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CORPORATE GOVERNANCE: ARMENIA SPECIFICS

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Corporate Governance Systems in Armenia: Overview of Legal Framework

The importance of corporate governance - assuring that enterprises are run in the interest of their owners - has long been recognized in market economies. For transition economies, however, the problem acquires an added significance, as the absence of effective controls on managerial behavior can easily bolster external and internal problems which privatization is supposed to mitigate.

Poor corporate governance practices, lack of transparency and management accountability, as well as the underlying legal framework that lacks sufficient mechanisms of shareholder protection is rather a common problem in the transition economies and generally it is detrimental to the investment potential of local companies. In Armenia this general problem has several specific manifestations. For instance, the business environment demonstrates even stronger dependence on personal relationship and political connections that creates obstacles and increased uncertainty for foreign investors.

At the same time, the ownership structure of Armenian corporation is very concentrated. While the voucher privatization led to some initial dispersion of ownership, it then has been quite quickly consolidated by managers/owners. However, these pre-conditions are not sufficient yet for strengthening incentives of managers/owners to restructure and maximize the value of the firm, which is a result of various factors, especially uncertainty in the business environment.

The Government of Armenia has been making some progress in several key areas of the corporate governance agenda. In particular, several core pieces of legislation were enacted, including the 1999 Civil Code, 2000 Securities Market Regulation Law, and the 2000 Law on Accounting. An independent market regulator - the Securities Commission - was set up. Also, a central share registry (Central Depositary) was established and made fully operational, registration with which is mandatory for all companies with number of shareholders, exceeding a minimum established by the Law. The Joint Stock Company Law (JSCL) is a key law that influences corporate governance practices in Armenia. The JSCL contains several fundamental provisions that support good corporate governance: the requirement that company managers must have less than half the seats at the company board; specific liability provisions for the board members and the company executives; and the requirement for independent audits for all open joint stock companies.

The strengths in the JSCL are undermined, however, by other weaknesses in the business environment or legal framework. For instance, with respect to liability for board members and company managers, the current legislation does not include a detailed description of specific roles and responsibilities of directors and managers, beyond the provision of official information. In the absence of such defined roles and responsibilities, it would be rather difficult to determine the extent of liability of specific individuals.

Other important weaknesses of the corporate legislation relate to the following areas of corporate governance:

- Rules for decision making at shareholders' meetings and shareholder participation;
- Approval of large transactions by the company board; and
- Approval of compensation of auditors by the company board.

Shareholder participation: The JSCL allows important decisions (i.e. changing the company charter) to be made by 75 percent of votes of shareholders participating in the shareholders' meeting. International best practice requires that key decisions be made by shareholders representing not less than a minimum percentage of shares, regardless of actual attendance at the meeting.

Large transactions: The JSCL allows the company board to make decisions on transfer of large parts of company assets without calling a shareholders' meeting. Up to 50 percent of the total assets (book value) may be sold or transferred to other parties by an unanimous decision of the board. While the Law includes some mitigating provisions, such as identified procedures for determining asset values, international norms suggest that any transfer in excess of 25 percent of the company's assets should require the approval of the shareholders.

Audit framework: The JSCL requires the shareholders' meeting to approve both the company's annual financial statements and the selection of an auditor. However, the law authorizes the company board to determine the compensation level for the auditor. Because the quality of work undertaken by an external auditor maybe affected by the allocated compensation level, it create a possibility for the board to manipulate the quality of the audit. In Armenia, such risk maybe significant, given current weaknesses of the auditing profession. Thus, it seems important to amend the law and transfer the authority over auditor compensation to the shareholders' meeting.

The current legal framework makes outside investments in the existing corporations too complicated for investors, mainly because it over-regulates the investment process. It is a potential barrier for investments and it also undermines the efficiency of capital market mechanisms (e.g. it would reduce the threat of a takeover). The emerging concentrated forms of control do not facilitate the development of the capital markets in Armenia.

The Law contains several economically and legally unjustified technicalities that combined could lead to a substantial increase in transaction costs. Infusion of new capital in the company is difficult, because making respective amendments to the Charter could take up to three months. The delays derive from over-complicated procedures for holding shareholders' meetings, for registering the amended Charter, for issuing the shares, etc.

The equity investment also requires a full pre-payment of any increase in charter capital, i.e. investments are expected to be frozen at the company's account until the Charter has been re-registered and new shares are issued.

Another example of legal deficiencies relates to debt-for-equity swaps, which is a convenient investment and corporate restructuring instrument. For reasons unknown, the Armenian Law does not allow for this kind of transaction. Also, the established debt-asset ratio (1:1) is too low and limits opportunities for company financing, especially given the fact of artificially low valuation of many companies derived from valuation methods used during mass privatization.

One of the necessary and most important laws for the further strengthening of economic reforms in corporate governance – the Law of the Republic of Armenia "On Securities Market Regulation" – came into force in 1999. Such systemic changes and the new conditions created an absolutely new dimension for trading in securities, registration of ownership in securities and application of corporate governance principles. Furthermore, the system was almost entirely oriented toward the creation of vigorous mechanisms for investor protection. Under the stated Law, for the first time in the regulatory system of the Armenian economy the self-regulatory system was to be applied, the benefits of which has been obvious in the international practice. The biggest flexibility in market regulation was demonstrated in the countries, where the legislative authority delegated certain regulatory powers to non-governmental authorities.

The corporate governance regime in Armenia is also affected by a major inconsistency in bankruptcy legislation. This has significant negative implications for corporate governance, budget constraint, and contract enforcement. The exit of non-viable companies is limited, and so far was promoted through government sponsored liquidation of bankrupt state enterprises, but not through court-led regular bankruptcy procedures.

The continuing presence of non-viable companies has delayed formation of an even playing field in the economy, as loss-making companies are permitted to accumulate arrears in their payments of taxes and energy/utility bills, while profitable firms are required to pay their obligations in full.

The countries with developed economies apply two different systems of corporate governance - the group-based system and the market-based one, or as it are referred to more often - the insider and outsider systems. They have both grown from different institutional, regulatory and political surroundings, but with an internally consistent governance system and a unique mixture of corporate control.

The typical corporate governance system for Armenia is the insider model with concentrated ownership structures, when ownership and/or control is concentrated in the hands of a small number of individuals, families, managers, directors, holding companies, banks and/or other non-financial corporations. Insiders exercise control over companies in several ways. A common scenario is where insiders own the majority of the company shares and voting rights. If a few owners own shares with significant voting rights, they can effectively control a company even though they did not provide the majority of the capital.

Usually, in case of insider model the stock market is less developed with a large concentration of owners. The control over the company is executed by a small number of significant shareholders structured in relatively closed networks through planning and industrial policy mechanisms. Companies that are controlled by insiders enjoy certain advantages. Insiders have the power and the incentive to monitor management closely thereby minimizing the potential for mismanagement and fraud. Moreover, because of their significant ownership and control rights, insiders tend to keep their investment in a firm for long periods of time. As a result, insiders tend to support decisions that will enhance a firm's long-term performance as opposed to decisions designed to maximize short-term gains. Under the circumstances of diffuse ownership, it enables insiders to strip assets and leave little value for minority shareholders.

However, insider system predisposes a company to certain corporate governance failures. One is that dominant owners and/or vote holders can bully or collude with management to expropriate firm assets at the expense of minority shareholders. This is a significant risk when minority shareholders do not enjoy legal rights.

Similarly, when managers control a large number of shares or votes they may use their power to influence board decisions that may directly benefit them at the company's expense. In short, insiders who wield their power irresponsibly waste resources and drain company productivity levels; they also foster investor reluctance and illiquid capital markets. Shallow capital markets, in turn, deprive companies of capital and prevent investors from diversifying their risks.

To summarize, Armenia still need to improve the legislative framework for the implementation of new standards of corporate governance that should not be introduced through a slow process of economic osmosis. The extent to which the corporations use the basic principles of good corporate governance is a relative factor for making investment decisions. Even when corporations do not primarily use foreign sources of capital, the application of good corporate governance practices will help them to gain the trust of domestic investors, reduce their capital costs and induce more stable financial sources. However, the dynamics of today's changes in corporate governance field are not very favorable for investors. That's why it is necessary and important to have a coordinated initiative at the governmental level to promote good corporate governance standards in the country.

Company Forms and Board Structures

Most of Armenian joint-stock companies are the product of the privatization process and many exist mainly in name only, find that being an open joint-stock company and listed on Armenian Stock Exchange (which is the only stock exchange in the country) conveys no tangible benefit. These companies are often operating at fractions of prior levels of activity, in struggling industrial sectors that are trying to reconstruct customer bases. They are often impaired by many of the obstacles that confront most Armenian companies, including the lack of access to working capital, transportation and logistical impairment arising from the blockade situation with neighboring countries, and fragmented and non-empowered shareholder bases. They have stated that they see little benefit to continuing to exist as open joint stock companies and being listed on Armenian Stock Exchange. They view the reporting requirements are onerous and costly, and the listing has not provided any increased access to capital or a clear view as to tangible valuation of the companies.

In this regard, many companies are exploring the process of "taking the company private" by converting to closed joint stock or limited companies and de-listing from stock exchange. However it should be a goal to have the companies actually ready for trading on the exchange. Most of these companies are public only because of the peculiarities of the Armenian privatization process and would benefit both financially and operationally from a consolidation of ownership, rationalization of operations, and the rehabilitation of their businesses that might be best accomplished as a private entity. Those successful entities that make the transition could return to the listed markets at a future date.

Armenian Stock Exchange would function far better with small number of well-structured, mature and functioning firms listed on the exchange rather than just having 188 listed for the sake of being listed (as of January 1, 2004). For information: there are approximately 1,300 joint stock companies registered in the State Register (under the Ministry of Justice) of Armenia.

According to the Securities Market Regulation Law and pertinent Securities Commission's regulations, the open joint stock company is a Reporting Issuer, i.e. is subject to the corporate disclosure procedures (registration of the securities issued, filing of the periodical reports, beneficial ownership disclosure etc) in case it has 50 or more shareholders.

In compliance with the Securities Market Regulation Law of Armenia, issuers have two alternatives of securities registration: registration by Securities Commission of Armenia or registration by Armenian Stock Exchange.

Armenian Stock Exchange sets special requirements to securities and their issuers for listing. The main requirement is that before undergoing listing, securities should be registered in compliance with stock exchange rules and regulations. Currently, the listing on Armenian Stock Exchange covers securities of different qualitative levels. To classify securities according to their quality, Armenian Stock Exchange sets up different levels of listing: the higher the level of security listing, the higher the quality and safety of the security is considered to be. The more organized is the stock market, the stricter requirements are set to the listing procedures. Internationally, there is a general trend to toughen the listing requirements at stock exchanges. However, taking into consideration the state of Armenian economy, and hence, the state of securities market, Armenian Stock Exchange aspired to establish the listing requirements, which would stimulate the listing process instead of hindering it. Therefore no minimum requirements or criteria were established for the lower level listing that gives the opportunity to each issuer to submit the listing application.

Outline of Corporate Governance Principles in Armenia

There are two forms of joint-stock companies in Armenia - closed and open. The closed company should have not more than 49 shareholders. If the number of the shareholders of the closed company exceeds 49 (50 and more), within one year it should either be reorganized into an open one or reduce the number of shareholders.

Rights of Shareholders: Each common share of the Company grants the shareholders the same rights. The shareholder owning the common share is entitled to:

- participate with the voting right in the Company general meeting on the issues within its authority;
- participate in the management of the Company;
- receive dividends from the profit generated from Company activity (although the payment of dividends for common shares is not guaranteed by the Company);
- acquire the shares allocated by the Company on a priority basis, if the present legislation and the Company Charter do not define different provisions;
- receive any type of information on Company activities according to procedures defined by the Charter, except secret documents, including getting acquainted with the balance sheet and other accounting statements, and the Company economic activity. Shareholders owning at least 5% voting shares of the Company equity can require the checking of the statements and secret documents referring to Company activity by an external specialized audit firms. The checking expenses are reimbursed by the shareholders requiring the checking;
- authorize a third person to represent his(her) rights at the Company Constituent Meeting (the first annual general meeting of the Company shareholders);
- make proposals at the shareholders' general meeting;
- vote at the shareholders' general meeting according to the number of voting shares fully paid by him;
- appeal to the court regarding decisions taken by the shareholders' general meeting that contradict current laws and other legislative acts;
- in case of Company liquidation, receive the part pre-determined for him;
- in the case of Company Charter Capital accumulation, receive free of charge the relevant number of common shares at the expense of Company funds;
- sell or somehow transfer shares owned by him to other persons;
- use other rights determined by the Company Charter.

Management Structure: There are three levels of management in a joint stock company:

- ✓ The Company Shareholders' General Meeting
- ✓ The Company Board/Chairman of the Company Board
- ✓ The Executive Body/Company Executive Director

Responsibilities of the Shareholders' General Meeting: The responsibilities of the Company shareholders' general meeting include:

- approving the Company Charter, making amendments and changes in it, approving a new version of the Company Charter;
- reorganization of the Company;
- liquidation of the Company, appointment of the Liquidation Committee, approval of the Company intermediate and summarizing liquidation balances;
- approval of the quantitative composition of the Company Board, election of its members and termination of their rights ahead of schedule;
- definition of the maximum number of authorized shares;

- increase of the Company Charter Capital size through the increase of the share face value and the allocation of additional shares;
- decrease of the Company Charter Capital through the decrease of the share face value, the acquisition of allocated Company shares for the purpose of reducing the total share number, the cancellation of partially paid shares, as well as through the cancellation of shares acquired or bought back by the Company;
- establishment of the Company executive body (the Executive Director, Administration), termination of its authority ahead of schedule;
- election of the Company Control Commission members (Internal Audit) and termination of its authority ahead of schedule;
- approval of the person carrying out the Company audit;
- approval of the Company annual statements, accounting balances, profit and loss statement, distribution of profit and loss; decision-making on the annual dividend payment and approval of the annual dividend size; as well as approval of the annual activity results of the Company branches and representations;
- decision-making on the non-implementation of the priority right of the Company shareholders owning Company shares or other securities convertible to shares;
- approval of the procedures on holding the general meeting and setting the counting commission;
- definition of the form of informing the data and materials by the Company to the shareholders, including the selection of the relevant means of mass media if the message is to be sent through public announcements;
- decrease (splitting) and increase (consolidating) of the share face value;
- conclusion of specific transactions as outlined in other articles of the Law;
- acquisition and buy-back of the Company allocated shares in cases defined by the Legislation;
- definition of payment terms for the Company's leading officials;
- creation of subsidiaries by the Company and participation in subsidiary and dependent companies;
- creation of Company branches and representations;
- adoption of other decisions defined by the present legislation and Company Charter.

Decisions of the Shareholders' General Meeting:

- shareholders holding common shares are entitled to vote;
- most decisions are made on the basis of a simple majority of votes, while other decisions require a 75% majority;
- the procedures for decision-making at the general meeting are defined by the Company Charter or by the general meeting itself;
- the Company shareholders' meeting is not entitled to change the meeting agenda, or to take decisions on issues not included in the agenda;
- shareholders should be informed within 45 days concerning decisions taken at the meeting, as well as voting results;
- a shareholder is entitled to appeal to the Court a decision taken by the general meeting that is a violation of the requirements of legislative acts and the Company Charter if he has not participated in the meeting or has voted against it, and his legal rights and interests have been violated by the decision.

Elections of the Company Board:

- The Board members are elected at the Company shareholders' annual general meeting for 1 year.
- Shareholders, owning 10% or more of the Company voting shares are entitled to be included in the Board without the election.
- In the Company with shareholders owning more than 500 voting shares of the Company the elections of the Board are carried out through cumulative voting.
- During the cumulative voting each voting share has the number of votes equal to the number of members being elected and the voting shareholder is entitled either to grant the votes to one candidate or to distribute the votes among several candidates.
- The quantitative composition of the Board is defined by the Company Charter or by the decision of the shareholders general meeting. In the Company with shareholders owning more than 500 voting shares, the Board staff cannot be less than 7 persons.
- The member of the Board of the Company can be any able-bodied natural shareholder or the persons not being the Company shareholders as well, if that is not prohibited by the Company Charter.

Chairman of the Board:

- the Chairman of the Company Board is elected by the Company Board members out of the Board staff by a majority vote of the total number of Board members, if the Company Charter does not define a bigger number;
- the Company Board can re-elect the Chairman or elect a new Chairman any time;
- in a Company with shareholders owning more than 500 voting shares, the positions of the Company Board Chairman and the Executive Director cannot be combined;
- the Chairman of the Board:
  - ✓ organizes the works of the Company Board;
  - ✓ holds the sittings of the Board and presides at them;
  - ✓ organizes the protocol-making on the sittings;
  - ✓ presides at the Company shareholders' general meetings unless the Company Charter has different provisions.

The Company Executive Body:

- the management of the Company's current activity is carried out by the Company executive body, which is the Executive Director alone or the Executive Director together with the Company Administration;
- if the Company Charter determines the existence of an Administration, the Charter should differentiate the authority of the Executive Director and the Administration;
- in the case of existence of an Administration, the Executive Director carries out the responsibilities of the Administration Head as well;
- the establishment of the Company executive bodies and the suspension of their authority ahead of schedule are carried out according to the decision of the Company Board, if so authorized by the Company Charter;
- all management issues are within the authority of the Company executive body except those that according to the Company Charter are within the authority of the shareholders' general meeting or the Company Board;
- the Company executive body organizes the implementation of the decisions taken by the shareholders' general meeting and by the Company Board;
- the Company Executive Director and the Administration are appointed by the Company Board unless the Charter defines that as under the authority of the general meeting;

- the contracts with the Executive Director and the Administration members are concluded by the Company Board Chairman or other person as defined in the Charter.
- the Company Executive Director:
  - ✓ disposes the Company assets, including the financial resources, and carries out transactions on behalf of the Company;
  - ✓ represents the Company in the Republic of Armenia and abroad;
  - ✓ acts without a letter of authority;
  - ✓ gives letters of authority;
  - ✓ concludes contracts in accordance with defined procedures, including employment contracts;
  - ✓ opens deposit and other accounts in banks;
  - ✓ submits the Company employment regulations, separate unit regulations, and the Company administrative and organizational structure to the Company Board for approval;
  - ✓ gives orders or commands within his authority, gives instructions subject to compulsory implementation and controls their implementation;
  - ✓ hires and dismisses Company employees in accordance with defined procedures;
  - ✓ has other authority as defined by the Charter.
- the rights and responsibilities of the Company Executive Director and the Administration members are defined according to the present Legislation, other legislative acts, and contracts concluded by them with the Company;
- the Company Executive Director and Administration members can occupy paid positions in other organizations, but only upon agreement of the company Board;
- the general meeting is entitled to take decisions any time on contracts concluded with the Company Executive Director, Administration members, a managing organization or individual manager unless the Charter places settlement of that issue within the authority of the Company Board.

Rights of Minority Shareholders:

The minority shareholders have the following rights to protect their interests and to influence on the management of the company:

- The shareholders, owning at least 1% or more common shares of the company are entitled to submit a claim to the Court against the company Board Members, the Executive Director, the Administration members, demanding the reimbursement of the loss they have caused to the company.
- The shareholders, owning at least 2% voting shares, are entitled to submit not more than 2 proposals on the agenda of the company shareholders' annual general meeting, as well as to propose candidates for the Board and Control Commission membership.
- The shareholders, owning at least 5% voting shares of the company can demand the checking of the financial-economic activity of the company by the outside auditors. In that case the services of the auditor are paid by the shareholders having demanded the audit.
- The shareholders, owning at least 10% of the company voting shares can demand holding of the extraordinary general meeting.
- The shareholders, owning at least 10% voting shares of the company have a right to require from the Control Commission to check the financial-economic activity of the company.

The Company Control Commission (Internal Audit Body of the Company): The Control Commission is an internal audit structure of the company. It has the mandate of internal auditor to examine and evaluate the effectiveness of the applicable operational activities and the systems of internal financial control, so as to bring material deficiencies, instances of non-compliance and development needs to the attention of the Board and shareholders' resolution. The elected members of the Control Commission perform the internal audit functions. In case of need the Commission may act involving a team of appropriately qualified and experienced employees or through the engagement of external practitioners upon specified and agreed terms with equivalent access.

The Control Commission monitors that adequate and appropriate internal financial controls are in place; statutory and financial risks have been identified and are being monitored and managed; and that appropriate standards of governance, reporting and compliance are in operation. The Control Commission also advises the Board and the shareholders' general meeting on issues relating to the financial information.

The Control Commission is entitled to carry out the checking of the annual results of the company financial-economic activity, at its own initiative; by the decision of the shareholders general meeting or the Board, as well as upon the requirement of the shareholders owning at least 10% of the company voting shares.

The Control Commission is entitled to demand the holding of the shareholders extraordinary general meting. The Control Commission members are elected at the shareholders' general meeting for a 3-year term. The Control Commission cannot have less than 3 members.

Disclosure Requirements: All joint-stock companies are required to publish selected information from their accounts, the audit opinion, and annual accounts in national newspapers every year. They must disclose information about the capital structure, management and activities of the company; directors' shareholdings and rights issues, and audited annual reports, major corporate acquisitions and events default, among others.

Armenian legislation also requires from joint-stock companies to publish a copy of their fiscal year-end annual report in a public newspaper. Basic required financial statements in annual reports to shareholders are the balance sheet and profit and loss statement. Annual audited financial statements must be filed with the appropriate requirements in the fiscal year-end. Copies must be distributed to shareholders within the same time period.

Large Transactions: The corporate governance issues include also the regulations on carrying out large transactions, which are related to the company assets acquisition and selling, and are crucial for the company's financial-economic activity. The following transactions are considered to be large:

- One or few interrelated transactions, which are directly or indirectly related to the assets of the company, and the value of which is 25% or more of the company assets book value as of the date when the decision was made on carrying out the transaction;
- One or a few interrelated transactions, which are directly or indirectly related to the allocation of company common shares or preference shares to be converted into common shares and the value of which is 25% or more of the total face value of the common shares having been already allocated by the company.

The decision on carrying out the large transactions, concerning the assets of the company the value of which is 25-50% of the company's assets book value as the date of the decision made on carrying out the transaction, should be taken unanimously by the company Board. In case, when the value of assets is more than 50% of the company assets book value, the decision on carrying out the transaction should be taken by the company's shareholders' general meeting by 75% vote of the shareholders participating in the meeting.

Conflict of Interest Considerations: When an interested party engages in a transaction with the Company, certain steps must be taken to ensure there is no conflict of interest.

The following persons are considered to be interested parties:

- a Board member
- a person engaged in the company management bodies
- a shareholder ore group of shareholders, owning 20% or more voting shares of the company, in the case when the stated persons, their parents, husbands, children, sisters, brothers as well as the persons cooperating with them are to be parties or agents or representatives in the transaction.

The persons considered to be interested in transaction should provide necessary data on the existence of conflict of interest to the Board, Control Commission and the external auditor carrying out the company audit about the conflict. They should inform that they themselves or their relatives are interested persons in the transaction that should be carrying out.

In the company having less than 500 voting shares, the decision on carrying out the transaction where interest exists, is taken by the majority vote of the company board members, lacking interest in the transaction. In the company having more then 500 voting shares, the decision on the transaction where interest exists, is taken by the majority of vote of company Board independent members (who is not the company Executive Director or member of Administration). When the market price of transaction, where the interest exists, exceeds 2% value of company assets, the decision is taken by the general meeting of shareholders, by the majority vote of the shareholders lacking interest in the transaction. The person recognized interested, is responsible to the company in the size of loss caused to it. If several persons carry the responsibility, they are proportionally responsible to the company.

Corporate Governance Development Challenges

The development of corporate governance in Armenia is currently in a pilot phase. There are corporate laws and regulations which define the role and responsibilities of those charged with conducting corporate business and it may take some time, however, before these mechanisms mature enough in Armenia to serve as effective controls of corporate activity. The practical impact of legal regulations depends not so much on what is regulated as on what can be enforced: if the enforcement infrastructure is missing, legal regulations are of little assurance to the owners.

However, the problems of corporate governance in Armenia are not limited to securing managerial accountability. The corporate sector in Armenia consists of companies formed as the result of mass privatization, without the simultaneous development of legal and institutional structures necessary to operate in a competitive market economy. Under the existing economic environment in Armenia in most cases individual minority shareholders are passive. Shareholders are not considered as a source of financial resources and are perceived rather as a problem than a potential. Public companies, which by definition have to ensure maximum transparency of their operations practically, do not follow this basic principle of corporate governance.

The main corporate governance issues currently being debated in the country are:

- High degree of concentration of ownership structure in corporations.
- Under unpredictable economic circumstances, managers see their positions as temporary and uncertain which leads to maximizing their own profit instead of maximizing the company profit.
- Open joint stock companies avoid disclosing information concerning their activity. In particular, they did not disclose the financial results of their activities. The companies are "closed" system for investors, a circumstance, which undoubtedly was shattering their confidence towards the companies and their activities. The companies, without revealing the process and results of their activities, operated under certain "hidden" conditions, which also had its impact on the development of the atmosphere of confidence, so necessary for the market.
- However, resulting from the lack of the state enforcement measures, even the minimum requirement defined under the Armenian Law on "Joint Stock Companies" have not been followed. Prior to the adoption of the Armenian Law on "Securities Market Regulation" the shareholders were deprived from the possibility to exercise their rights to receive information. The issuers and their managers did not bear any material responsibility for not following the requirement of data disclosure and providing non-realistic data to the investors.
- The most important issue is connected with the problems and tasks of companies' management. The investors are unaware of the preparation and adoption of the decisions, the necessity and purpose of the adopted decisions are not revealed to them. The outcome of this is the certain passiveness of the investors in making investment decisions due to the poor quantitative and qualitative data.
- The rights of the shareholders are violated at the process of management. The minority is not only deprived of its rights to participate in the management, but is extensively ignored by the issuers. The general meetings of the shareholders are called with the gross violations of the legislation. The shareholders are not informed about the meeting agenda, adopted decisions and their possible consequences. The decisions are adopted by the gross violation of the voting rules, in particular proxy statement rule.

- Through re-organization (usually splitting or separating) and other means the major shareholders transfer the current assets of the company without the adequate indemnification to the newly established company which sole owners they are. In the result of this the rest of the shareholders remain in the structure of the company which assets are not working, and their shares are "devaluating". The low level of the enforcement of laws excludes the proper performance of the minority rights' protection.

Institute of Director Development Aspects

In market economies, directors are pressured by outside forces to act in the best interests of their companies. Most corporate directors in Armenia are desperately scrambling to figure out how to oversee their businesses and understand their new roles. They may have to develop new products or markets-or both. Moreover, they have to perform these tasks in a demanding, rapidly changing global economy.

The oversight function of corporate boards requires the presence of directors drawn from the ranks of people who are free from any business or other relationship with the company. Only such directors can pass a truly disinterested and independent judgment on those who manage the company's business. However, the same function also requires an intimate knowledge of the company and its business, and such knowledge can be provided only by the executive officers of the company. The foremost responsibility of the board is to ensure that management is accountable for the company's performance and results. To run a business enterprise, management must be accorded ample power to manage, but to run it effectively, it must be held accountable for the use of this power. The only way of making sure that managers are accountable for their actions is to ensure that directors are accountable for theirs.

To say that management must be accountable for corporate performance, however, only begs the question of what corporate objectives the performance should achieve. There is a difference between "doing the right thing" and "doing the thing right," and the analogy makes it clear that it is up to shareholders to decide what the purpose of corporate activity is, up to the board to formulate this purpose in executable terms, and up to management to execute it efficiently. Corporate directors can be pressured by shareholders on ethical or specific management issues. Shareholders may file lawsuits to force directors to act or present resolutions to the board of directors. While the majority of shareholders choose to go along with the company's vote against the resolution, such resolutions send a clear and powerful signal to directors that they are accountable to the interests of shareholders.

Occasionally, coinciding with the generational turnover in management is a desire to present a successful image, rehabilitate reputations, and to be a progressive force in the economy is beginning to take shape in some instances. While these signs are encouraging, there are significant expectation gaps between the needs of the capital markets and investors and the second generation management teams as to what qualify as transparency and corporate governance.

Mass privatization distributed ownership of an existing enterprise among many individuals who must entrust the responsibility for managing the enterprise to a professional manager. Those individuals need to make sure the manager operates the business in their interest. In addition to capital markets and investors, society also plays a key role in how directors of a given company act. Many directors think that their primary job is to maximize the wealth of shareholders.

Individual personality and corporate culture also often play a profound role in shaping a given board. Some boards are dominated by the chief executive of a company, who usually is a director. Others are quite aggressive in overseeing company management. In general, however, company directors approve not only major corporate strategies, but also everyday decisions, which need to be left up to management. At annual shareholder meetings some stockholders accuse directors of self-dealing, fraud, incompetence, and receiving excessive fees.

Given the importance of directors in running their companies and in building and sustaining democratic reforms in Armenian economy it is obvious that an adequate director qualification and training programs in corporate governance should be implemented in the country. The main goals of such programs must be to:

- Develop a core of senior Armenian directors schooled in the basis of corporate governance;
- Strengthen emerging corporate institutions in Armenia;
- Develop a new generation of directors who understand their corporate governance responsibilities, such as their accountability to different constituencies (stock and bond holders, workers and the public);
- Develop standards of corporate governance that can be adopted voluntarily by corporate entities throughout the country.

For directors the most interesting part of training program can be an all-day simulation of a board meeting, with help from some board members of Western companies. This simulation can integrate the lessons participants will learn and serve to reinforce the challenges of being a director. Those people who wouldn't change had to leave the board and replaced with those who are able to adapt and speak the common language of western business.

The important issues of basic training can be also on financial accounting, corporate law and the responsibilities of directors to cover such topics as:

- Evaluation of financial reports, including concepts such as liquidity, debt and profitability.
- The role, fiduciary responsibilities and ethics of a corporation's board of directors.
- The different forms of corporate governance, involving different combinations of inside and outside directors, informational requirements and structures for board meetings.

Corporate Governance Development Perspectives in Armenia

Now, when soviet system has crumbled in Armenia, the companies play by a completely different set of rules, based on democratic society and market economy. As the country's democratic transition unfold, it is clear that the newly private companies' ability to compete successfully in the international marketplace will be crucial to the strengthening of new democracy. The failure to create well-run, profitable companies could mean high levels of long-term unemployment in Armenia, which, in turn, could destabilize the democratic reforms in the country.

Should the board represent interests of only those who contribute financial assets to the corporation, or should it also represent interests of those who invest in it in different ways? What are the costs of putting some interests ahead of others? Who should bear these costs? These are important and difficult questions, as they touch on issues of equity as much as efficiency.

Some observers predict that instilling principles of modern corporate governance in Armenian companies will be all the more difficult because they are starting out with little or no experience. Learning how to make democratic decisions on a local level without the intervention of the state will eventually allow our society to mature into full-fledged democracies. Other observers state that corporate governance sounds complicated but really is not. It involves the set of basic controls by which most companies are governed.

Unfortunately, companies in Armenia lack the advantages of well-developed domestic capital markets or experienced investors to ensure proper direction. To a large extent, investors do not have access to the information vital for proper investment decisions, such as past stock performance or companies' profitability and outlook. Shareholder resolutions are unknown. As a result, most investors are ill-equipped and operate in a vacuum.

In this regard, special programs related to the effective enforcement and improvement of corporate governance principles should be implemented in the country. In the framework of these programs the appropriate governmental bodies should undertake more consistent and active efforts to enforce the compliance of performance of issuers operating in Armenia with the requirements of the legislation, simultaneously protecting the investor rights to the fullest extent and ensuring the transparency of corporations. The primary steps to be taken will include the following:

- Adoption of regulations that will make the companies' corporate governance smoother and more transparent and will enable small shareholders to efficiently participate in the management.
- Periodical disclosure of information, clarifications and statements concerning corporate governance principles, and when possible, organization of seminars for the persons participating in the companies' management.
- Necessary assistance for preparation of model issuers that should also include the training of a given company's certain specialists. Such assistance will involve steps directed to making the given issuer more transparent and securing the observance of corporate governance principles. The assistance will also be rendered through activities that will be carried out within the framework of meetings and assistance projects, resulting in development of relevant information system in the company.
- Development of internal norms and regulations that are conditioned by the company's activities in the securities market.
- Development of corporate finance management mechanisms in the companies, based on general principles of corporate governance and implementation of international accounting standards (already adopted in Armenia).

- Strengthening the ties between the investors and companies through meetings and on-going and direct information provision. It is desirable to maintain such cooperation not only within the scope of legislative requirements, but also to make it deeper and more diversified in order to ensure long-lasting cooperation in the future.

Successful implementation of the above mentioned measures will enable the creation of a stable, reliable and dynamic economic system through the settlement of sound and effective corporate governance principles in the companies.