

CORPORATE GOVERNANCE SCORECARD: THE CASE OF KOSOVO ENERGY CORPORATION (KEK J.S.C.)

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Abstract:

The best practices of corporate governance (CG) can help companies in Kosovo increase efficiency, protection of shareholders' rights and improve their access to international capital markets. The purpose of such an evaluation system is to develop a sound basis for an assessment of the implementation of best practices and principles of the CC in Kosovo and to contribute to future development of CG. Scorecard structure contains key criteria that include CG standards (OECD) in seven key areas with relevant group of questions for each of the principles of the CG field. The research sample was taken for analysis from the most complex company "Kosovo Energy Corporation" (KEK JSC) owned 100 % by the government of Kosovo.

Research methods: survey based on questionnaires (51 questions scorecard with seven areas of CG principles OECD) and interviews with key actors involved in the KEK JSC CG (shareholders, board of directors and management). Scorecard development for CG standards is based on the German model. The results are important for future development of CG standards in general, and can be compared with countries in the region.

Keywords: Corporate governance, scorecard, KEK JSC, Kosovo.

JEL Classification: G30, G32, G34, G39

1. Introduction

The best practices of corporate governance (CG) can help companies in

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Kosovo, increase efficiency, protection of shareholders' rights and improve their access to international capital markets. Empirical studies confirm that companies with good CG standards are higher valued in financial markets (McKinsey, 2002). Promoting CG has become a global movement developing wide array of standards, codes and criteria for evaluation. This research of KEK JSC scorecard is intended to be a baseline to create a landmark and is expected to contribute to increasing the awareness and knowledge at CG in Kosovo. The importance of adherence to the principles of the OECD at KEK JSC will be evaluated using analysis of scorecard to assess the implementation of best practices and principles of the OECD CG. Kosovo government supported by international institutions operating in Kosovo has shown a commitment to improving CG. The Government of Kosovo has achieved inter alias approved Law No. 02 / L-123 Commercial Society (2007), Law No. 03 / L- 087 Public Enterprises (LPE, 2008), which was later amended, Law No. 04 / L-111 (2012), was established, Policy and Monitoring Unit of PE (PMUPE), Code of Ethics and Corporate Governance PE (PMUPE, 2010), etc..

2. Concept and Theory of Corporate Governance

Corporate Governance (CG) is one of the most debated issues in contemporary literature, and in the last decade has attracted attention and widespread across the globe, as well as in Kosovo. Countries and companies that have not addressed the problems of the CG, are threaten to be left behind in the global race for capital.

If countries want to reap the full benefits of the global capital market, and if they are to attract long-term capital, the actors have to believe and understand clearly corporate governance across borders (OECD, 1999).

It is important to note that the "framework of CG does not guarantee acceptance and best implementation if companies do not comply with the code" (Strenger, 2004). Practical ways to make company executives make more than the minimum are essential. One of the proven ways to achieve this is systematic analysis of government from the market participants through a scorecard.

One of the most important aspects for investors when making investment decisions is the level of implementation of the principles of CG (information disclosure, protection of shareholders' rights and equal treatment of all shareholders and other actors) and profit that provides return from their investment.

The purpose of such an evaluation system is to develop a sound basis for an assessment of the implementation of the principles of good corporate governance in public enterprises (PE) in Kosovo with a special emphasis on the Kosovo Energy Corporation (KEK JSC), and to provide a framework for political discussions and

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future development of CG. This research through the scoreboard will be basic study to create a landmark and that is expected to raise awareness and increase knowledge in CG in Kosovo. This research is possible to be used for comparative purposes to measure future progress in CG in Kosovo.

Scorecard of corporate governance is an effective tool for all stakeholders to assess the fulfillment of best practice CC companies . Its concise criteria provide important information that can be compared easily, as a valuable asset for investors to assess property portfolio and new investment opportunities (Strenger, 2003). Scorecard is an effective tool to measure adherence to a code or corporate governance standards and can generate a result that indicates the level of compliance with the benchmark.

"Good corporate governance helps to bridge the gap between the interests of those who manage a company and the shareholders who own it, increasing investor confidence and making it easier for companies to raise equity capital and finance process investment. better corporate governance also helps ensure that a company engages and respects its own laws and forms of value in establishing relationships with stakeholders, including employees and creditors" (OECD, 2013) Following the financial scandals of the last decade and numerous debates concept of separation of ownership and control was developed (Berle & Means, 1932). Many researches have come to the conclusion that the CG problems are due to a conflict of interest between the parties involved in CG (Fama & Jensen, 1983). According to (Shleifer & Vishny, 1986, 1997) interest conflict can be reduced if shareholders increase their ownership in the company being motivated to monitor carefully managers, making sure that their interests are not ignored . Agency problem is an essential element of the so-called contractual view of the firm, developed by (Coase, 1937; Jensen & Meckling, 1976; Fama & Jensen, 1983 a, b), and others. CG theme is becoming increasingly important on a global scale after the Asian financial crisis of 1997, Russian in 1998 and bankruptcy and scandals in the U.S. during 2001 and 2002 and the outbreak of the financial crisis that engulfed the global economy in 2008 (GCGF, 2012). In response to these scandals Organization for Economic Cooperation and Development (OECD) developed a set of standards and guidelines on CG. OECD Principles on CG was accepted in 1999 and were reviewed in 2004 (OECD, 2004). OECD principles (OECD, 2004), are internationally recognized, and treat all of the CG framework. OECD Principles have served as a reference point for the development of a growing number of CG standards in different countries. After many infamous scandals academic, expert and professional organizations presented their recommendations (Becht, Bolton, & Roell, 2005). Experience shows that the issue of salaries of managers and their relation to performance was at the center of debates and literature from CG

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(Baker, Jensen & Murphy, 1988; Jensen & Murphy, 1990). OECD has developed guidelines on CG state enterprises, designed to meet the OECD principles on CG (OECD, 2005). OECD is seeking to push the implementation of the OECD principles on non-CG in its member by organizing round tables, such are organized in Asia, Latin America, Russia, Eurasia and Southeast Europe (OECD, 2003). PE in Kosovo are government owned (Law 03/L-087, 2008), and may be subject to guidelines (OECD, 2005). KEK JSC is incorporated in December 2005, where for the first time CG was adopted. Different authors define the concept of CG in different ways. Universally accepted definition of the CG term is derived from the ratio of Sir Adrian Cadbury, as the system by which the company is directed and controlled (Cadbury, 1992).

Internationally accepted definition of give (OECD, 1999, 2004).

Other authors define as: Relations between the various participants in determining the direction and performance of corporations. The main participants are 1) shareholders, 2) management, and 3) the board of directors (Monks & Minow, 2001), and other definitions (Shleifer & Vishny, 1997). In summary, we will provide the following definition: CG is a system of relationships, defined by the structures and processes, the International Finance Corporation (IFC, 2009). Kosovo government supported by international institutions operating in Kosovo: International Development Agency of the United States (USAID), IFC, World Bank (WB), OECD, etc., has shown a commitment to CG improved. The Government of Kosovo has achieved inter alia approved the Law on Commercial Companies (Law No. 02 / L-123, 2007) , the Law on Public Enterprises (PE), (Law No. 03 / L- 087, 2008) which was amended later (Law No. 04 / L-111, 2012), Code of Ethics and Corporate Governance for PE 2010, and has established, Policy and Monitoring Unit of PE (PMUPE). Kosovo Energy Corporation (KEK JSC) is the only energy company in the Republic of Kosovo. It is vertically integrated and is incorporated in late 2005. Government under the Law is mandated to initiate the introduction of the private sector in this enterprise (privatization through concessions or partial or complete certain segments of the enterprise). Government of Kosovo in June 2012 the company announced the winner for Limak & Çalik privatization of Distribution and Power Supply (KEDS), priced at 26.3 million, and was owned in May 2013, and this process was opposed as not transparent as from the opposition, non-governmental organizations and the general public. Government for not effectively exercising the property rights of PE, mismanagement, corruption and many other factors contributed to the corporation's assets were sold at a price so low when considering the fact that neighboring countries like Macedonia, Montenegro black etc., roughly the same assets were sold tenfold on higher prices. This becomes even more contentious by the fact that even after the sale of KEDS corporation has over invested 10 million Euro in this sector. Today, the primary function of

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corporate is of coal production and electricity generation. Corporate functions are regulated by the policies of the Energy Regulatory Office (ERO) of the Republic of Kosovo.

3. Scorecard Methodology

The research sample taken for analysis was the most complex company in Kosovo "Kosovo Energy Corporation" (KEK JSC) 100% owned by the government of Kosovo. The purpose of developing a scorecard is to create a tool for assessing the application of best practices and principles of the CG. Basis of preparation of scorecards are CG standards (OECD, 2004). Scorecard for CG standards should enable users to evaluate the principles and practices of CG in a fast and systematic way (Strenger, 2003). Structure scorecard contains key criteria that includes standards of CG principles (OECD, 2004) in seven key areas relevant group of questions for each area of the CG principles as:

1. Commitment to the principles of CG;
2. The rights of shareholders;
3. Equal treatment of shareholders;
4. The role of actors (interested parties) in CG;
5. Discovery and disclosure of information;
6. The role and responsibilities of the board, and
7. Audit and internal control system.

Each score area individually carries a weight factor. Within seven fields each question carries its weight factor, which is calculated after the answers (Yes, Partially, No) according to standard MS Excel software program. Summary of all fields produces overall score, which provides an overview of the implementation of standards and best practices to CG. Developing standards for CG scorecard is based on the German model (DVFA, 2000, 2010).

German model of scorecard has been implemented on an international level. Forum Global Corporate Governance (GCGF) and IFC have supported the development and adaptation of scorecards in Croatia, Bulgaria, Macedonia, Bosnia and Herzegovina, Montenegro, Azerbaijan, Georgia, Serbia, Indonesia, Vietnam, and the Philippines (GCGF & IFC, 2012). Scorecard facilitates the work of analysts and investors, providing an easy and systematic review of all relevant issues of good corporate governance. World Bank (WB) and other international organizations engaged in the promotion of best practices recommend CG scorecard. Scorecard enables companies to easily evaluate the application and the quality of the CG in their companies and comparability of data within an enterprise, between enterprises and countries steadily every year.

The survey was based on a questionnaire (scorecard with 51 questions) and

interviews with persons responsible for the Policy and Monitoring Unit of PE (PMUPE) and the board of directors of KEK JSC. In principle, evaluation of the application of the principles of the CG standards and an active commitment must attain a score of 65% -75% potential. The remaining percentage should be achievable if the other important elements of CG are met. 75-100% score is intended to stimulate companies to track higher standard than recommendations.

4. Analysis of results and discussion of scorecard on the implementation of the principles of at KEK J.S.C.

The overall result of scorecard to evaluate the implementation of standards and best practices in KEK JSC CG is shown in Figure 1:

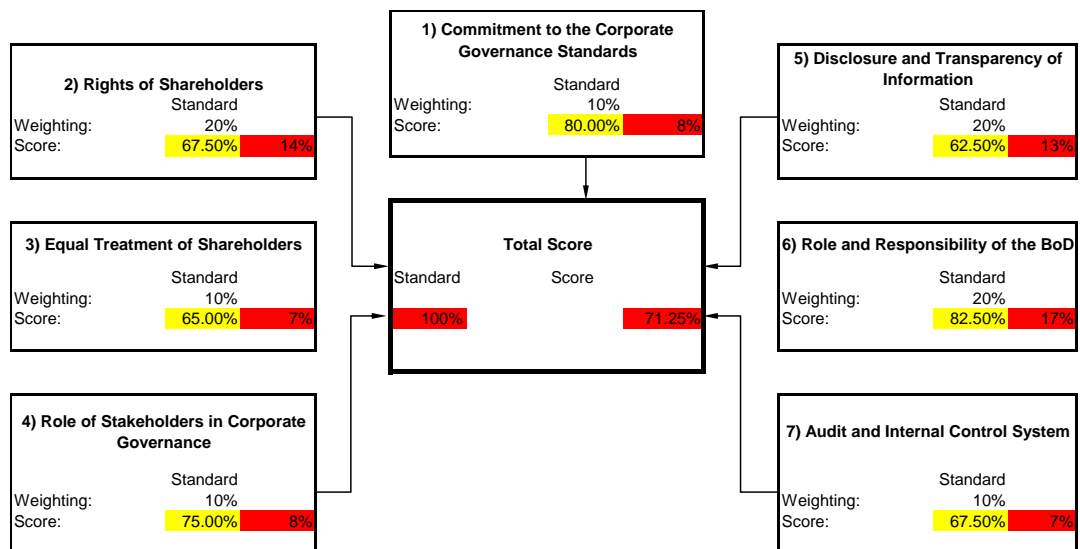


Figure 1. The overall result of scorecard to evaluate the implementation of standards and best practices in KEK JSC CG. (Source: authors research).

1) Average score of 80% is satisfactory. Law on PE No. 03/L-807 (2008), article 37, has enabled the establishment of the Policy and Monitoring Unit of PE (PMUPE) which has adopted a Code of Ethics and CG (2010) and is mandatory to be implemented by all PE in Kosovo and published on its website. KEK JSC possesses its web site, which among other things has published a code of ethics and CG. As above KEK JSC has not made public the implementation of this code in practice. Detection and reporting of this information is done by the Ministry of Economic Development (MED) in annual reports but more delay.

2) Average score of 67.5% is partially satisfactory. Protecting the rights of

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shareholders is a central element of corporate governance and is particularly important for businesses and investors who wish to invest in a company. Protection of shareholders' rights in Kosovo is guaranteed by law. KEK JSC has not disclosed enough information on conflicts of interest of board members or transactions with relates parties. As for the dividend KEK JSC does not share dividend to the government of Kosovo.

3) Average score of 65% is partially satisfactory. The Government of Kosovo is 100% shareholder of KEK JSC. Equal treatment of shareholders is defined by Law. Since Kosovo government is on the verge of privatization of many PE assets, especially the KEK JSC, a need to strengthen further the position of shareholders, strengthening internal management, to regulate more precisely the conflicts of interest, and to give detailed and timely information to shareholders for the company's operations.

4) Average score of 75% is good. It is necessary to continue to cooperate actively with all stakeholders in order to create jobs, prosperity and financial stability of the company.

5) Average score of 62.5% is not good. However, KEK JSC and other PE tend not to increase the transparency of their actual potential investors, because their web sites do not provide enough information and because most of them do not have any department in connection with investors. KEK JSC has formed a committee of internal audit and is being audited by external auditors for each calendar year. KEK JSC has published external audit reports on its web site in 2012 but with delay. MED also has made public on its website the external audit reports for all PE but with more delays. There is a need for companies to publish more information in a timely manner and to increase transparency.

6) Average score of 82.5% is good. Corporate Governance is essential to an effective board of professional and independent dicertors. The board must act in the best interest of the company and its shareholders. The board determines the company's strategy, protects the rights of shareholders and monitors financial and executive bodies of the company. The board shall ensure professional management company that works on behalf of the owner, and not in their own personal interest. Election of board of directors is determined by law (5-7 directors) and competition becomes more public, and the board of KEK JSC, has seven directors. The findings identify that their selection is made by the political lines of authority. It is recommended that the board of directors should be chosen based on merit and professionalism, it should increase the independence of board members and not be influenced politically, the rewards should be linked to business results and they should be professionally trained.

7) Average score of 67.5% is relatively good. According to the law KEK JSC

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has established internal audit committees and is being audited by external auditors. Internal control system should work at any time and without interruption, in order to identify primary deviations and helps to predict possible deviations in the future. KEK JSC has not formed committee for risk management. A need to strengthen these committees and their independence is present.

Performance evaluation of KEK JSC: KEK JSC is rated positively by PMUPE that it has complied fully fiduciary duties (trusted) to the shareholder, but in practice the situation is different. The findings using source data from public information: website, annual reports, financial statements and independent auditors' reports. Table 1: will present the findings to the performance of KEK JSC.

Table 1: The performance of the Kosovo Energy Corporation (KEK JSC), in, 000 Euro

Year	2008	2009	2010	2011	2012
Sales	163,043	174,392	192,757	215,960	222,591
Revenue from grants and subsidies	47,695	58,472	44,055	38,033	27,115
Revenues (including grants and subsidies)	217,647	237,908	238,827	256,835	250,620
Other revenues	6,909	5,044	2,015	2,842	914
Revenues (without including grants dhe subsidies)	169,952	179,436	194,772	218,802	223,505
Costs	218,841	232,895	224,865	240,979	245,375
Profit / Loss (including grants and subsidies)	-1,194	5,013	13,962	15,856	5.245
Profit / Loss (without including grants and subsidies)	-48,889	-53,459	-30,093	-22,177	-21,870
Number of employees	7529	7800	7749	7676	7449
Commercial loss (%)	25.77%	23.63%	22.47%	19.79%	18.99%
Technical loss (%)	17.06%	17.1%	17.05%	16.62%	16.50%
Total loss (%)	42.82%	40.73%	39.52%	36.41%	35.49%

Source: author's research, the Finance Division KEK JSC, annual reports KEK JSC, and independent auditors.

From Table 1. it is shown that KEK JSC in the years 2010 and 2011 had an increase in profit and a decrease in 2012, but here the grants and subsidies received from the government are included. If we look at the lack of grants and subsidies then KEK JSC results in loss. Financial losses in the last year have

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decreased to 21,870 million, while commercial and technical losses are approximately 36% which is very worrying and has a negative impact on attracting foreign investment. The above financial performance is not satisfactory.

5. Conclusions and recommendations

German Model Scorecard has been implemented on an international level. Scorecard facilitates the work of analysts and investors, providing an easy and systematic review of all relevant issues of good corporate governance. World Bank (WB) and other international organizations engaged in the promotion of best practices recommend CG scores. Scorecard enables companies to easily evaluate the application and the quality of the CG in their companies and comparability of data within an enterprise, between enterprises and countries steadily every year. Is available to all interested parties via the Internet and has low cost. Overall assessment of the application of the CG standards at KEK JSC is partly satisfactory 71.25%, while Germany reaches 80% -95% (Strenger, 2003). The situation differs in letter and it is not in line with the real situation in practice. As above for the Kosovo government law enforcement remains a challenge. Greater involvement in the CG standards is recommended such as: information disclosure and transparency for investors, strengthening boards, strengthening internal control (committees, and effective mechanisms for risk management, shareholder rights, etc.). In order to recognize the benefits of improving CG, MED should have the main role, respectively PMUPE for supervision of financial services, and judiciary in Kosovo.

Future improvements in standards of CG through scorecards will be made periodically to change the CG standards, or to change the subject of legislation, but also significant developments in the CG standards in general. As above our results can be compared with countries in the region, and numerous studies by the World Bank (WB), the Global Corporate Governance Forum (GCGF), International Finance Corporation (IFC), etc..

Recommended: that the government of Kosovo to become a "champion" of good practice identified by the CG public statements and support for good CG by key individuals. CG quality practices should have been mandated in PE where the government holds a majority stake, and should hold PE principals responsible for the quality of the CG in their companies that they manage. Finally, empirical evidence shows that the practice of CG is significantly associated with the company's economic performance, although the connection is relatively weak.

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