ECONOMIC ANNALS, Volume LXIII, No. 216 / January – March 2018
UDC: 3.33 ISSN: 0013-3264

https://doi.org/10.2298/EKA1816063A

*Ana Aleksić Mirić**
*Miroslav Todorović***
*Nebojša Janićijević****

HOW CAN THE EFFICIENCY OF CORPORATE GOVERNANCE IN SERBIAN STATE-OWNED ENTERPRISES BE INCREASED?

ABSTRACT: *This paper focuses on the practical coexistence of agency and stewardship theories. By analysing the three dimensions of government structures, compensation schemes, and monitoring activities, we show that this coexistence is possible due to several situational factors. Using field research data, we examine the causes of this coexistence and the effects it has on the efficiency and effectiveness of corporate governance, and question the practical sustainability of this dualism. We conclude that coexistence is possible but is unsustainable, and it would be wrong to support such a situation for a long period of time. We discuss paths of potential action and their implications for key stakeholders.*

KEY WORDS: *corporate governance, agency theory, stewardship theory, state-owned enterprise*

JEL CLASSIFICATION: M10, M19, G34

* Faculty of Economics, University of Belgrade, anaa@ekof.bg.ac.rs (corresponding author)
** Faculty of Economics, University of Belgrade
*** Faculty of Economics, University of Belgrade

INTRODUCTION

Though agency theory is extensively explained in the literature (Jensen & Mackling 1976; Fama & Jensen 1983a, 1983b; Williamson 1985; Eisenhardt 1985, 1988, 1989) and is commonly prescribed as a preferred business policy model (OECD 1999, 2004, 2005, 2015; Council of Institutional Investors in the US, Cadbury [1992] in the UK, Australian Institutional investors [AIMA 1995], etc.), Donaldson and Davis (1991, 1993) developed the alternative approach of stewardship theory. The two theories take opposing positions in their key assumptions about the model of man, the psychological mechanisms of managerial motivation, identification, and the use of power, and have opposing approaches to management philosophy and cultural values (Davis, Schoorman, & Donaldson 1997). Many authors, and especially the proponents of the two theories, see one theory as contradicting the other. Since these two theories take opposite positions they are not expected to cross over or coexist in practice. Some authors argue that the challenge is to blend the best of the stewardship model with the best of the agency model (Hambrick 2005), and that the dynamic between principal and agent can change their attitudes towards agent–steward positions through the individual learning that occurs each time they interact (Pasteroza & Ariño 1997). However, empirical evidence regarding the practical intersection and interaction of the two theories is rare.

Our research into governance structures in state-owned enterprises (SOE) in the Republic of Serbia recognizes the coexistence of the agency and stewardship theories and shows what happens when the principles of the two contrasting theories meet in practice. During this process the following theoretical issues arise: Is the coexistence of the stewardship and agency theories of corporate governance possible in practice? What are the causes of this coexistence? What are the effects on the efficiency and effectiveness of corporate governance? Is this coexistence sustainable? Relying on Davis, Schoorman, and Donaldson's (1997) principal–manager choice model, we discuss paths of potential action and the implications they have for key stakeholders. Also, and more relevant to the Serbian economy and business practice, we ask: 1) What do governance structures in Serbian SOEs look like? 2) Are they efficient in terms of a) protecting the interests of various stakeholders (e.g., creditors, suppliers, etc.), including the general public, b) disclosure and transparency, and c) integrity and ethical behaviour? 3) How can the efficiency of corporate governance in Serbian state-owned enterprises be increased?

THEORETICAL BACKGROUND

Corporate governance can be defined in different ways. The most important aspects of corporate governance are 1) the way in which the organization (company) defines managerial accountability to the Board of Directors and 2) the way both managers and board are accountable to the owners. Corporate governance refers to the system that defines the sources, uses, and limitations of the use of power in an organisation, identifies rights and obligations, gives legitimacy to activities, and determines responsibility. The framework for a system of corporate governance is a set of regulations (laws governing corporate law, financial markets, mergers and acquisitions, accounting and auditing, etc.), calculated to encourage or compel the directors to act in the best interest of the owners. The term 'corporate governance' therefore refers to the processes through which corporates are governed, the way power over the company is executed and control over managerial decisions is achieved, and the application of responsibilities and obligations in accordance with the legal provisions of the country in which the company operates. Most broadly defined, the term 'corporate governance' includes the entire network of formal and informal relationships between all stakeholders and the consequences of these relationships for society as a whole.

The generally accepted OECD definition of corporate governance is provided in its Principles of Corporate Governance and includes the relationships between managers, the board of directors, the owners, and other interest groups that provide the structure through which company objectives are set and determine how objectives are achieved and performance is monitored. The five major OECD principles are: 1) the rights of the owners, 2) equal treatment of owners, 3) the role of stakeholders, 4) disclosure and transparency, and 5) the responsibilities of the board.[1]

Two opposing approaches to corporate governance theory have developed: agency theory vs. stewardship theory. Agency theory (AT) assumes that the goals of the principal and the agent differ. It is deeply rooted in an economic rationality view of the individual as being driven by self-interest, bounded rationality, and risk aversion. Owners would like to manage their companies by themselves, but as this proves impossible they have to contract executives to manage their property. Agency theory considers the Board of Directors as a mechanism that enables pursuing policies consistent with shareholders' interests (Fama 1980) and monitoring executive directors. According to agency theory, effective corporate

1 OECD (1999) and OECD (2004).

governance requires the following: 1) governance structures with an independent board and with mandatory separation of the functions of the Chairman of the Board and the CEO, 2) appropriate executive compensation schemes that provide rewards and penalties so as to align principal–agent interests, and 3) monitoring activities designed to keep the agent's self-serving behaviour under control.

Contrary to AT, stewardship theory (ST) assumes that the behaviour of managers is aligned with the goals of their principals. Managers are not agents but good stewards of the corporations, who work diligently to attain high levels of corporate profit and shareholder returns (Donaldson & Davis 1991, 1993).

Stewardship theory's understanding of the board is directly opposed to that of agency theory (Muth & Donaldson 1998). Stewardship theory assumes that a non-executive board of directors is, by design, an ineffective control device (Donaldson & Davis 1991) and that it is much more productive to free managers from subservience to non-executive director-dominated boards. In fact, the board is an excessive mechanism of corporate governance. Stewardship theory assumes that boards are often established due to 'cultural habits', a blind faith that they are effective, or so that state-owned enterprises or family firms can maintain the appearance of having a business-like model. Boards are certainly excessive when a dominant shareholder is present. Brewer (1996) mentions that "one of Canada's most well-known business leaders has suggested that boards be cancelled and replaced by advisors' committees". The insistence that the board be independent is also wrong: Donaldson & Davis (1991) observe that those who promote the institution of independent boards are existing independent (non-executive) directors or those who wish to become independent directors. If a board already exists the functions of CEO and Chairman of the Board should be merged, since this is the only way to amplify the board's pro-organizational characteristics (Davis, Schoorman, & Donaldson 1997; Hawley & Williamson 1996: 29). The power and authority should be concentrated in one person, that is, the corporate leader, who is a dual CEO–Chairman. This is the only way to clearly and consistently unite the expectations of such a corporate leader of both subordinate managers and other board members. The benefits of unity of command and strong control will provide superior shareholder returns.

Stewardship theory challenges agency theory's assumptions regarding human motivation: financial incentives are not needed because managers are principally motivated by achievement and responsibility. Managers need responsible, self-directed work to gain intrinsic satisfaction, to exercise responsibility and authority, and thereby to gain recognition from peers and superiors. Thus, stewardship theory focuses not on the CEO's motivation but rather on facilitative, empowering structures.

Stewardship theory argues that rather than monitoring mechanisms, empowering government structures should be created. Control is potentially counter-productive because it undermines the managers' housekeeping-like behaviour and reduces their motivation. The CEO needs to have complete authority over the company in a role that is unambiguous and unquestionable. Governance structures should serve to create a structural situation that will help managers' effective action and empowerment. Some of the mechanisms that empower managers are information exchange/interaction with the owners, face-to-face meetings, written communication, building a principal–steward relationship based on trust, social relations/interaction (getting to know each other, attending social events), etc.

RESEARCH

Research Background

In contrast to private companies, the aim of state-owned enterprises is usually not to maximize profits or shareholder value. State-owned enterprises, especially those operating in areas of strategic importance, are usually expected to pursue social goals, such as the provision of services at below market price in order to make them accessible to all citizens, and development goals, such as encouraging the development of a region or industry. Multiple goals occur because they are legally defined as such or because government ministries are in a position to influence the company's operations. These political goals may conflict with the business paradigm. State-owned enterprises face specific challenges in the field of corporate governance practice, which differ from those governing private sector companies. Dilution of performance accountability is one of them, resulting from responsibility involving a long chain of agents such as managers, supervisory boards, ministries, government, etc.

The most significant corporate governance challenge that Serbian SOEs face is, the fact that the state is both the owner and the market regulator of companies that are significant market players. The Republic of Serbia has 33 businesses to which the Law on Public Enterprises applies, which are very significant economically due to the value of the services they deliver, the large amount of social wealth that they control, and the around 79,000 people they employ. SOEs still represent a significant part of Serbian gross domestic product, employment, and total assets. They dominate the energy, transport, and telecommunications infrastructure. Data shows that in 2014 and 2015 the 39 state-owned public enterprises and capital companies realized a net loss of 557.3 million euros and 29.3 million euros respectively. Therefore the strategic goal of Serbian economic reform should be to restructure these companies in order to achieve better business results. In order to achieve this it is necessary to change the current management method in the SOEs; that is, to improve corporate governance and professionalize management.

RESEARCH METHODOLOGY

This research was conducted between April and September 2016, using two methods: 1) desk research, which included the analysis of relevant legislation and internal documents from selected SOEs,[2] and 2) field research. We investigated governance structures in Serbian state-owned enterprises (SOEs) in Serbia. There are 33 SOEs in Serbia at state level and more than 1,000 mostly smaller ones at local level: our research encompassed only the former group. The desk research covered all state enterprises, while the field research covered 15 of the 33 SOEs.

Field research was conducted by means of interview, questionnaire, and focus group. Interviews were conducted with CEOs or their representatives in order to collect and check their attitudes and opinions towards the research topic. They were semi-structured, a less formal type of interview where questions are generally defined but the approach to asking them is flexible and the interviewer

2 Desk research was based on comprehensive review and analysis of the following regulations: Law on Public Enterprises (Off. Gazette of RS 119/12, 116/13, 44/14); Law on Public Enterprises (Off. Gazette of RS 15/16); Decree on Criteria for the Appointment of Directors of Public Enterprises Founded by the Republic of Serbia (Off. Gazette of RS 102/13); Company Law (Off. Gazette of RS 36/11, 99/11, 83/14, 5/15);Law on Budget of the Republic of Serbia for 2016 (Off. Gazette of RS 103/2015); Law on Budget System (Off. Gazette of RS 54/09, 73/10, 101/10, 101/11, 93/12, 62/13, 63/13, 108/13, 142/14, 68/15, 103/15); Law on the Public Sector Salary System (Off. Gazette of RS 18/16); Rulebook on Common Criteria and Standards for the Establishment, Operation and Reporting on the Financial Management and Control in the Public Sector (Off. Gazette of RS 99/11 and 106/13); Rulebook on the Common Criteria for Organization and Standards and Methodological Guidelines for the Conduct and Reporting of Internal Audit Public Sector (Off. Gazette of RS 99/11, 106/13); Rulebook on the Common Criteria for Organization and Standards and Methodological Guidelines for the Conduct of Internal Audit in the Public Sector (Off. Gazette of RS 82/07); Accounting Act- The Law on Accounting (Off. Gazette of RS 62/2013);Auditing Act - The Law on Auditing (Off. Gazette of RS 62/2013).

can supplement, change, or omit certain questions in order to follow the natural flow of the conversation and to adjust to the situation.

Parallel with this research, a questionnaire was sent to all 75 board members in the companies included in the research (response rate of 45.3%) in order to understand the role of the board as the body to which the principal assigns property rights and the board's relation to managers.

In addition, three focus groups were formed comprising legal sector managers, financial sector managers, and internal audit managers respectively.

RESULTS

The regulatory framework of corporate governance (CG) in Serbian SOEs[3] clearly accords with agency structure. The law decrees that a board must exist, that it should be competent, and that it should include independent members. There must also be an audit committee. With respect to monitoring activities, the board plays an important role in the strategic governance and control of the company: it is responsible for adopting a business plan, developing strategy, and implementing them; adopting interim and annual reports and financial statements; deciding the distribution of profit and loss coverage; supervising the CEO; deciding on status changes in the Articles of Association; etc. Finally, financial incentives are prescribed for managers in addition to a fixed salary. However, corporate governance practice in Serbian SOEs also contains many elements of stewardship theory.

Governance Structures.

Our research shows that in practice there is no guarantee that the board is competent, independent, or capable. There are several reasons for this. The principles, rules, and practices for candidates' nomination and election to board membership are unclear. Particularly, the process of electing board members is insufficiently regulated by the Law on Public Enterprises (Off. Gazette of RS 15/16, hereinafter referred to as 'the Law') and insufficiently transparent. The Law prescribes that the government appoints the Chairman and Members of the Board of SOEs but specifies neither the nomination procedure nor the

---

3 The Law on Public Enterprises (Off. Gazette of RS 15/16) and previously the Law on Public Enterprises (Off. Gazette of RS 119/12, 116/13, 44/14).

election process. That the board members' election is unregulated means that there is no guarantee that competent and independent candidates are selected for these positions, leaving the door wide open for political party influence and all other kinds of influence that have nothing to do with SOE operations or the public interest. Competency and independence are the key board member characteristics that provide the preconditions for adequate corporate governance, and the current manner of selecting board members is insufficient to ensure their existence. Establishing nomination, compensation, strategic planning, risk, and audit committees can strengthen the capacity of the board. However, in our research only audit committees were reported in the SOEs.

Competency means that board members must have sufficient knowledge and experience to enable them to monitor managers. They do not have to have the knowledge and experience to manage the enterprise operatively, since that is the management's responsibility. The regulatory framework prescribes that board members must have knowledge in the fields of corporate governance or finance, but there is no prescribed procedure to evaluate this knowledge. It is also decreed that board members undergo professional training in corporate governance, but it is not prescribed how this training will be realized, nor what sanctions will be imposed if the board members fail to undertake training.

The Law defines an independent board member as 1) not having been engaged in auditing the company's financial statements in the five preceding years, 2) not being a member of any political party, and 3) not being appointed, delegated, or selected and not being employed or hired on other grounds in the public enterprise concerned or in another company related to the public enterprise concerned. These are necessary strictures, but insufficient to ensure that board members are truly independent. Results from the field research show that in some SOEs, key buyers and suppliers employ three out of five board members.

The procedure for electing the board member who will represent the employees is also inadequately regulated. The Law prescribes that the board, CEO, and executive directors cannot nominate the employees' representative, but it does not define who should nominate the employees' representative and in what way: it is left to the SOEs to regulate this issue in their Articles of Association. Results from the field research show that the employee representative was not always nominated or selected by the employees. Finally, the Law does not precisely regulate if the board members who are neither independent nor employees' representatives can be high-ranking political party officials.

The capacity of the board is inadequate to perform its assigned duties, not to mention all the duties that a board should have. Of all the committees that could significantly empower a board, only the audit committee is prescribed. In practice, the audit committee either does not exist, or it consists of SOE employees, or it has insufficient accounting and finance knowledge, as these skills are not evaluated. The tenure of the audit committee members and reasons for and manner of their removal are not precisely regulated. The regulations state that the audit committee must report to the board at least once a year, which is not enough.

We surveyed board members to capture their point of view regarding important corporate governance issues. In their answers they stated that important political positions were not relevant to gaining a board member position in SOEs, and that it was important for board members to be competent and to have the necessary ability to direct a company. Although they mainly have degrees in engineering (57.2%), they highly value their CG knowledge (91.4%). In addition, they reported additional training in CG (80%), which was not confirmed when reviewing the available resumes of the board members. They did not consider their (lack of) competence as an obstacle to improved CG.

Compensation Schemes.

Although agency theory long ago identified relating compensation to performance as an important control mechanism for better aligning the interests of owners and managers, it is not currently business practice in Serbian SOEs. In the researched SOEs there is no effective evaluation of companies' and managers' performance and the CEOs all have fixed salaries. Thus, achieved results are not linked to rewards and penalties, successful and unsuccessful CEOs receive equal recognition, and attracting good CEOs is very difficult. The 2012 Law allows CEOs and executive directors to receive incentive pay in addition to their regular fixed salary, but almost four years on the government has not passed a bylaw to regulate this issue. Unfortunately, the deadline for passing the bylaw has expired, even pursuant to the new 2016 Law. The board does not participate in the evaluation of managers' performance, nor does it determine managers' compensation.

The manner of controlling the board's performance, the related compensation system for board members, and their possible removal are not connected to rewards and penalties in order to achieve results. There are no regulations as to how the state, as the owner, should maintain regular and effective communication with board members and monitor the results of their work. Currently, the level of compensation for board members is often disproportionate to the responsibility they bear. The new 2016 Law prescribes that the government shall set the criteria and measurements for determining compensation levels. The deadline for this expired at the beginning of June 2016, and they are still not set. The reasons and the procedure for board members' removal are not precise enough. The Law's statement that a board member should be removed when "it is determined that he/she acts to the detriment of the public enterprise concerned by their unscrupulous conduct or in some other way" is vague and imprecise and does not state who determines this fact, who removes the member concerned, or in what way.

Monitoring Activities.

The monitoring activities we examined are CEO election and removal processes and the design of internal control and supervision and planning, reporting, and performance evaluation practices. We found an asymmetry between the board's authority and responsibility, since the board is responsible for the SOE's performance but has no impact on major decisions that drive that performance.

The board has no authority over the election of CEOs. Pursuant to the Law, a government committee elects the CEO of a public enterprise rather than the board, as in common practice globally. This exclusion of the board undermines its authority and responsibility. The CEO election committee comprises four permanent members (one being the Chairman), only one of them being a member of the board. This practice assumes that the permanent members of the committee are sufficiently familiar with the very different areas of the SOE's business, which is not necessarily the case. The Law does not regulate how and by which criteria the government committee is chosen, so there is no guarantee that it will include experts who have knowledge of CG or of the area of business of the SOE. Likewise, there is no guarantee that the government committee will be independent of both political influence and the influence of the SOE concerned. Therefore, the procedure for CEO election is insufficiently developed to ensure necessary competence and to ensure that the best candidate is chosen.

The evaluation of CEO candidates' competency is inadequate. The election of the CEO is based on the evaluation of three categories: 1) level of expertise, 2) knowledge, and 3) skills. Level of expertise is defined as the capability to apply knowledge and skills in performing CEO duties and is measured based on: 1) acquired level of education and 2) work experience. Level of expertise is evaluated by reviewing a candidate's application and interviewing the candidate, which is insufficient to determine the candidate's capability to apply knowledge and skills in practice. While work experience is correlated with the capability to apply knowledge and skills, acquired level of formal education is no guarantee of a candidate's capability to apply that knowledge and those skills in everyday work. Level of expertise, understood as the capability to apply knowledge and skills in everyday work, cannot be evaluated based on the data from a candidate's application or through interview. There is no system of additional training for CEOs and executive directors to raise the level of knowledge in the fields important for corporate governance.

Pursuant to the 2016 Law, the Ministry of Economy submits proposals to the government for the removal of CEOs of SOEs. The board of a public enterprise may also submit such a proposal through the Ministry of Economy. Although the Law defines the conditions for the CEO's removal before the expiration of his/her term of office, the removal procedure itself is unclear and, above all, the role of the board in this process is insufficient. We have no knowledge of a board ever having initiated the removal of management, even though the performance of SOEs is Serbia is unsatisfactory.

However, contrary to our findings, in their answers to the questionnaire, board members reported as follows: 82.9% believe that the CEO should not be elected by the board, and 60% that the board should be authorized to remove the CEO. A large majority of board members (68.5%) see the entire process of CEO election as transparent (74.3%), prescribed by clear procedures (77.2%), fair to all the candidates who apply (71.4%), and as guaranteeing that the best candidate will be elected (60%).

In the majority of SOEs, internal control systems are poorly designed. The risks that SOEs face are often not identified, and controls that could prevent, eliminate, or decrease risks do not exist. In the vast majority of SOEs, all internal control components have significant weaknesses. Not all SOEs have internal audits, and in the SOEs that do there are an insufficient number of internal auditors, too few audits, few recommendations, and poor acceptance and implementation of recommendations.

In most SOEs the board does not participate in defining company strategy or in formulating long-term strategic planning. Operative planning and implementation procedures are formalized and lack specific detail. Performance control is based on quarterly reports on business programme realization, which are filed in a standardised form (Excel tables) and contain no explanations. This facilitates the Ministry's control of the public enterprise but diminishes the reports' quality and the performance control itself.

Performance control is often a non-systematic and spontaneous activity; thus the form is satisfied, but the point of the performance control process is completely missed. Of the three activities in the performance control process – gathering performance data, analysing achieved performance, and taking corrective action – only the first is performed in all SOEs, while the second is partially performed in some companies. In most SOEs the gathered data is not analysed. Discrepancies with planned objectives get detected but are rarely analysed and their causes are rarely examined. Most SOEs only deliver performance measurement results in the prescribed Excel Tables without any kind of explanation.

In the companies where there is some analysis of discrepancies the focus is on cost and not on revenue. It appears that in a public enterprise it is much more important not to exceed planned costs than it is to achieve planned income. All this points to the prevailing attitude that a public enterprise is not an independent market actor but more of an organizational unit of the state in a specific industry; hence its goal is not to cover its expenses with its own income, development, innovation, and quality but merely to avoid exceeding budgeted expenditure.

The third activity in performance control – taking corrective action if achieved performance deviates from that planned – is also problematic. This does not mean that SOEs take no corrective action to improve performance, but that this action is not based on reports that plan the realization of objectives as the basis for performance control. Thus performance control turns into a nonsystematic and spontaneous activity with respect to corrective action, and the reports cease to make much sense and become just another imposed obligation that must be fulfilled. The reports contain unnecessary content such as company history, vision, mission, organizational structure, and the like.

However, in their questionnaire responses, as many as 88.5% of the respondents who are board members express the opinion that they are able to effectively and appropriately control the performance of both management and the company (business results) during the year, particularly based on financial reports. Only 11% of the respondents believe that the internal controls have weaknesses. The large majority (74.3%) believe that SOEs develop and apply effective internal controls that prevent bad or criminal behaviour by employees, executive directors, and the CEO himself/herself, and 57% of the respondents are not concerned that weak internal control and internal audit could cause irregularities in business operations for which they are directly responsible. Only 14% of the respondents see a problem in the fact that the internal audit's recommendations are not accepted and implemented. Although the internal audit is poorly positioned, only 11% of the respondents observe this as a problem with regard to independence in work. Only 14% of the respondents think that risk assessment and control are poorly devised. As many as 77.1% of the respondents believe that the audit committee helps them in their work, although our research revealed that in many cases there is no audit committee or it is inactive.

COMMENTS ON RESULTS AND DISCUSSION

The first column of the following table gives an overview of the necessary corporate governance mechanisms and their characteristics according to agency theory: according to stewardship theory, these structures and their characteristics are undesirable. The second and third columns assess the CG regulative framework and CG practice in SOEs in the Republic of Serbia according to whether the present situation most reflects AT or ST.

We observe that there is a significant discrepancy between CG regulations and practice: while Serbian regulation mostly accords with AT, SOE business practice in the field of CG undoubtedly demonstrates ST principles. What lies behind this coexistence?

- All the enterprises in our sample are state-owned, old, large, and bureaucratic. Throughout their history they have developed meta-routines that are deeply rooted in their organizational contexts and govern their employees' behaviour. Habits and well-established manners of behaviour are very prominent and regard the CEO as a good steward of the systems that he/she is entrusted with based on his/her loyalty to the principal. Unfortunately, this loyalty usually includes loyalty to the political structures that were given the right to manage certain sectors in the distribution of political power. Although Serbia is undergoing economic, social, and political transition, these models of behaviour were established a long time ago and remain fundamentally unchanged; although they are publicly discussed no real transformation has taken place. Large-scale transformation of SOEs should be based on liberalization and deregulation, strengthening the role and function of the market, restructuring, and changing the old models of governance. These changes take time and require that all those involved be retrained. Thus, the coexistence of AT and ST principles is characteristic of the transition economy and its SOEs.

Table 1: Corporate governance regulation & practice in Serbian SOEs according to agency/stewardship theory

		CG regulation	*CG practice*
1.	*Board*		
	Presence	AT	AT
	Competency	AT/ST	ST
	Comprised of mostly independent members	ST	ST
2.	*Incentive Schemes*		
	Incentive schemes for managers that link compensation and government (public) interests, which should primarily be long-term to prevent short-term orientation	AT	ST
3.	*Monitoring activities*		
	Election of the CEO: Competency as the precondition for a successful CEO	AT/ST	ST
	The board directs and controls company	AT	ST
	CEO performance evaluation	ST	ST
	The board is in charge of removing the CEO in the case of his/her poor performance	AT	ST
	Internal control and internal audit to prevent managers' opportunistic behaviour	AT	ST
	Reporting procedures	AT	ST

Source: Authors

- Regulations promoting AT principles have been adopted because of the impact of international financial institutions, but they are undermined by the underdeveloped structures that should support them. The result is that the regulations are not implemented, and the non-implementation is not penalized. This situational context impacts how the government and the CEOs position themselves and see their roles. CEOs see themselves as stewards and they are frustrated, disappointed, and feel betrayed by the fact that the principal prescribes a regulatory framework for agents, and then the government takes a lenient position and supports the agents' failures by not sanctioning them.

- The nature of Serbian culture supports the coexistence of the different factors. According to Hofstede's classification (Hofstede 2001), Serbian culture is characterized by high collectivism, high power distance, high uncertainty avoidance, and femininity. The impact of such a cultural context on the development of CG in Serbia is controversial, since high power distance and femininity favour ST, high uncertainty avoidance favours AT, while collectivism is characteristic of both. High power distance favours the ST setting, as in an authoritarian culture the principal is expected to set goals, determine how they are to be accomplished, and control their achievement. In our case, SOE managers expect the government, as a higher authority, to control the planning and to determine the way of working, and they willingly submit to its control, which they consider its natural right. Feminine cultures emphasize the values of balance, harmony, and being. Unlike masculine cultures, which emphasize aggressiveness, assertiveness, results, and efficiency, feminine cultures do not attach too much importance to results, so ST is preferred in 'feminine' cultural contexts. High uncertainty avoidance favours AT, since high uncertainty avoidance cultures do not like change, risk, uncertainty, vagueness, and the like. There is greater uncertainty in ST settings due to the absence of control mechanisms. Managers find it more acceptable to deal with the clear situation in AT structures that are imposed by the state. Collectivism is ambivalent as regards ST and AT. In collectivist cultures the metaphor for an organization such as a company or a state is the family. In collectivism, individuals believe they have the right to expect the collective to take care of them. In return, they owe complete loyalty to the collective and its leader. Davis, Schoorman, & Donaldson (1997) propose that people in a collectivist culture are more likely to develop a principal–steward relationship than people in an individualistic culture. However, when high power distance is added to high collectivism, as in the Serbian national culture, it is self-evident that the 'family' is led by a powerful pater familias who takes care of the interests and needs of its members. Therefore, the CEOs of SOEs see themselves as pater familiases of the companies they manage, which implies the implementation of an ST model of CG. However, the managers see the state as a higher level of community, in which they are members that need to be taken care of by others, which again inclines to an AT model of CG.

The coexistence of agency and stewardship theories is possible under certain conditions. However, we believe that it is unsustainable and it would be wrong to maintain it for a long period of time: it leads to organizational underperforming, does not contribute to healthy governance relationships, is not good for organizational development, and is bad for leadership and motivation.

In Davis, Schoorman, and Donaldson's (1997) principal–manager choice model (see Figure 1) the principal–manager relationship in Serbian SOEs fits into Quadrant 3.

Figure 1. Government–CEO Choice Model

Government Choice

CEO's Choice	*Agent*	*Steward*
Agent	Minimize Potential Costs Mutual Agency Relationship (Quadrant 2)	CEO Acts Opportunistically Government is Frustrated Government is Betrayed (Quadrant 1)
Steward	Government Acts Opportunistically CEO is Frustrated CEO is Betrayed (Quadrant 3)	Maximize Potential Performance Mutual Stewardship Relationship (Quadrant 4)

Source: Davis, Schoorman, and Donaldson (1997), adapted by the authors.

The only two outcomes that would eliminate frustration are to have a pure ST situation where the government views CEOs as stewards and where CEOs choose to be stewards (Quadrant 4), or to move in the direction of a pure AT solution (Quadrant 2).

The justification for moving in the direction of Quadrant 4 is that there is no reason to believe a priori that a conflict exists between CEOs and the government. The long-term benefit for the government of adopting the model in Quadrant 4 would be decreased costs: there would be no costs associated with continuously revising the contract, financial incentives, or strict monitoring controls. However, there are even more reasons not to move into Quadrant 4.

1) There is as little evidence for the ST assumption that managers have pro-organizational rather than individualistically oriented behaviour as there is for the agency theory assumption that managers are inherently opportunistic.

2) The organizational complexity of large, old, and highly structured organizations is a serious barrier to implementing soft mechanisms of control and coordination. There are no clear answers as to how to balance building a principal–steward relationship founded on trust and the need to control potential errors or disinformation with how to evaluate CEO performance, at least to a minimal degree, and still preserve the trust component in the relationship.
3) The Serbian cultural model may also pose an obstacle to the development of the principal–steward relationship, since the cumulative characteristics of Serbian national culture are more suitable to the implementation of AT.
4) SOEs in Serbia are extremely important both to the entire economy and to the citizenry because of the extensive value of the services they deliver, the large social wealth under their control, and the roughly 83,000 people employed by them. These companies function in areas that are of vital importance not only to the country's economy but also for the social system. Therefore, it would be very hard to recommend that the principal should rely primarily on the use of soft mechanisms of control such as trust. SOEs spend their budget in direct subsidies, the government guarantees their debt, and even pays the debt in some cases. In addition, they have large unpaid tax liabilities (indirect subsidies) and debts to other SOEs. It is estimated that their annual cost equals 3% of GDP (Fiscal Council, 2014).

A relationship of mutual agency is an option supported by several arguments. In this case, the government, acting as the citizens' agent, must push regulation in the direction of Agency Theory (that is, OECD, Sarbanes–Oxley Act, etc.) and also insist on strict implementation. To achieve the transition from Quadrant 3 to Quadrant 1, it is necessary to do the following.

Governance Structures

It is necessary to improve and refine the procedures for candidates' nomination and election onto the boards of SOEs. The issue of nomination, election, and removal of SOE board members should be under the jurisdiction of an ownership entity that will execute the property rights of the state. This ownership entity should be authorized to implement the licensing process for board member candidates, create and update the database of licensed board candidates, provide training, and implement the election process. The ownership entity should be able to select the best candidates from the database of potential licensed board members in a transparent process based on criteria set in advance. The ownership entity should also be responsible for ensuring the independence of the board members of each individual SOE.

It is essential to elect a board that is majority-independent. It is necessary to ensure that no board member is a high-ranking political party official. The board members should also be autonomous of management, key buyers, suppliers, and creditors. The requirements that ensure the independence of board members should be defined, as should the position of the employees' representative, to ensure their independence with respect to the management. It is necessary to prevent board members being representatives of key buyers, suppliers, or creditors.

A training programme for board members in corporate governance should be adopted as soon as possible. Boards should be empowered by means of specialized committees, primarily a compensations committee and a nomination committee. The nomination committee would empower the board regarding the election of the CEO, while the compensations committee would monitor work results and rewards for the CEO. Regarding the audit committee, it is necessary to precisely define who is authorized to evaluate candidates' finance and accounting knowledge, and in what way. SOE employees must be prevented from becoming members of audit committees, and members' tenure and the reasons for and manner of their removal must be defined. Finally, the audit committee must file reports to the board at least once every three months.

It is necessary to improve the manner in which the state as the owner maintains regular and effective communication with board members and monitors the results of their work. The government should provide compensation for board members to promote the long-term interests of SOEs and attract and motivate qualified experts.

It is necessary to precisely define the reasons for the removal of a board member, who determines that these reasons have occurred, who dismisses the member, and in what way. Removal of SOE board members should be under the jurisdiction of the ownership entity that executes the property rights of the state.

Compensation Schemes

It is necessary to prescribe the criteria for and measures of CEO compensation and to connect the level of compensation to the performance of the SOE.

Because they are obliged to evaluate and monitor CEO performance, SOE boards should also have a decisive say in CEO compensation. SOE boards must establish a suitable performance measurement system and link performance to compensation. The board should also play a more important role in removing CEOs when SOE performance is unsatisfactory.

Monitoring Activities

The CEO should be elected by the board based on a public announcement and on criteria set in advance.

In order to perform their role as monitor, boards should do the following: 1) formulate, monitor, and analyse corporate strategy and not just rubber-stamp it, that is, not merely accept submitted propositions; 2) identify appropriate performance measurement systems, evaluate and monitor management, and develop an effective compensation plan for higher level management that is dependent on their performance; 3) monitor communication and information exchange processes; 4) establish self-evaluation practice. However, the key function of SOE boards should be the nomination and removal of CEOs. Without this authority, SOE boards cannot fully perform their monitoring function and take responsibility for the performance of the enterprise.

It is necessary to speed up the development of internal control systems and oversee them better, with clear deadlines for completing the various stages in the process and with adequate sanctions for failing to perform these activities. SOEs need to be given help with both risk management in general and specifically with mapping, listing, and describing business processes for the purpose of establishing appropriate controls, taking into account material risks, risk assessment, compiling risk records, and adoption of a risk management strategy. It is also necessary to develop effective mandatory internal audit and provide a sufficient number of internal auditors and appropriate deadlines and sanctions. The nomination and removal of the internal audit manager and supervision of the internal audit should be assigned to the audit committee, which should be authorized to adopt internal audit reports. The internal audit should be externally examined. The responsibilities of SOE CEOs should be increased, giving them responsibility for ordering managers to adopt and implement audit recommendations, make implementation plans, and provide follow-up data.

CONCLUSION

In this paper we have presented evidence regarding the coexistence of agency and stewardship theories in practice. By using three dimensions in our analysis – government structures, compensation schemes, and monitoring activities – we show that this coexistence is possible due to several situational factors. Thus, our study contributes to the existing corpus of knowledge on the situational and psychological factors that predispose individuals to become either agents or stewards (Davis, Schoorman, & Donaldson 1997; Pasteroza & Ariño 1997). However, the existing literature does not address conflict between psychological and situational factors or conflict among situational factors. Our study shows that the coexistence of agent and steward models may be the reason why Serbain CEOs, boards, and organizations are underperforming. Managers feel both frustrated by and resigned to the principal's attitude towards them, which they see as a betrayal. Although principals may initially show understanding towards managers' behaviour, they will also experience frustration once they realize that the managers are not behaving as they would like. Thus coexistence is possible, but it is unsustainable, and such a situation should not be supported for a long period of time: it is not a healthy governance relationship, and is not good for organizational development and performance or for leadership and motivation practices. We suggest further steps for building clear agency structures and argue for the benefits of this option.

REFERENCES

AIMA (1995). Corporate Governance. *Australian Investment Managers' Association*, Sydney.

Brewer, J. (1996). Editorial, *Corporate Governance Quarterly*, Hong Kong Institute of Company Secretaries, vol. 2, no. 1, March, p. 1.

Cadbury, Sir A. (1992). *Report of the Committee on The Financial Aspects of Corporate Governance*. The Committee and Gee & Co. Ltd., London.

Davis, J.H., Schoorman, F.D., Donaldson L. (1997). Toward a stewardship theory of management. *Academy of Management Review*, vol. 22, pp. 20–47.

Donaldson, L., Davis, J. H. (1991). Stewardship Theory or Agency Theory: CEO governance and shareholder returns. *Australian Journal of Management*, 16: 49–65.

Donaldson, L., Davis, J. H. (1993). The Need for Theoretical Coherence and Intellectual Rigour in Corporate Governance Research: Reply to Critics of Donaldson and Davis. *Australian Journal of Management*, 18: 213–225.

Eisenhardt, M., K. (1985). Control: Organizational and economic approaches. *Management Science*, 31, 134–149.

Eisenhardt, M., K. (1988). Agency and institutional explanations of compensation in retail sales. *Academy of Management Journal*, 31, 488–511.

Eisenhardt, M., K. (1989). Agency Theory: An assessment and review. *Academy of Management Review*, 14(1): 57–74.

Fama, E.F. (1980). Agency Problems and the Theory of the Firm. *The Journal of Political Economy,* Vol 88, No 2, pp 288-307.

Fama, E., Jensen, M. (1983). Agency Problems and Residual Claims. *Journal of Law and Economics*, vol. 26, pp. 327–49.

Fama, E.,Jensen, M. (1983). Separation of Ownership and Control. *Journal of Law and Economics*, vol. 26, pp. 301–26.

Fiscal Council, (2014). Analysis of SOEs: Fiscal Aspect. Available at http://www.fiskalnisavet.rs/doc/ocene-i-misljenja/analiza_preduzeca_u_drzavnom_vlasnistvu-fiskalni_aspekt.pdf

Hambrick, D. (2005). Just How Bad Are Our Theories? A Response to Ghoshal. *Academy of Management Learning & Education*, 4: 104–107.

Hawley, J.P., Williams A.T. (1996). *Corporate Governance in the United States: The Rise of Fiduciary Capitalism*. Working Paper, Saint Mary's College of California, School of Economics and Business Administration.

Hofstede, G., (2001). *Culture's consequence*s. 2nd ed. Thousand Oaks, CA: Sage.

http://www.oecd.org/corporate/guidelines-corporate-governance-SOEs.htm

Jensen, M.C., Meckling, W.H. (1976). Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure, *Journal of Financial Economics*, vol. 3, pp. 305–60.

Jensen, M.C., Meckling, W.H. (1979). Rights and Production Functions: An Application to Labor-Managed Firms and Codetermination, *Journal of Business*, vol. 52, no. 4, pp. 469–506.

Muth M.M., Donaldson L. (1998). Stewardship Theory and Board Structure: A contingency approach. *Corporate Governance*, vol. 6, pp. 5–28.

OECD (1999) Principles of Corporate Governance. http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=C/MIN(99)6&docLanguage=En

OECD (2004) Principles of Corporate Governance. http://www.oecd.org/corporate/ca/corporategovernanceprinciples/31557724.pdf

OECD (2005) Guidelines on Corporate Governance of Government-Owned Enterprises. http://www.oecd.org/corporate/guidelines-corporate-governance-SOEs.htm

OECD (2015) Guidelines on Corporate Governance of State-Owned Enterprises

Pastoriza, D., Ariño, M.A., (2008). When Agents Become Stewards: Introducing Learning in the Stewardship Theory, Humanizing the Firm & Management Profession. Barcelona, IESE Business School, June 30–July 2, 2008.

Williamson, O.E. (1975). *Markets and Hierarchies: Analysis and Anti–trust Implications*. Free Press, New York.

Williamson, O.E. (1979). Transaction cost economics: The governance of transactional relations. *Journal of Law and Economics*. Vol. 22, pp. 233–61. (Reprinted in Barney & Ouchi 1986).

Received: November 5, 2017
Accepted: March 2, 2018