

CORPORATE GOVERNANCE IN MUNICIPALLY OWNED COMPANIES: THE CASE OF ZAGREB CITY HOLDING

KORPORATIVNO UPRAVLJANJE U KOMPANIJAMA U VLASNIŠTVU LOKALNE SAMOUPRAVE: POSLOVNI SLUČAJ ZAGREBAČKOG HOLDINGA

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Abstract: *Municipal ownership refers to the city's ownership of public utilities. On behalf of the city authorities, municipally owned company (MOC) is entitled to govern and perform operations over city's property, and provide up to date services needed in contemporary urban life. Consequently, a high-quality corporate governance system, understood as a multifunctional set of processes affecting the way a company is administrated and controlled, is as much needed in public ownership as it is in private. Moreover, as a category that shape company behavior, good corporate governance system makes the platform for sustainable economic growth, increases economic efficiency, stakeholders' satisfaction and availability of capital sources. Reviewing the conditions under which corporate governance issues are relevant to MOC, this article is aiming to highlight the governance challenges in the largest Croatian MOC – Zagreb City Holding.*

Key Words: *Corporate governance, Code of conduct, Zagreb City Holding, Croatia*

Sadržaj: *Opštinsko vlasništvo odnosi se na vlasništvo javnih komunalnih preduzeća. U ime gradske vlasti, opštinsko preduzeće (MOC) ima pravo da upravlja i obavlja poslove nad imovinom grada, odnosno pruža usluge potrebne savremenom urbanom životu. Shodno tome, visoko kvalitetan korporativni sistem upravljanja, shvaćen kao multifunkcionalni skup procesa koji utiču na način na koji se upravlja kompanijama i iste kontrolišu, je isto toliko potreban javnom vlasništvu kao i privatnom. Štaviše, kao kategorija koja oblikuje performanse kompanija, dobar sistem korporativnog upravljanja čini platformu za održivi ekonomski rast, povećava ekonomsku efikasnost, zadovoljstvo zainteresovanih strana i dostupnost izvora kapitala. Razmatranje uslova pod kojima su pitanja korporativnog upravljanja relevantna za MOC, ovaj članak ima za cilj da istakne upravljanje izazovima u najvećem hrvatskom MOC - Holding Grada Zagreba.*

Ključne reči: *Korporativno upravljanje, Kodeks ponašanja, Zagreb holding, Hrvatska*

1. INTRODUCTION

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Corporate governance (CG) can be defined as a form of “management of management or *metamanagement*, since it embodies the set of relations between the management, board, shareholders and stakeholders of a firm; it defines the framework for setting goals and determining the means to achieve those goals, as well as for monitoring the performance and efficiency of the firm” [1]. A narrow view of CG portrays it as an enforced system of laws and financial accounting. There is, however, a broader CG conceptualization, emphasizing every business’ responsibilities toward the different stakeholders that provide it with the necessary resources for its survival, competitiveness and success [2]. The complexity of the issue has been recognized and supported by OECD issue of *Key Findings and Main Messages* [3].

Availability, transparency and disclosure of information in listed companies that corporate governance is genuinely oriented to are of the utmost importance for company law and capital market law, performing as the instruments for the protection of shareholders and to control the activities of management and supervisory boards, and to ensure reliable and accurate information for the whole capital market as well. But what about the governance of MOC? Although the elements of corporate governance are progressively applied by companies which are formally not listed or present at the capital market, the field literature is parsimonious upon the theoretical conceptualization and is lacking the case studies. This article is aiming to fill this important gap. The implementation of a good corporate governance practice in forms of established supervisory mechanisms aimed to direct and control corporate performance, sustained by the corporate Code of Conduct in the Croatian business environment is to be shown through the case of the municipally-owned company Zagreb City Holding.

2. CORPORATE GOVERNANCE AND MOC IN CROATIA

In the context of the Croatian legal framework, the Companies Act of the Republic of Croatia is the *lex generalis* for the corporate governance area. The term “corporation” corresponds to the term joint-stock company and implies a legal subject, transferability of ownership, limited liability and no temporal limitations of business activities. Capital market in Croatia was established in 1991 when the process of privatization was started. Zagreb Stock Exchange and Varaždin Stock Exchange were founded in Croatia. In 2007 Varaždin Stock Exchange was merged with the Zagreb Stock



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Exchange (ZSE), while in the same year Croatian Agency for Monitoring Financial Services (HANFA) has established a framework of corporate governance code. The corporations at ZSE quotation are obligated to submit Annual financial report and questionnaire of Corporate Governance Code to ZSE and publish them on official corporate web sites. Some parameters for corporate governance quality are defined in Corporate Governance Code: business transparency, clearly defined procedures for the activities of the Supervisory Board, Management Board, executive management, and other bodies and structures making important decisions, avoidance of conflict of interest, efficient internal control and efficient responsibility system.

On the other side, the limited liability companies are actually the legal form corresponding to MOC. Croatia, like majority countries in transition, has prevalently adopted an insider control system characterised by high ownership concentration [4]. A high ownership concentration for MOC means actually a public ownership, whose defining characteristic is the existence of the corporation for fulfilment of the interests of multi-stakeholder groups, not only of its owner. Consequently, the Croatian MOCs are often 100 percent owned by the Cities, represented by the authority of the City Assembly and the Mayor.

The Companies Act anticipates the situation in which the City as the legal entity performs the founder-owner role for the companies dealing with municipal and other kind of businesses. Corporate governance mechanisms work for this situation too. Among two basic mechanisms of control: external and internal, MOC generally applies the insider control model, due to the regulation of private partnership share limits. A characteristic of MOCs, as well as the State owned companies, is that they do not imply the existence of a corporate control market. Thus the possibility to supervise the success of the company by following the price of shares does not exist. Nevertheless, MOC regularly apply all established internal control mechanisms: boards, management compensations, ownership concentration, relationship to stakeholder groups, corporate reporting, while only one external: legislative and regulatory framework. The main internal processes refer to the financial and organizational aspects, while external factors include international and national standards, legal framework and ethical rules. Due to predominantly single City ownership, the supervisory boards, especially their structure and its committees, have the key role in the corporate governance of MOC.



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Internal mechanisms and their interrelations are to be included in the Code of Conduct. Besides Code for listed companies, Croatian government [5] has issued the Code for the companies whose shares or stocks are owned by the Republic of Croatia (State Code). The later Code prescribes the same basic framework and corporate governance bodies as for joint-stock companies. Both of the Codes have brought a great shift in standardization and the quality of corporate governance in Croatia, since they include the general principles and specific legal, financial and ethical framework for top level managers in private and public sectors, hence perform as a self regulatory mechanism of corporate control. Although taken as a “soft law”, Codes of conduct complement the legal framework of performance and sustain stakeholding governance mode that MOC could rely on in fulfilling their economic and social mission and responsibility.

3. THE CASE OF ZAGREB CITY HOLDING

3.1. COMPANY PROFILE

Zagreb City Holding Ltd has been established in 2007, pursuant to the Companies Act and is 100% owned by the City of Zagreb. It consists of 16 subsidiaries performing business activities of former City companies, with a total number of 8000 employees. Zagreb Holding also owns 5 companies and one institution that together form the Zagreb City Holding Group. Zagreb City Holding ranks the top ten of Croatian companies, evaluated by the revenues of total HRK 5,506,000 thousand realized in 2014 and the employees' number of total 10,263. The share capital of the Group amounts HRK 2,069,128 thousand. The Group has bond emission at the Luxembourg Stock exchange, amount total 300.000 thousand EUR.

The businesses of the Company are grouped into three divisions: municipal, transport and market services. Principal activities of the Group comprised the provision of the following services: cleaning and waste removal services; public passenger transport services; water collection, treatment and supply; landscaping and plant growing; management, maintenance, construction and protection of regional and local roads; parking services; gas supply and distribution; drugstore; warehousing and rental services; waste disposal and management; flat, business premises and garage construction and sale and some other side business services.



Daniela Franić holds a Bachelor degree from the Faculty of Law in 1999, University of Zagreb, and in 2003 she passed a Bar Exam. In 1999 she starts her professional career in the City of Zagreb as a trainee, continues as an independent referent for legal-property affairs, and after passing a Bar Exam Ms. Franić becomes an expert associate for legal representation of the City of Zagreb. In 2005 she becomes a Head of City Office for representation, and in 2007 she is appointed for the position of Assistant Principal for representation. In 2013 Ms. Franić is appointed for a member of the Management Board of Zagreb City Holding Ltd. By the decision of the Commercial Court from October 31, 2014, Ms. Franić was appointed as Interim Manager of the Zagreb City Holding Ltd, and from March 6, 2015, she is re-appointed as a member of the Management Board, which position she still holds today.

Corporate Mission is to provide municipal and urban services effectively with respect to corporate responsible behavior aimed for matching stakeholders' expectations. The commitment to corporate responsibility and operational excellence, aiming at attainment of an optimal combination of price and service quality, operational efficiency, improvement of urban lifestyle and satisfaction of consumer, employees, owners and social and business communities are the Group core values. The Vision of the company is to become a synonym for comfortable, organized and healthy living in Zagreb, an example of excellent public service provider, promoter and holder of the commercial development of the City and the Republic of Croatia. It aims to realize the vision through corporate development strategy for the period 2015-2020, where the core corporate strategic goals are highlighted: a high-quality and reliable public service; growth and development of the utilities as the corporate core business, and corporate sustainability as an operating corporate model. The generic business strategies for Utilities are the cost optimization and sustained profitability, while the market services orientation is diversification strategy, sustained by the availability of the Group resources synergy.

3.2. CORPORATE GOVERNANCE SYSTEM

The main challenges of the Zagreb City Holding corporate governance system have been determined by the full municipal ownership, its heterogeneous business activities portfolio and the complexity of the legal framework being consist of the Law on Communal Management; the Law on Local Self-government; the Law on Waste; the Institutions Act; the Law on Waters; the Cemeteries Act; the Building Maintenance Act and the Act on Free Zones, performing as the *lex specialis* for the pertaining business. The Group is committed to dynamic stakeholder governing model [6] that promotes the collaborative dialogue and sustained corporate performance by leveraging economic, social and institutional corporate goals and responsibilities. The Company and its constituencies practice two tier model of corporate governance. The corporate bodies are Management Board, Supervisory Board and The Assembly. The company nourishes collaborative relations with its unions.

Being a limited liability company, it is governed according to its Constituting Statement that contains all the mayor responsibility of the bodies, their relation and responsibilities. Besides, the governance framework consists of following corporate Acts: Rules of Conduct of the Assembly, Rules of Procedure of the Supervisory Board and the Management Board, the Ethical Code, the Anticorruption Programme and by the Basic Collective Agreement, while Company's behaviour complies with the Code of Conduct. Though not being obligated, Zagreb City Holding Ltd. has issued its Code of Conduct¹³², having in mind that the transparency of the corporate governance and the conformity by the "comply or explain rule"[7] contributes to the quality of its governance system as well as to the corporate performance and reputation. Moreover it helps in balancing relations with its numerous stakeholder groups and ensures the high level of disclosure.

Besides, the Management Board is responsible for ensuring that consolidated financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union which give a true and fair view of the state of affairs and results of the Group, as well as for keeping proper accounting records, which disclose with reasonable accuracy at any time the financial position of the Group and must

¹³² The document is in the procedure of verification by the Corporate Bodies.

also ensure that these comply with the Croatian Accounting Law. The Management Board is also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities. The quality of the corporate performance in 2014 has been recognized by rating service agencies, assigning to Zagreb City Holding the upgraded rating and outlook, as the sole company in Croatia for the year [8].

4. CONCLUSION

Since the main issues of corporate governance refer to questions of power, authority and responsibility in accomplishing main companies' activities [9], adopting a good corporate governance system and practice helps resolving some of the core governance difficulties of municipal companies, i.e. opacity of goals due to multiple stakeholder and political interference [10].

The quality of the corporate governance system is a complex issue for unambiguous explicating, as well as for measuring. That is undoubtedly, a factor contributing to the attention aimed at governance indices, which combine various dimensions of governance into one number. Respecting the specific features of the Region, South East Europe customized measure of corporate governance quality has been developed recently. *SEECGAN index of Corporate Governance* comprises seven selected segments as follows: (1) Structure and Governance of Boards; (2) Shareholders' Rights; (3) Transparency and Disclosure of Information; (4) Audit and Internal Control; (5) Compensation / Remuneration; (6) Corporate Risk Management; and (7) Corporate Social Responsibility [11]. The authors find the newly conceptualized measure convenient to apply to the Zagreb City Holding in 2016. The idea is to evaluate the overall governance system quality and to spot the performing segments that have the potential to be improved.

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