

Corporate Governance in the Serbian Banking Industry

Case Studies: Commercial Bank, Halk Bank, Erste Bank

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1. Abstract

In this paper we will illustrate the structure that relates to Corporate Governance in the financial industry, focusing on the banking system objectives and tools through which the monitoring and evaluation of corporate governance framework operates.

Seemingly, a well structured corporate governance model incentivizes banks, businesses and other stakeholders to achieve operational efficiency and manage resources efficiently.

Considering that Serbia, Macedonia, Albania and Monte Negro are developing countries, the banking industry is often seen as the main industry within the country. For this reason, this paper will focus on the corporate governance methodologies and tools deployed in Serbia. Similar findings are foreseen to be achieved as well in other West Balkan countries, for which, this paper will present the organizational structure and processes by introducing three case studies from the Commercial Bank, Halk Bank and Erste Bank.

Keywords: Corporate Governance, Financial System, Banks, Serbia, Case study

2. Introduction

The reformation process which happened in the Western Balkan countries and especially in Serbia, as a suitable country for investments, has attracted a lot of attention for international banks, European banks and other industries, to get into the markets of these countries by bringing on their best experiences of various governing models.

Corporate Governance has been dominant in doing business, while in the most recent history has served as a new strategic imperative to overcome various financial crises. Despite the economic developments of different countries, even for emerging economies such as Serbia, it is important to choose the best experiences of corporate governance that could well fit to country's legislation, culture, tradition and, in general, the business climate.

Corporate Governance is related to the way business is governed in the industry of various areas. Governance consists of a range of relations between shareholders, board, senior management and other actors, and normally both lenders and other fund providers are more willing to provide funds when there is a safe stability in corporate governance.

Good corporate governance should protect the shareholders' rights and ensure equal treatment, including for minorities and foreign shareholders. It should acknowledge the rights set forth by law and encourage active co-operation between corporations and stakeholders concerned in creating economic conditions by generating jobs and financial sustainability of enterprises.

In addition, good corporate governance should ensure that accurate and timely disclosure is made with respect to all aspects of the corporation, including its financial state of play, corporate performance, corporate ownership and management. It should also provide strategic guidance of the company, effective management monitoring by the board, and accountability of company's board to respective shareholders.

Empirical evidence shows that good corporate governance leads to achieving a sustainable economic growth. It has a long-term impact on the development of financial markets and

economic risk and tends to reduce the degree of corruption and business mismanagement, by impacting sustainable economic growth. In this regard, formalizing good governance practices is not only a tool to survive in today's economy, but may also be known as a strategy to escape.

As such, it seems unbelievable to assume that good governance will be important not only for developed markets, but potentially even more for developing countries such as Serbia. Moreover, it has been widely recognized that corporate governance practices do not have any standard regime; they do not have a form that suits to everyone and for this reason it cannot be applied in the same way to all situations and to all countries when dealing with different cultures and laws. This is also well known in the literature that poor experiences of corporate governances can lead to loss, mismanagement, and corruption. Only good governance can deliver sustainable business performance. Based on these experiences, developing economies like Serbia can be inspired and can benefit by these experiences of developed countries in selecting corporate governance practices such as their legal regulation, reforms, culture, but also with their help to improve the efficiency of their economies during different economic crises periods.

3. Corporate Governance: Evaluation and the origin

There are papers and discussions on corporate governance for many years, but this paper aims to provide an understanding on the importance of corporate governance concept for managing modern businesses.

Some definitions were set to understand the pillars of current research, and the paper also provides a brief overview of recent international developments in corporate governance, which serve and are important for model comparisons about governance of financial institutions in Serbia.

3.1 Concepts of Corporate Governance

Corporate Governance is not just the management of a particular form organisation, in this case of a narrow circle, but has a wider meaning. The concept is used by different people and yet

there is no universal definition of corporate governance (Rezaee, 2009). The importance of corporate governance came to the attention of governments in the 1990s, since western economies experienced a series of financial scandals such as Enron, World Com, Paramalat which alleviates the mistakes of management, auditors, and financial market operatives. These scandals hampered citizens' confidence in the institutions of these economies and led to drafting strict regulatory mechanisms. As a result of this, each company listed as a serious company should split a share at the end of the year, all important issues to be addressed and reports to be explained by treating them with corporate governance procedures. However, the following definitions should give readers a general idea about the concept: "Corporate Governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment" (Shleifer and Vishny 1997 p. 737). Corporate Governance refers to "the design of institutions that encourage or force the managed to absorb the well-being of the interested stakeholders" (Tirole 2001, f.4).

3.2 The problem of corporate governance

La Porta et al. (2000 b) has identified the risk of foreign investors by expropriating it internally as a problem of corporate governance. Berglof and Von Thadden (1999, f.4) stressed that "the recent literature is based on the premise that the main corporate governance problem is self-interested management and weak, dispersed shareholders". In a similar way, and in this spirit Berle and Means, Enriques and Volpin (2007, f.1) think that "the fundamental problem of corporate governance in the United States is to alleviate the conflict of interest between dispersed small shareowners and powerful controlling managers ".

3.3 Classification of Corporate Governance

Researchers have identified two systems of corporate governance: Anglo-American system based on the market and the German-Japanese system, models/systems for long-term periods for large investors. This division is appropriate for all corporate governance systems which have same or similar elements.

3.4 Anglo-American system

In order to adopt this corporate governance system, led by the United Kingdom and the United States, countries have generally well developed capital markets, broadly distributed the ownership structure and have well established rules and regulations that regulate the capital market, and rely on markets to run their companies.

Although the two countries are put together in one category, there is an important difference between the United Kingdom and the United States in corporate governance practices. While in the United Kingdom, the position of Chief Executive is not held by the Chairman of the Board, in the United States this is a defined norm, despite some significant reserves of practitioners and academics (Shleifer and Vishny, 1997; La Porta et al. 2000). On the other hand, Anglo-American system of corporate governance stresses the interests of shareholders. Non-executives, independents, Board Directors and the directors of different levels are elected by shareholders. In most cases they have key positions, such as: commissions of compensation, auditing, where they exceed executive directors.

3.5 German-Japanese system

The main characteristic of this model is the existence of large investors such as banks and other financial institutions. Given that they are able to invest large funds, they are interested in accessing corporate governance and to be more involved in the company's finances. This, in itself, addresses the problem of free salary of Anglo-American model. Large investors are also able to carry out and facilitate long-term investments while monitoring managers they consider to be as one of the major problems of the Anglo-American model. Supporters of this model think that it should be a close relationship between banks and capital's shareholders and also give companies access to capital at lower cost than their counterparts in the US and the UK. This means that projects that will be subject of rejection by American or English funders on the basis of the benefits will be supported by Germans or Japanese (Keasey et al. 1998).

3.6 Which is the best model for governance?

Some researchers consider the Anglo-American corporate governance system as a better model than their continental counterparts (Hansman and Kraakman 2001). The relative flexibility of entry and exit for shareholders with lower cost make this system to be considered more attractive. However, legal standards and regulations in place that enable running this corporate governance system are relatively high, making the Anglo-American system suitable for developed countries with developed financial markets and democratic political systems, something that on a global scale, is more exceptional rather than a rule. On the other hand, the German-Japanese corporate governance system is a system that has succeeded in overcoming the problems in successful corporations in both countries.

4. Corporate Governance of Financial Institutions

The role of the banks and other financial institutions is to provide funding for enterprises, facilitate the performance of various transactions, as well as providing other services that make their position more favourable in the economy. However, the complex nature of finances means that daily concepts and activities of financial institutions have not been easily met by most people, so they should have sufficient information about the finance system. Almost all researchers, some more clearly than others, agree that the main problem is more complex for banks and other financial institutions, because bank managers should not always think about maximizing and earnings for shareholders as a single purpose, as this may have negative consequences for depositors (as primary stakeholders) and taxpayers (Alexander, 2006, Mullineux, 2006).

4.1 Banking system in Serbia

Something that is evident in Serbia in the recent years shows that the financial system, banks mainly, have had a positive trend of growth, which proves the fact that in recent years there was

the influx of some banks with foreign capital i.e (Intesa bank, Generale Societe bank, Erste bank, Addiko bank, etc).

However, although economic problems have a common denominator in certain sectors, the banking sector has its own specifics. This sector has found the models to resist negative phenomena, but anyone can ask how stable is the banking sector in Serbia? Based on many published data, as well as the fact that we have an incursion of foreign banks, shows that we are dealing with a stable and favourable environment in the banking sector in Serbia. The banking system of the Republic of Serbia consists of the central bank (National Bank of Serbia) and commercial banks. Banks in Serbia operate in an independent system pursuing their business activities for profit-making purposes, always based on the principles of liquidity, profitability and solvency.

4.2 Classification of legal entities

We understand that in different countries of the world the classification of legal entities is regulated by laws, based on the number of employees, their turnover, etc.

According to the law on the National Bank of Serbia, banks and other financial institutions, insurance companies, financial landlords, voluntary pension fund management companies with voluntary pension funds, scholarships, brokers - commercial companies, for managing investment funds with funds of open investment, house/private investment funds, factoring company, payment and securities institutions, are classified into major legal entities.

5. Commercial, Erste Bank, Halk Bank

Given that the banking sector in Serbia belongs to the big businesses segment (Financial Corporations), we'll try in this paper to analyze their governance models and will present our conclusions on which model is most adaptable to the Serbian market, based on their data and organograms.

5.1 Commercial Bank

Commercial bank has 45 full years of security, successful business, banking products and services according to customer needs and highest European standards. All these years of bank growth have been built for our people, clients and partners. Today, the commercial bank is stronger than ever with 23 branches nationwide, 205 units, more than 1,300,000 open accounts and 900,000 satisfied customers. Commercial bank: has the power, security and trust in the country. All customers of this bank are served by our banking team of about 3,000 employees and trained in all banking transactions. Many of them are also capable of dealing with national and international financial flows, professionals with banking experience, ambitious for young bankers, educated and trained at home and abroad. Services for domestic, foreign companies and commercial financial banking institutions AD Belgrade has an active role not only at the national level but also in international payments or transactions. Through the accounts this bank established connections with first-class world banks. The Commercial Bank fully meets all the needs of cross-border transactions based on customers' demand and needs.

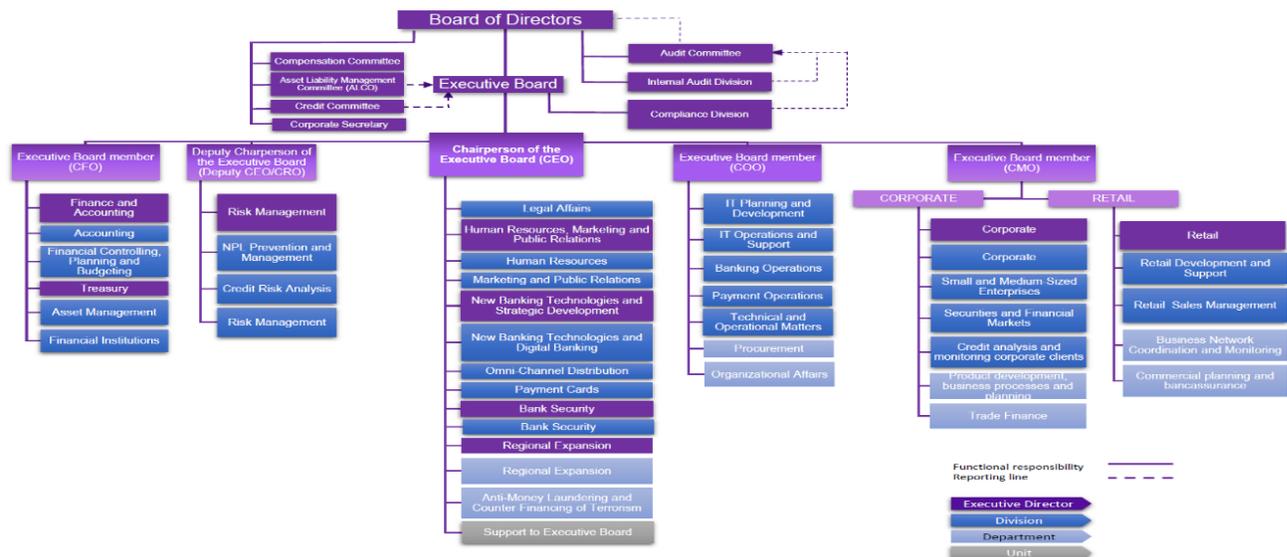


Figure 1 <http://www.kombank.com/pdf/upravnje.pdf>

5.2 Erste Bank

Erste Bank Novi Sad is part of Erste Bank Group, one of main financial institutions in Central and Eastern Europe, with over 17.3 million clients in eight countries. Erste Bank was established in 1819 as the first Savings Bank in Austria. It's operating in Serbia as of mid-2005 when it took over most of Novi Sad Bank shares, the oldest financial institution in our country, established in 1864. In December 2005 Novosadska Banka changed its name and become Erste Bank Novi Sad and started an intensive process to transform the bank into a modern financial institution in line with Erste Bank Group standards. This process was concluded on January 1, 2007 by migrating into a new information technology system. Erste Bank's focus is on operations with individuals, local communities and small and medium-sized enterprises. With its intensive investments during 2006 and rapid development in 2007, Erste Bank joined the ranks of banks with the most competitive products in Serbia for retail and corporate clients. The speed and quality of service, along with the concept of personal banker for each customer, were the pillars of further growth. Erste Bank's network in Serbia consists of 73 retail outlets and 10 corporate centers. Ad Erste Bank Novi Sad currently has about 1,000 employees.

Organogram Erste Bank ad Novi Sad

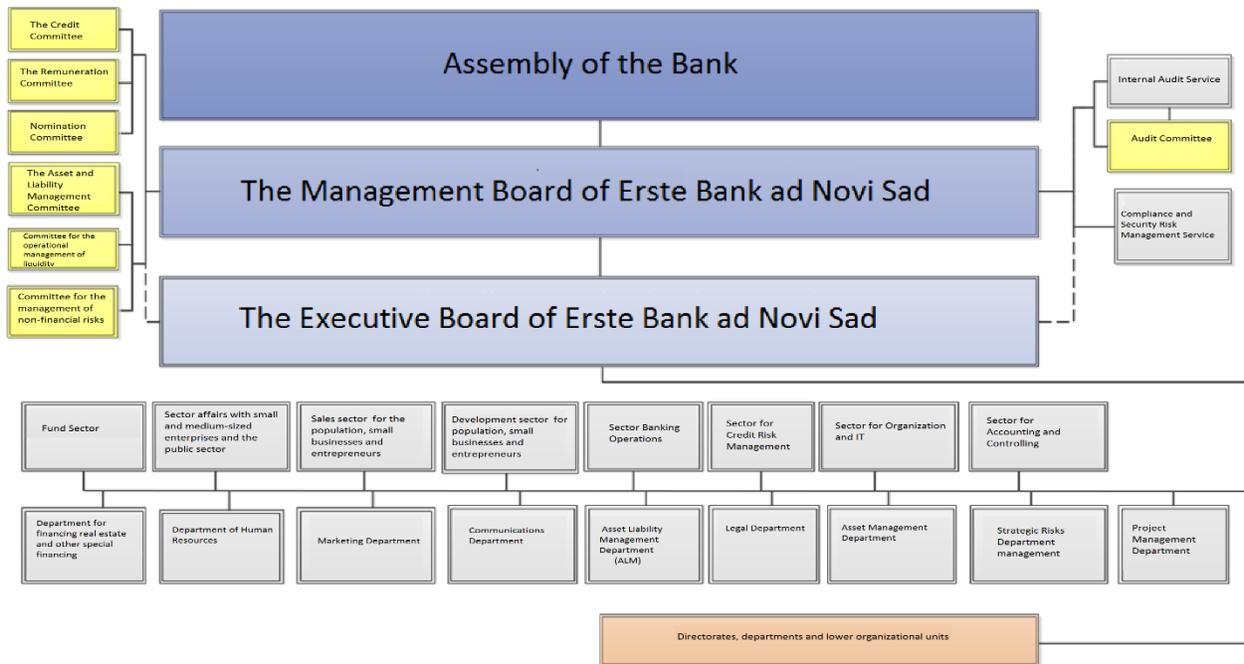


Figure 2 https://www.erstebank.rs/content/dam/rs/ebs/www_erstebank_rs/onama/Organogram2017.pdf

5.3 Halk Bank

Halkbank a.d. Beograd, is a universal bank that offers all kinds of banking services for businesses and households. Its mission is to be the bank that promotes and finances the growth and development of the country's economy, as well as being a safe place for savings for clients. In the territory of the Republic of Serbia exists as of September 1956 as a municipal bank for Čačak, and since then successfully and without any break has extended its network and customer base. Today, the products and services of this bank are available in 20 branches, 8 units and 4 counters. The main task of this bank is to create products that will fully meet the customers' expectations. Main developments that followed Halkbank a.d Beograd:

- 1956 - Established as a municipal bank for Srez Čačak
- 1992 - Converted into a joint stock company

- 2000 - Starts functioning under the name Čačanska Banka a.d. Čačak
- 2006 - EBRD becomes a shareholder with 24.99% of the shares
- 2010 - IFC becomes shareholder with 19.99% of the shares
- 2015 - Halkbank Turkey (Türkiye Halk Bankası A.Ş.) become the owner of the majority shareholders of Cacanska Banka with 76.75% of capital shares, changing its name to Halkbank A.d. Beograd.

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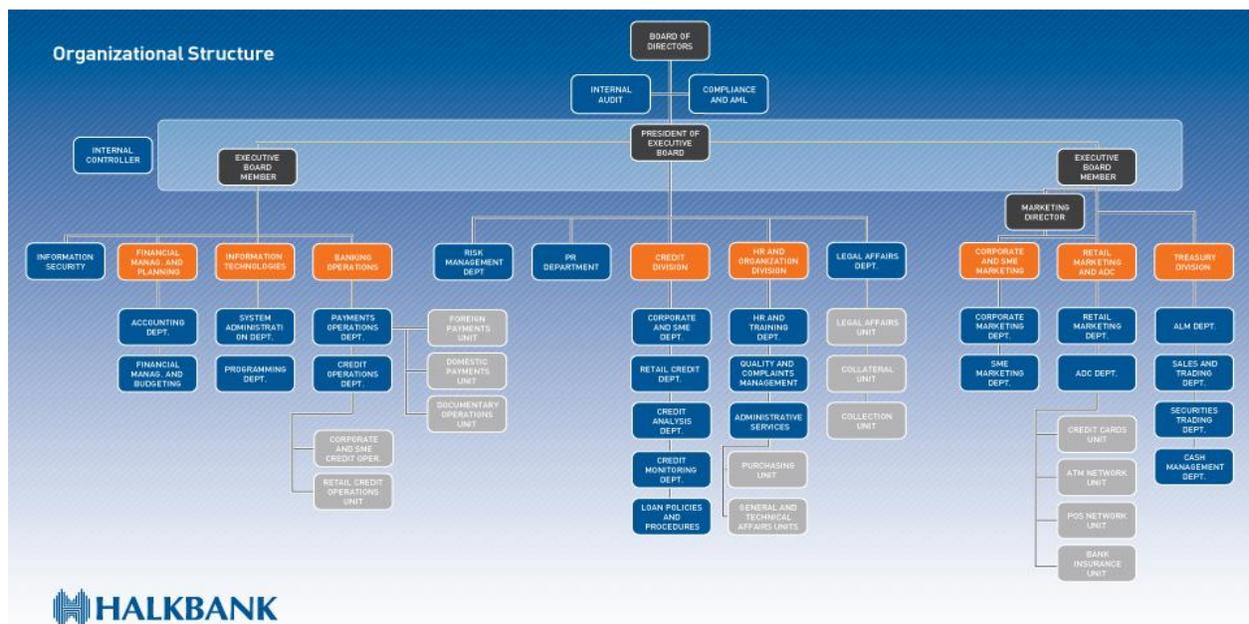


Figure 3 <http://www.halkbank.rs/content/images/halkbank-organizaciona-shema-EN.jpg>

6. Conclusions and Recommendations

Referring to the analysis of the organizational structure and organograms of the three above-mentioned banks, their form of organization and division of responsibilities, primarily the "Corporate Governance", we have drawn below the following conclusions and recommendations:

Conclusions

- In general, there is a fair division in the organizational structures of the analyzed banks, this means that there is a restrictive line between shareholders' intentions and executive management. In all three banks, the organizational structure in formal terms enables corporate governance.
- In absence of data, we are not aware of the structure and organization of shareholder management boards in order to analyze the concept of "conflict of interest" as well as the level of decision-making in relation to executive management.
- The organization of banks in terms of division of responsibilities and efficiency in fair and efficient communication is considered to be at a satisfactory level.
- We can also conclude that in the corporate governance of the three commercial banks operating in Serbia (Commercial Bank, Erste Bank and Halkt Bank) there are elements showing that these banks refer to both models of governance: Anglo-American and German-Japanese model.

Recommendations

- For the benefit of the institutions themselves, it is important that stakeholders' interests are consistent with the medium and long-term strategy of the institutions. This means not only the formal establishment of the organizational structure for a "Corporate Governance", but also other supplementary elements such as mission, vision, organizational behavior, work culture, business ethics, be part of corporate governance. This should be a continuous part of the external audit and monitored and analyzed on an annual basis by the management board of the institution.
- Transparency is an important element in Corporate Governance. Transparency in doing business, fighting destructive elements, and compliance aspects with national and international laws. This aspect should be monitored by the organizational structure of banks, especially reported on the management board, and there should be a formal approach to prevention and combating these phenomena. This is already an important element taking into account the circumstances created in the financial system.

- In relation to financial decisions, Corporate Governance requires much more especially in fair managing and maintenance of financial reports. Based on the financial aspects of the analyzed banks, there is no clear approach witnessed regarding the "over years" monitoring of financial indicators as well as decisions on the need to improve any position in order to increase the financial efficiency of the institution. As a result, banks need to be more proactive in identifying the financial areas in which they want to improve and should have a transparent strategy on the goals they want to achieve. This should be monitored by the country's regulatory agencies such as the central bank or any other governmental institution.

7. Literature

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