaches of corporate governance, next to shareholders, also other stakeholders, such as employees and customers, are included in the discussion. In general, the corporate governance discussion is loaded with normative statements, taking the Berle and Means kind of corporation as a point of departure. After the issuance of the Cadbury report in 1992 the subject increasingly moved to the attention of national and international policymakers. In many country committees on corporate governance and in organizations like the World Bank or OECD, discussions on corporate governance culminated in a set of principles and corresponding clarifications. The Asian economic crisis of 1997 was a further catalyst for this discussion.

It is clear by now that many differences exist between countries' corporate governance systems (cf. Becht and Mayer, 2001). For instance, based on their empirical research, La Porta et al. (1999) conclude that the Berle and Means image of the corporation is not at all prevalent all over the world, but is mostly restricted to Anglo-Saxon countries (mainly the US and UK). Moreover, the corporate governance practice of countries is not always attuned to the idealized sets of principles and clarifications of country committees and/or world institutions (such as OECD). Within these sets of principles, the general institutional setting does play an important role. In particular, it is argued that specific institutional frameworks should be in place in order to be able to support a strong corporate governance framework.

2.2 Defining corporate governance

Corporate governance may be defined in several ways. Shleifer and Vishny (1997:737) provide the following definition: "[corporate governance is] the ways in which the suppliers of finance to corporations assure themselves of getting a return on their investment". This definition takes a shareholders value approach. Tirole (2001:4) stresses that this shareholders value approach is too restrictive and provides a definition, which takes a broader stakeholders perspective. In his view "corporate governance is the design of institutions that induce or force management to internalize the welfare of stakeholders". According to this definition, corporate governance focuses on relations between stakeholders (such as capital suppliers (i.e. shareholders and debt holders), board members, managers, employees, suppliers, customers, tax-institutions, and society at large). The more restricted shareholders value approach of Shleifer and Vishny is confined to relationships between shareholders, debt holders, and supervisory and executive boards. Zingales (1997: 3) defines corporate governance as "the complex set of constraints that shape the ex-post bargaining over the quasi-rents generated in the course of a relationship". These constraints are largely determined by the institutional setting, which may influence contracting relationships between various parties. Boot and Macey (1999) indicate that corporate governance helps to allocate residual rights of control in the presence of incomplete contracts. With incomplete contracts the accountability of management vis-à-vis stakeholders and the governance and/or supervision provided by these stakeholders play an important role in the allocation of residual rights of control. Although, from a theoretical point of view, we subscribe to the broader stakeholder perspective, in the comparative analysis of corporate governance institutions in Central and Eastern Europe of this paper we concentrate on discussing (formal institutional) relationships between shareholders, debt holders, and supervisory and executive boards, to keep the empirical analysis focused.

2.3 Corporate governance institutions

Corporate governance institutions are those institutions that determine the playing field of internal and external actors/stakeholders in the firm. Stated differently, corporate governance can be considered as a form of institutional design. These institutions are mainly path-dependent (historically determined) and mostly determined by the institutional (legal and economical) context. Yet, they can, at least to some extent, also be adapted and designed to cope with new contingencies.

Corporate governance contains both internal and external control relationships (cf. World Bank, 1999; Postma, 2002). Internal control refers to the interplay between management, shareholders, and other stakeholders, such as debt holders and employees. As part of the internal control relationships, boards are usually created as solutions to address agency problems between shareholders and/or other stakeholders on the one hand and management on the other hand. External control refers to regulating agencies (e.g. government, regulatory agencies), reputational agents (such as accountants and financial analysts), and markets that function as a disciplining device for (top) management, such as financial markets (banks, stock exchanges), the market for corporate control, labour markets for (top)management; etc. Relationships between the internal and external control mechanisms reflect the interplay between internal institutions and external forces (notably policy, legal, regulatory, and market forces). Reputational agents may be particularly important incentives-providers to the markets with respect to the performance of a particular firm and vice versa.

Next to the abovementioned control relationships, which are generally more formal in character, there may also be informal institutions that play a role in corporate governance. Such informal institutions may be firm specific norms and values, management ethos and codes of conduct in business, as well as more general norms and values exisiting in society at large, self-regulation within a certain industry, and the reputation of a firm in its relations with its competitors, suppliers and customers. As was already mentioned in section 1 of this paper, when we present the comparative analysis of the corporate governance institutions in Estonia and Central and Eastern Europe in section 4, we focus on formal (internal and external) institutions and leave out discussions on informal institutions, since data on informal institutions are more difficult to obtain and compare between countries.

The specifications of corporate governance as described above indicate that corporate governance institutions are aimed at supplementing formal contracts (i.e. filling empty or not a priori specified spaces in contracts) between different stakeholders. These institutions may be designed purposefully (cf. Tirole, 2001).

The previous discussion on internal and external corporate governance control and formal and informal institutions may be combined in Table 1 below, which provides examples of corporate governance institutions, combining both dimensions of corporate governance with the two dimensions of institutions.

Table 1: Examples of internal and external corporate governance institutions

	Corporate governance	
	Internal control	**External control**
Formal	- Supervisory board - Management team - Shareholders - Workers council - Guidelines and authority relations	- Competition authorities - Laws on, *e.g.*, property rights, bankruptcy and insolvency procedures, and rules regulating enforcement - Exchange rules (stock exchange) - Accounting standards, and auditing and disclosure principles - Reputational agents (financial analysts, accountants, and the like) - Institutional organizations like Central Banks, OECD, World Bank, EBRD
Informal	- Firm specific norms and values - Managerial ethos - Codes of conduct	- Self-regulation in a sector - Reputation (trust) - Societal norms and values

3. The relationship between corporate governance institutions and the overall institutional environment

Recently, several international institutions and committees have made suggestions with respect to what may be considered as ‘sound’ and accepted corporate governance guidelines or principles. A well-accepted set of sound corporate governance principles is the set of OECD-principles (OECD, 1999). The main elements of the principles are summarized as follows[1]:

1. The protection of shareholders’ rights (receive relevant information about the corporation in a timely manner, have the opportunity to participate in decisions concerning fundamental corporate changes, and share in the profits of the corporation, among other things. Markets for corporate control should be efficient and transparent, and shareholders should consider the costs and benefits of exercising their voting rights).
2. The equitable treatment of all shareholders should be ascertained (especially minority and foreign shareholders, with full disclosure of material information and prohibition of abusive self-dealing and insider trading; all shareholders of the same class should be treated equally. Members of the board and managers should be required to disclose any material interests in transactions).
3. The rights of stakeholders in corporate governance should be clear (stakeholders should be recognized as established by law, and the corporate governance framework should encourage active cooperation between corporations and stakeholders in creating wealth, jobs, and financially sound enterprises).
4. To ensure timely and accurate disclosure and transparency (on all matters material to company performance, ownership and governance and relating to other issues such as employees and stakeholders; financial information should be independently audited and prepared to high standards of quality).
5. The responsibilities and roles of boards should be established (the corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board’s accountability to the company and shareholders).

The OECD principles suggest that the following aspects are key areas of corporate governance at the company level:

1. Ownership structure (who are the shareholders; are there major blockholders; is there a general shareholder meeting; how are voting

[1] For the complete set of principles, see annex 1.

rights organised; are there any anti-take-over mechanisms; is there any insider trading).

2. Board structure and process (what kind of board is prevalent (one/two tier boards); are there any committees).
3. Stakeholders' rights (are interests of stakeholders protected by law).
4. Transparency and disclosure (accountants; accounting standards; other reputational agents).

Clearly, these key areas comprise of both internal (1 and 2) and external (3 and 4) aspects of corporate governance. The OECD principles are mainly aimed at (large) firms with shares that can be traded on the stock exchange and are mainly focused at internal and external corporate governance institutions. Yet, we argue that internal and external corporate governance institutions are closely linked to the general institutional environment of a country. The general institutional environment may consist of aspects such as the government institutions at large, the general regulatory environment, the existing rule of law and (absence of) corruption. The development and strength of internal and external corporate governance institutions is dependent on the quality and strength of the general institutional environment. Or, stated in somewhat different words, the quality of the general institutional environment enables the development of internal and external corporate governance institutions. For instance, when a country is characterised by 'weak' governments, weak legislation and high corruption, corporate governance institutions (internal as well as external) may not be strongly developed and even if they are developed, they will not be very effective.

In several discussions on the role and importance of corporate governance in the process of economic development the link between internal and external governance institutions, and the general institutional environment has been put forward. In this respect, the discussion on the East Asian crisis of 1997-1998 and its consequences for domestic economies of the countries in this region, as well as for international capital flows, is a good example. According to Kawai (2000), among policy makers, international financial institutions (e.g. IMF and World Bank), private organizations, and academic circles, views are converging that the East Asian crisis was caused by interactions between massive capital inflows and outflows on the one hand, and the presence of so-called 'weak' domestic institutions on the other hand. As a result, discussions on this issue are currently proceeding on how the international financial system and the domestic underpinnings can be strengthened. Kawai discusses a number of proposals for strengthening domestic institutions in emerging markets. In particular, he stresses the need:

- for financial markets to improve transparency and supervision and do a better job in self-regulation and risk-management;

- for authorities to develop effective frameworks for resolving bank and corporate insolvencies (e.g. bankruptcy and foreclosure procedures) at minimum constant without creating moral hazard;
- to improve corporate governance through the adoption of international standards and best practices for accounting, auditing, and disclosure.

This indicates that a lack of transparency and supervision on financial markets, the lack of corporate restructuring procedures, and the lack of complying to internationally accepted corporate governance standards refer to what may be considered as weak institutions. It shows that weak institutions refer to both internal and external corporate governance institutions, as well as to the general institutional environment. Moreover, it refers to the interrelatedness between these different groups of institutions. Weak institutions lead to gaps in corporate governance systems. A good example of this is Indonesia. This country has a relatively well-developed legislation with respect to bankruptcy and foreclosure. Yet, the main problem is enforcement of laws and the high level of corruption.

The above described problems of weak institutions appear to be especially strong in emerging market economies like those in Central and Eastern Europe. Weak institutions may result in less well-functioning goods markets, labour markets and markets of corporate control. In this way top management of large dominant firms (which often are the result of mass privatisation programs) may entrench, it may prevent new entry on markets, and entrepreneurship may be strongly discouraged (World Bank, 1999: 14). In this way, weak institutions and thus weakly developed internal and external corporate governance institutions may hamper the process of economic transition of these countries. In light of the fact that many of the countries in Central and Eastern Europe aim to join the EU within the coming years, the slowing down of the process of economic transition in these countries may seriously compromise their efforts and may endanger their accession to the EU. This indicates the importance of evaluating the current state of the general institutional environment, as well as the internal and external corporate governance institutions, to see to what extent and what kind of policy reforms are needed in this respect.

To conclude this section, both internal and external governance institutions need to be developed in order to strengthen the corporate sector of a country. These governance institutions need to be developed, however, in conjunction with the development of the general institutional environment. In the next section we discuss both the external and internal corporate governance institutions as described in table 1, as well as the general institutional environment in Estonia.

4. Comparative analysis of corporate governance institutions in Estonia as compared to other Central and Eastern European countries

4.1 The general institutional environment

The World Bank has developed a comprehensive dataset with six broad governance dimensions of governance for 175 countries. The methodology is explained in Kaufman et al. (2002)[2]. The six dimensions are based on 17 separate sources of subjective data on perceptions. By using the unobserved components methodology, the World bank-researchers clustered variables based on the 17 groups into 6 clusters, which represent an aspect of so-called good governance. They define governance as: "*the traditions and institutions by which authority in a country is exercised*" (p.4). We focus on the following dimensions of the general institutional environment:

- Government effectiveness: what inputs are required for the government to be able to produce and implement good policies and deliver public goods; based on indicators that measure perceptions of the quality of public service provision, the quality of the bureaucracy, the competence of civil servants, etc.
- Regulatory quality: focused on policies; based on measures of the incidence of market-unfriendly policies such as price controls or inadequate bank supervision or excessive regulation.
- Rule of law: the success of a society in developing an environment in which fair and predictable rules form the basis for economic and social interaction; based on several indicators that measure the extent to which agents have confidence in and abide by the rules of society (also enforceability of contracts).
- Control of corruption: a manifestation of a lack of respect of both the corruptor and the corrupted for the rules which govern their interactions; based on indicators ranging from the frequency of additional payments to get things done, to the effects of corruption on the business environment, to measuring grand corruption in the political arena.

For each of these clusters the component indicators are combined into an aggregate governance indicator. The choice of units for governance for a country is on a scale ranging from –2.5 to 2.5, with higher values corresponding to better governance outcomes.[3]

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[2] See also the website of the World Bank for an overview of the data, methodology, and data-sources: http://worldbank.org/wbi/governance.

[3] For more details on the governance scores of our selected group of countries, see annex 2.

From table 2 we may conclude the following:

- Government effectiveness: Estonia has a higher score compared with the other Central and Eastern European countries. Government effectiveness in Estonia is lower than UK, France and Germany.
- Regulatory Quality: Estonia has a higher score compared with the other Central and Eastern European countries; it is lower than in the UK, but higher compared to Germany and France.
- Rule of Law: Of the Central and Eastern European countries Estonia is the second best. It scores less than UK, France and Germany.
- Control of corruption: Of the Central and Eastern European countries, Estonia is the second best. Yet, it performs less than UK, France and Germany on this aspect.

Table 2: General institutional environment, 2001

	Government Effectiveness	**Regulatory Quality**	**Rule of Law**	**Control of Corruption**
Bulgaria	-0.26 (9)	0.16 (9)	0.02 (9)	-0.16 (9)
Czech Rep.	0.58 (4)	0.54 (3)	0.64 (4)	0.31 (5)
Estonia	***0.86 (1)***	***1.09 (1)***	***0.78 (2)***	***0.73 (2)***
Hungary	0.60 (3)	0.88 (2)	0.76 (3)	0.65 (3)
Latvia	0.22 (8)	0.30 (6)	0.36 (6)	-0.03 (8)
Lithuania	0.26 (6)	0.30 (6)	0.29 (8)	0.20 (7)
Poland	0.27 (5)	0.41 (5)	0.55 (5)	0.43 (4)
Romania	-0.54 (10)	-0.28 (10)	-0.02 (10)	-0.51 (10)
Slovak Rep.	0.23 (7)	0.27 (8)	0.36 (6)	0.23 (6)
Slovenia	0.70 (2)	0.52 (4)	0.89 (1)	1.09 (1)
France	1.24	0.59	1.22	1.15
Germany	1.67	1.08	1.57	1.38
UK	1.77	1.32	1.61	1.86
Average 10 CEECs	0.25	0.45	0.46	0.29
Average 3 ECs	1.56	1.00	1.46	1.46

Source: http://worldbank.org/wbi/governance; Country ranking between brackets

These rankings show that compared to other Central and Eastern European countries Estonia performs very well. It is also interesting to see that, as far as regulatory quality is concerned, Estonia scores close to some of the largest EU-countries.

What accounts for this relatively good performance of Estonia, as compared to most other Central and Eastern European countries in terms of the development of the general institutional environment? A number of explanations have been suggested in the literature (Nørgaard and Johannsen, 1999; Nørgaard, 2000). First, history plays an important role. Between 1918 and 1940 Estonia (as well as Latvia and Lithuania) gained independence after the collapse of the Russian and German empires. The interwar independence has been an important focal point for the country's leaders and population to pursue reform policies, including institutional reforms, and accept the sometimes difficult consequences of these policies. This may also explain why Estonia started initiating these reform policies shortly after gaining renewed independence in 1991.

Second, Estonia was in a good position to introduce such reforms (as compared to both Latvia and Lithuania), because the Estonian economy is characterized by a relatively non-capital intensive industrial structure. This made it easier to carry out reforms and introduce new market institutions, since there was relatively weak opposition from vested interests of communist elites in old large-scale capital intensive industries. To put it differently, the new political leaders were relatively isolated from previous societal interests, giving them more freedom to introduce new institutional and economic structures.

Third, the new political leaders in Estonia were relatively receptive to policy advice from international financial institutions such as IMF and World Bank (Amsden, Kochanowicz and Taylor, 1994). These institutions favoured rapid and sweeping economic and institutional liberalizations. Added to this, the Estonian reform team consisted of economic and political experts who were capable of translating policy advice into actual policy making. These circumstances may explain why the Estonia government was among the fastest in Central and Eastern Europe in carrying out reform policies.

Finally, Estonian leaders were strongly focused on connecting to Western European partnerships, such as membership of the European Union and NATO for political, economic and security reasons. The struggle for EU membership also required major institutional reforms. In conclusion, in our view, Estonia's relatively good performance in terms of the general institutional environment (and, as will be shown below, also in terms of the more specific external corporate governance institutions) is based on the combination of all these circumstances.

4.2 External corporate governance

The EBRD discusses the progress in transition of Central and Eastern European countries in its annual Transition reports. These reports provide data on the developments with respect to privatisation, competition policy, infrastructure, financial markets and institutions, and legal development, using a four-scale classification system. These data provide direct and indirect information on developments with respect to external corporate governance institutions as discussed in Table 1. In particular, we use the following indicators as defined by the EBRD Tranisition reports:

- Corporate governance and enterprise restructuring: range from 'soft budget constraints (lax credit and subsidy policies, weakening financial discipline at the enterprise level); few other reforms to promote corporate governance' (1) to 'standards and performance typical of advanced industrial economies; effective corporate control exercised through domestic financial institutions and markets, fostering market-driven restructuring' (4+).
- Large-scale privatisation: range from 'little private ownership' (1) to 'standards and performance typical of advanced industrial economies: more than 75% of enterprise assets in private ownership with effective governance' (4+).
- Small-scale privatisation: range from 'little progress' (1) to 'standards and performance typical of advanced industrial countries: no state ownership of small enterprises; effective tradability of land' (4+).
- Banking reform: range from 'little progress beyond establishment of a two-tier system' (1) to 'standards and performance norms of advanced industrial economies: full convergence of banking laws and regulations with BIS standards; provision of full set of competitive banking services' (4+).
- Non banking financial reform: range from: 'little progress' (1) to 'standards and performance norms of advanced industrial economies: full convergence of securities'(4+).
- Legal extensiveness: range from 'legal rules concerning pledge, bankruptcy and company law are perceived as very limited in scope; company laws do not ensure adequate corporate governance or protect shareholders rights' (1) to 'comprehensive legislation exists in all legal sectors that were part of the survey' (4+).
- Legal effectiveness: range from 'commercial legal rules are usually unclear and sometimes contradictory'(1) to 'commercial laws are perceived as clear and readily ascertainable' (4+).

Based on the analysis of the EBRD Transition Report 2001 (EBRD, 2001a), the following picture emerges for Estonia as compared to other countries in Central and Eastern Europe that want to join the EU with respect to some of the most important external corporate governance institutions.

a) Governance and enterprise restructuring (table 3)

According to the EBRD, Estonia has made substantial progress with respect to corporate governance and enterprise restructuring. Countries like Latvia, Lithuania, and Slovenia are lagging behind somewhat, while Romania and Bulgaria clearly still have a long way to go.

b) Small scale and large scale privatisation (table 3)

The Estonian government has made substantial efforts in privatisation. In 2000 the SME-sector was in private hands. As far as large-scale privatisation is concerned Estonia made some substantial progress towards the advanced economies (more than 75% of enterprise assets of large companies are in private hands with effective corporate governance). In both sectors the other Central and Eastern European countries made about the same progress (with exceptions of Bulgaria and Romania).

Table 3: Corporate governance and enterprise restructuring, small and large scale privatisation

	Corporate gov. and enterprise restructuring			**Small-scale privatisation**			**Large-scale privatisation**		
	1992	1996	2000	1992	1996	2000	1992	1996	2000
Bulgaria	1	2	2.3	3	2	3	1	3	3.7
Czech Rep	2	3	3.3	3	3	3	4	4.3	4.3
Estonia	***2***	***3***	***3.3***	***2***	***3***	***3***	***2***	***4.3***	***4.3***
Hungary	3	3	3.3	3	3	3.3	2	4	4.3
Latvia	2	3	2.7	3	3	3	2	4	4.3
Lithuania	1	3	2.7	2	3	3	2.7	4	4.3
Poland	2	3	3	3	3	3.3	4	4.3	4.3
Romania	1	2	2	2	3	3	2	3	3.7
Slovak	2	3	3	3	3	3	4	4.3	4.3
Slovenia	1	2.7	2.7	3	3	3.3	3	4.3	4.3

Source: EBRD Transition Report 2001

c) Banking and non banking reform (table 4)

Estonia made substantial progress on both indicators. With respect to banking reform Estonia shows progress in establishment of bank solvency and of a framework for prudential supervision and regulation; also full interest liberalisation is present and significant lending to private enterprises. Next, a movement of banking laws and regulations towards BIS-standards is visible. When it comes to non banking reforms, Estonia shows substantial issuance of securities by private companies; establishment of independent share registry (see also the sub-section on Tallinn Stock Exchange), some protection of minority shareholders, and the emergence of some non-bank financial institutions (e.g. investment funds, private insurance and pension funds) and associated regulatory framework. For the other Central and Eastern European countries the same progress is visible, with Bulgaria and Romania somewhat lagging behind.

d) Legal extensiveness and legal effectiveness (table 5)

As far as legal extensiveness is concerned, we see that Estonia made progress towards legislation on pledge, bankruptcy and company law, but it is not in the forefront when compared with the other Central and Eastern European countries. Company law may contain limited provisions for corporate governance. Bankruptcy legislation may place claims of certain creditors above those of secured creditors in liquidation. In the field of legal effectiveness Estonia is one of the leading countries. This means that commercial laws are reasonably clear and administrative and judicial support of law is reasonably adequate. As far as legal effectiveness is concerned the Czech Republic lags somewhat behind the other countries.

Table 4: Banking and non-banking financial reform

	Banking reform			**Non-banking financial reform**		
	1992	1996	2000	1992	1996	2000
Bulgaria	1.7	2	3	1	2	2
Czech Rep.	3	3	3.3	1	2.7	3
Estonia	***2***	***3***	***3.7***	***1***	***2***	***3***
Hungary	2	3	4	2	3	3.7
Latvia	2	3	3	1	2	2.3
Lithuania	1	3	3	1	2	3
Poland	2	3	3.3	2	3	3.7
Romania	1	3	2.7	1	2	2
Slovak	2.7	2.7	3	1	2.7	2.3
Slovenia	2	3	3.3	2	2.7	2.7

Source: EBRD Transition Report 2001

Table 5: Legal extensiveness and legal effectiveness

	Legal extensiveness				Legal effectiveness			
	1997	1998	1999	2000	1997	1998	1999	2000
Bulgaria	3	4	4	4	3	4	3.7	3.7
Czech Rep	4	4	3.3	4	4	4	2.7	2.7
Estonia	***4***	***3***	***3.3***	***3.3***	***4***	***4***	***3.7***	***4***
Hungary	4	4	4	4	4	4	3.7	3.7
Latvia	3	3	3.7	4	3	2	3	3.7
Lithuania	4	4	4	4	3	3	3	3.3
Poland	4	4	4	4	4.3	4	3	4
Romania	3	4	3.3	3.3	3	4	3.7	3.7
Slovak	3	3	4	3	3	2	3.3	3
Slovenia	3	3	4	4	4	3	4	3.7

Source: EBRD Transition Report 2001

When we consider the average scores of all EBRD ratings (discussed in Tables 3-5) in the period 1992-2000, we see that Estonia worked itself up from one of the lowest scoring countries in 1992 to the top three in 2000 (Table 6). Basically, the positive performance of Estonia, relative to the other countries in the region, in terms of building external corporate governance institutions can be explained by referring to the same set of circumstances that was already discussed when we considered the background to the relatively positive performance of Estonia regarding its general institutional environment, *i.e.* Estonia's historical background; weak interest groups based on old capital, making the new policy makers relatively isolated from potentially strong interest groups in society; swift and deep reforms, which among other things, were inspired by the involvement of international financial institutions; and the eagerness of Estonia's political leaders to become embedded in Western European partnerships.

Stock market

The data provided by the EBRD do not discuss stock market developments. Yet, the stock market is one of the more important external corporate governance institutions. In this market, shares of corporations are traded. The stock market may play an important role in disciplining the management of these corporations in terms of their activities, since price changes may signal the opinions of shareholders with respect to these activities. The stock market therefore plays a pivotal role in corporate governance structures.

Table 6: Average ratings of EBRD indexes 1992-2000

	1992	**Rank**	**1996**	**Rank**	**1998**	**Rank**	**2000**	**Rank**
Bulgaria	1.63	7	2.14	10	2.92	8	3.08	9
Czech Republic	2.43	1	3.29	1	3.48	3	3.40	4
Estonia	***1.57***	***8***	***3.04***	***5***	***3.29***	***4***	***3.48***	***3***
Hungary	2.29	4	3.29	1	3.69	1	3.70	1
Latvia	2.00	5	2.86	7	2.78	10	3.14	8
Lithuania	1.53	9	2.86	7	3.03	5	3.22	6
Poland	2.43	1	3.19	3	3.50	2	3.54	2
Romania	1.39	10	2.39	9	2.84	9	2.86	10
Slovak	2.39	3	3.10	4	3.00	7	3.18	7
Slovenia	1.86	6	2.91	6	3.03	5	3.33	5

Source: EBRD Transition Report 2001

Estonia has a stock market: The Tallinn Stock Exchange (TSE).[4] The TSE came into existence primarily due to initiatives from a number of commercial banks and brokerage firms to create a liquid and transparent securities market. Since the beginning of the 1990s, securities trading started, but initially this was largely done in primary markets by a select group of companies, which offered highly illiquid and non-transparent securities. These early initiatives culminated into the official regulation and codification of security trading with the adoption of the Securities Market Act in June 1993. In August 1994 the Estonian government ratified the procedure of public sale of shares of firms that were to be privatised; and in October of that year the government ratified the statutes of the Estonian Central Depository of Securities (ECDS), which was founded by the main market participants. The ECDS stipulates registration of shares for all public limited companies registered in Estonia. The foundation of the ECDS created a regulated and efficient environment for clearing and registering shares. This would support the functioning of an efficient secondary market. In 1995 this was established when the TSE was founded by a group of commercial banks, brokerage firms and state actors. The TSE started operating on May 31, 1996, after the Ministry of Finance had regulated and licensed the market. At the start of its operation 11 securities were listed at the TSE.

4 The information in this paragraph has been taken from the website of the Tallinn Stock Exchange. The full address is: http://www.tse.ee/english/general/overview/default.html

On June 12 2002, 16 firms were listed at the TSE. One of the general requirements of a listed firm is that at least 25% of the shares must be freely tradable or when the market functions properly at a lower percentage. Some other relevant requirements are that listed shares must be freely transferable, shares must be registered with the ECDS, the issuer must have been carrying on an independent business for at least three years, the issuer must show half yearly and also audited annual reports for the preceding three years, it must show a net profit and an operating profit in the preceding financial year, the foreseeable market capitalisation of shares is at least 300 million EEK, and at least 300 investors (with each of them investing at least 10,000 EEK or else 1000 investors) must be present (source: Listing Rules see footnote 4). In general, the transparency of the listed firms will be improved because of the registration of shares in the ECDS. This also may enhance creditworthiness of the listed company and gives opportunities for publicity among Estonians as well as foreign investors. After registration in the ECDS data on securities, corporate actions, owners and trading statistics will be publicly accessible. From the Listing Rules it also becomes clear that listed firms have audited reports, supervisory boards and that there are rules with respect to board-members and management having shares, shareholders having more than 5% of the shares and finally voting rights. In 2001, the Estonian Parliament passed legislation that merges the supervisory bodies for securities, banking and insurance into one single entity, the Financial Supervisory Authority (FSA, see EBRD, 2001b). The FSA will be independent of state entities. The FSA will oversee all listings of public companies, as well as the Central Registry of Securities, in which all shares (including both private and public companies) will need to be registered within the next two years.

The above discussion of the TSE and its regulation seems to suggest that the Estonian government has put much effort in setting up a set of rules that should enhance the role of the TSE in corporate development of Estonia. In other words, the institutional setting appears to be rather well developed in this respect. Yet, the figures on the market capitalization and the number of stocks traded show that the TSE is still relatively small in size, indicating that only a small portion of the Estonian corporate sector is traded publicly. Table 7 provides information on the stock market capitalization of a number of Central and Eastern European countries. This table shows that the market capitalization of the TSE has increased since the mid-1990s. Moreover, market capitalization of the TSE is relatively high as compared to other stock markets in the region. With a market capitalization of 35 per cent the TSE is comparable to stock exchanges of Turkey, Mexico and Brazil. Yet, it is still relatively low as compared to those in developed economies: market capitalization of the United States is around 150 per cent, in Sweden it reaches 100 per cent and even in Germany it is 50 per cent (Claessens, Djankov and Klingebiel, 2000).

Table 7: Stock markets: market capitalisation

	1994	1995	1996	1997	1998	1999	2000	1997-2000
Bulgaria	-	0.5	0.2	0.0	7.7	6.0	5.1	4.7
Czech Rep.	14.2	30.2	31.3	26.6	20.1	23.1	23.2	23.3
Estonia	***-***	***-***	***-***	***24.7***	***9.4***	***36.6***	***35.2***	***26.5***
Hungary	4.2	5.8	12.4	35.2	29.9	36.2	26.3	31.9
Latvia	-	0.2	3.0	6.1	6.1	5.9	8.3	6.6
Lithuania	1.0	2.6	11.4	17.8	10.0	10.7	14.0	13.1
Poland	3.5	3.9	6.6	9.6	13.1	20.0	18.8	15.4
Romania	0.0	0.4	0.2	2.0	3.3	3.1	3.8	3.1
Slovak	7.3	6.7	11.5	9.3	4.7	3.8	3.9	5.4
Slovenia	4.1	1.8	3.6	9.3	12.2	11.9	24.0	14.4

Source: EBRD Transition Report 2001a
"-" means not available

Moreover, information on turnover ratios and value of traded shares relative to GDP provide further evidence to the fact that the stock market in Estonia (and the Baltic states) is relatively unimportant as a source of external finance for firms (Table 8).[5] Vensel and Wihlborg (1998) show that Estonian firms generally rely much more on own savings and bank loans.

Table 8: Stock market turnover rates and value traded, 2000

	Estonia	Latvia	Lithuania
Turnover rate[1]	16.9	25.7	6.6
Value traded[2]	6.0	3.2	1.8

Source: Pajuste and Olsson (2001)
1. percentage of total market capitalization
2. percentage of GDP

[5] Note, however, that during large parts of 1997 and 1998, trading activity at the TSE was relatively high due to adverse macroeconomic conditions following the outbreak of the Asian crisis, bad loan problems of Estonian domestic banks, and a general drop of confidence in the Estonian economy. These developments led to a general loss of confidence in Estonian securities, which led to extremely high daily turnover figures reaching almost 300 million Estonian Kroons during July 1997 (information taken from the website of the TSE at hhttp://www.tse.ee/English/sitemap/bottom.html, then go to "trading statistics").

The relatively underdeveloped state of the stock market in Estonia (and other Central and Eastern European countries) may explain the existence of large ownership blocks (see next section). Providing capital through buying shares is only attractive for potential investors if they are also able to control the company. With a relatively small stock market it is more difficult and perhaps also less profitable to sell shares. Therefore, satisfactory returns on investment can only be expected from dividends and/or from selling the company. Both decisions with respect to dividend payments and selling of the company can only be influenced if the investor has a large stake in the company, enabling him to influence decisions in the management board.

Another reason for the relatively poor performance of the stock market in Estonia and several of the other Central and Eastern European countries is the weak enforcement of capital market regulations. In a study for nine Central and Eastern European countries during 1994-2001, Pajuste (2001) shows that enforcement of (corporate governance) rules is the most important determinant for explaining stock market returns. Although Estonia and the other two Baltic countries did implement relatively strict rules on stock markets from the beginning (see also the short discussion of the TSE previously), the enforcement of these rules appears to be lagging far behind. In particular, a weak factor in this respect is disclosure and transparency of information on the voting power of controlling owners, concerted action (such as voting agreements, corporate linkages, etc.) and (in some cases) the true identity of the owner(s). The lagging behind of enforcement is due to the lack of clear legal responsibilities, as well as insufficient resources, corruption and inexperienced personnel to carry out enforcement (Pajuste, 2001:15). This latter argument again shows the close relationship between corporate governance institutions and the general institutional environment. In the context of the discussion on the role of stock markets in the process of corporate development, it shows that having established a set of rules that enhances the role of stock markets in corporate development alone is not enough. More than having these rules, they should be implemented and enforced. Enforcement demands a strong institutional environment, which is characterised by a strong government, a strong legislation and low levels of corruption (see table 2).

4.3 Internal corporate governance

As was discussed above, both the general institutional environment and external corporate governance institutions are crucial to develop strong internal corporate governance institutions. The previous section also made clear that Estonia has made important improvements with respect to the institutional environment in general, as well as with respect to the external corporate governance institutions, during the 1990s and early 2000s. The next question to be answered is how internal corporate governance institutions have developed in Estonia during the last decade. Important internal governance institutions are the ownership structure, share and stakeholder rights, transparency and disclosure, and board structure and process. Below, we mainly discuss the issue of ownership concentration and blockholding of shares in Estonia as compared to other Central and Eastern European, as well as Western European countries.

Ownership concentration

In several European countries ownership concentration is very high (see e.g. Becht and Mayer, 2001). Estonia is no exception to this finding. In fact, research by Pajuste and Olsson (2001) shows that ownership concentration in Estonia is among the highest in the region. Based on a sample among 103 Estonian, 56 Latvian and 105 Lithuanian firms (carried out in 2000), they find that the largest owner in Estonia has a stake of over 60 per cent, whereas in Latvia and Lithuania this is 45-50 per cent (see Table 9). This is rather high when compared with ownership concentration in many Western European countries, such as France and the UK. At the same time, however, high ownership concentration is not unique to the Central and Eastern European countries. Countries like Germany (see table 9), Belgium and Italy also have high ownership concentration. What is more important perhaps is that also the second largest owners have a relatively high stake in Estonia: more than 20 per cent, whereas in Lithuania and Poland this is around 15 per cent and 10 per cent in Latvia. These figures are much higher than in most Western European countries, like for instance France and UK.

Table 9: Comparison of the cash flow/voting rights held by the three largest owners[1]

Country	**1st largest**	**2nd largest**	**3rd largest**
Estonia	***61.1***	***21.6***	***10.1***
Latvia	49.5	9.7	5.4
Lithuania	44.7	16.0	11.7
Poland	42.4	14.8	9.2
Slovenia	27.4	13.4	9.2
Finland	32.8	9.8	5.7
Germany	57.0	less than 5	less than 5
France	20.0	5.9	3.4
UK	9.9	6.6	5.2

Sources: Pajuste and Olsson (2001); Becht and Mayer (2001)

1. For Germany, France and the UK the figures refer to voting rights; for the other countries the figures refer to cash flow rights.

Pajuste and Olsson (2001) also discuss the type of owners of the firms in their sample. They show that in general domestic and foreign companies have large stakes in companies as largest owner. Again, this is particularly true for Estonia. Table 10 shows that domestic companies as largest owner hold almost 70 per cent of capital, whereas in Latvia and Lithuania this is 55 and 45 per cent, respectively. Foreign companies hold 64 per cent of capital as largest owner in Estonia; in Latvia and Lithuania this is 46 and 64 per cent, respectively. One of the reasons why foreign companies do play an important role in Estonia (but also in the other two Baltic states) is that during the initial phase of the process of privatisation in the 1990s the government tried to attract strategic foreign investors to invest in formerly state-owned enterprises. Later on during the 1990s, the main part of foreign investment in Estonian companies consisted of foreigners buying a share in privately held companies.

The above discussion clearly shows that in Estonia (but also in other Central and Eastern European countries) the ownership structure is highly concentrated. One of the reasons for this may be that the stock market in Estonia (and other Central and Eastern European countries) is relatively under-developed, as was also discussed in the previous section.

5. Concluding remarks: how far has Estonia gone in developing its institutions and corporate governance?

The analysis of corporate governance institutions, as well as of the general institutional environment in Estonia reveals that in general these institutions have been improved during the past ten years. The Estonian government has taken its job seriously and has done a reasonably well job in designing various kinds of general and external corporate governance institutions. At the same time, however, further improvements with respect to developing corporate governance institutions, as well as the general institutional environment need to be made in the near future. In particular, the following problems remain:

- The introduction of ‘sound’ corporate governance institutions in itself does not always result in proper implementation. Managers, board members, regulators and shareholders all have to be convinced of the usefulness of these institutions. This is of course a problem that is not specific for Estonia, but will generally show up when existing institutions are changed or new institutional principles are introduced.
- When enforcement of rules (regulations, law, etc.) is lacking or missing, disclosure of information, transparency and accountability will be probably less than needed. In this respect Estonia and other Central and Eastern European countries lag behind.

Table 10: Type of largest owner by country

Type of the 1st largest owner	Average % of capital		
	Estonia	Latvia	Lithuania
Private (domestic)	45.98	52.77	25.85
Company (domestic)	69.01	54.62	44.66
Financial (domestic)	41.42	55.40	54.24
Company (foreign)	63.50	45.91	63.81
Private (foreign)	94.42*		32.97
Financial (foreign)	56.63	36.34	33.58
Other (including Privatization Agency)	32.91	38.40	70.35
State insurance fund		8.81	29.28
Total average % capital (1st largest owner)	60.77	61.09	49.47

Source: Pajuste and Olsson (2001)
* This is based on only one observation.

In Estonia, these problems are reflected in the concentration of ownership (large blockholders), and still low liquidity and market capitalization of the stock markets. One typical solution for this, which is offered by Johnson and Shleifer (2001:22-23), is to introduce properly designed US-type of legal reform aimed at investor protection. In contrast, Berglof and Von Thadden (1999) stress that for transition economies the focus on internal governance institutions (and especially the narrow version of this, i.e. the shareholder value approach) is too restrictive. They argue that since there is a lack of qualified people to be on the boards of supervisors of firms, managers have the power to subtract rents from firms without being well monitored. Therefore, stakeholders outside enterprises should play an important role in the corporate governance of firms. These parties could be banks, labour organisations, the government, etc. In particular, foreign banks could play an important role as monitors of firm managers. In many Central and Eastern European countries foreign banks have become an important player in banking markets. These foreign banks may introduce new corporate governance practices that may help to restructure corporate governance of firms in Central and Eastern Europe. Further research on the internal corporate governance structures of corporations in Estonia (and other Central and Eastern European countries) is needed to get a better picture of the developments and constraints existing internal corporate governance practices lay on the process of a successful economic transition.

One important conclusion that is related to further developing and improving internal corporate governance structures, is that Estonia and other Central and Eastern European countries should aim at gaining public confidence to raise the liquidity of stock markets. In turn, this can be achieved by improving enforcement of regulations, and increasing disclosure and transparency of information. At the same time, the general institutional environment needs to be improved: a stronger government with well-qualified personnel and stronger legislation needs to be developed, while corruption should be reduced. Consequently, in order to function well internal corporate governance institutions need to be attuned with the external corporate governance institutions, whereas both need to be embedded in an adequate supporting political and institutional environment.

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Annex 1: OECD-principles

1. The rights of shareholders

The corporate governance framework should protect shareholder's rights.

A. Basic shareholder rights include the right to: 1. Secure methods of ownership registration; 2. Convey or transfer shares; 3. Obtain relevant information on the corporation on a timely and regular basis; 4. Participate and vote in general shareholders meetings; 5. Elect members of the board; and 6. Share in the profits of the corporation.

B. Shareholders have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes such as: 1. Amendments tot the statutes, or articles of incorporation or similar governing documents of the company; 2. The authorisation of additional shares; and 3. Extraordinary transactions that in effect result in the sale of the company.

C. Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules, including voting procedures, that govern shareholder meetings:

1. Shareholders should be furnished with sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be decided at the meeting

2. Opportunity should be provided for shareholders to ask questions of the board and to place items on the agenda of at general meetings, subject to reasonable limitations

3. Shareholders should be able to vote in person or in absentia, and equal effect should be given to votes whether cast in person or in absentia

D. Capital structures and arrangements that enable certain stakeholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.

E. Markets for corporate control should be allowed to function in an efficient and transparent manner.

1. The rules and procedures governing the acquisition of corporate control in the capital markets, and extra-ordinary transactions such as mergers, and sales of substantial portions of corporate assets, should be clearly articulated and disclosed so that investors understand their rights and recourse. Transactions should occur at transparent prices and under fair conditions that protect the rights of all shareholders according to their class.

2. Anti-take-over devices should not be used to shield management from accountability.

F. Shareholders, including institutional investors, should consider the costs and benefits of exercising their voting rights.

2. The equitable treatment of shareholders

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

All shareholders of the same class should be treated equally.

1. Within any class, all shareholders should have the same voting rights. All investors should be able to obtain information about the voting rights attached to all classes of shares before they purchase. Any changes in voting rights should be subject to shareholder vote.

2. Votes should be cast by custodians or nominees in a manner agreed upon with the beneficial owner of the shares.

3. Processes and procedures for general shareholder meetings should allow for equitable treatment of all shareholders. Company procedures should not make it unduly difficult or expensive to cast votes.

B. Insider trading and abusive self-dealing should be prohibited.

C. Members of the board and managers should be required to disclose any material interests in transactions or matters affecting the corporation.

3. The role of stakeholders in corporate governance

The corporate governance framework should recognise the rights of stakeholders as established by law and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financial sound enterprises.

A. The corporate governance framework should assures that the rights of stakeholders that are protected by law are respected.

B. Where stakeholder interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights.

C. The corporate governance framework should permit performance-enhancing mechanisms for stakeholder participation.

D. Where stakeholders participate in the corporate governance process, they should have access to relevant information.

4. Disclosure and transparency

The corporate framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

A. Disclosure should include, but not limited to, material information on:

1. The financial and operating results of the company.

2. Company objectives

3. Major share ownership and voting rights.

4. Members of the board and key executives, and their remuneration.

5. Material foreseeable risk factors.

6. Material issues regarding employees and other stakeholders.

7. Governance structures and policies.

B. Information should be prepared, audited, and disclosed in accordance with high quality standards of accounting, financial and non-financial disclosure, and audit.

C. An annual audit should be conducted by an independent auditor in order to provide an external and objective assurance on the way in which financial statements have been prepared and presented.

D. Channels for disseminating information should provide for fair, timely and cost efficient access to relevant information by users.

5. The responsibilities of the board

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board's accountability to the company and the shareholders.

A. Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.

B. Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.

C. The board should ensure compliance with applicable law and take into account the interests of stakeholders.

D. The board should fulfil certain key functions, including:

1. Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures.

2. Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning.

3. Reviewing key executive and board remuneration, and ensuring a formal and transparent board nomination process.

4. Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions.

5. Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for monitoring risk, financial control, and compliance with the law.

6. Monitoring the effectiveness of the governance practices under which it operates and makes changes as needed.

7 .Overseeing the process of disclosure and communications.

E. The board should be able to exercise objective judgement on corporate affairs independent, in particular, from management.

1. The board should consider assigning a sufficient number of non-executive board members capable of exercising independent judgement to tasks where there is a potential for conflict of interest. Examples of such key responsibilities are financial reporting, nomination and executive and board remuneration.

2. Board members should devote sufficient time to their responsibilities.

F. In order to fulfil their responsibilities, board members should have access to accurate, relevant and timely information.

Source: OECD, 1999

Annex 2: Detailed information on the indicators of the gernaeral institutional environment as provided by the World Bank

	Voice and account		**Political stab**		**Government effect**		**Regulatory quality**		**Rule**
	estd.	SE	estd.	SE	estd.	SE	estd.	SE	estd.
	173		161		159		168		169
Bulgaria	0,59	0,16	0,37	0,26	-0,26	0,19	0,16	0,32	0,02
Czech Republic	1,04	0,16	0,74	0,23	0,58	0,18	0,54	0,26	0,64
Estonia	0,94	0,16	0,73	0,24	0,86	0,18	1,09	0,28	0,78
France	1,11	0,23	1,04	0,22	1,24	0,19	0,59	0,29	1,22
Germany	1,42	0,23	1,21	0,22	1,67	0,19	1,08	0,29	1,57
Hungary	1,19	0,16	0,75	0,22	0,60	0,17	0,88	0,26	0,76
Latvia	0,81	0,16	0,50	0,28	0,22	0,21	0,30	0,32	0,36
Lithuanina	1,00	0,16	0,29	0,26	0,26	0,19	0,30	0,30	0,29
Poland	1,21	0,16	0,69	0,22	0,27	0,17	0,41	0,26	0,55
Romania	0,50	0,16	-0,08	0,26	-0,54	0,19	-0,28	0,30	-0,02
Slovak Republic	0,99	0,16	0,62	0,25	0,23	0,19	0,27	0,28	0,36
Slovenia	1,07	0,16	0,87	0,24	0,70	0,19	0,52	0,28	0,89
United Kingdom	1,46	0,23	1,10	0,22	1,77	0,18	1,32	0,27	1,61

The column labeled "estd." provides the point estimate. The column labeled "SE" contains the corresponding standard error. The indicators are based on 2000/01 data. Details on the concepts measured by each indicator, its components, and the interpretation of the point estimates and standard errors can be found in Kaufmann, Kraay and Zoido-Lobaton (2002). All indicators are subject to a margin of error.