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Transparency and Disclosure Regulations—A Valuable Component of Improving Corporate Governance Practice in Transition Economies

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8.1 Introduction

The main purpose of disclosing corporate governance information is to reduce information asymmetry and agency costs resulting from separation between ownership and control, and to improve confidence of investors in the reported information on a firm (e.g., Bauwhede and Willekens 2008; Healy and Palepu 2001). Greater transparency and better providing of information enable stakeholders to be better informed about how a company is governed and managed (Patel and Dallas 2002), thereby being an important factor in recovering trust in capital markets (Bauwhede and Willekens 2008). For these reasons,

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transparency and disclosure practices are recognized as an important component of good corporate governance. Companies all over the world face information asymmetry and agency problems (Bauwhede and Willekens 2008), even though there are evidences that the type and severity of agency problems differs across companies due to the differences in ownership and control structures (Luo and Salterio 2014). Additionally, differences in variety of the factors that are inherent to the companies' environment importantly influence not only the extent of agency problems but also the type of governance mechanisms applied for controlling the potential self-interested behavior of managers (Aguilera et al. 2008; Larcker and Tayan 2011). Therefore, the main research question that we address in our research is to what extent transparency and disclosure practices are implemented in transition economies and what are their implications for corporate governance quality.

The motivations for our research are twofold. First, several studies investigated corporate governance quality and ways to improve transparency and disclosure practices, where the United States (US) institutional context has been among the most studied ones (e.g., Durisin and Puzone 2009; Larcker and Tayan 2011; Patel and Dallas 2002; Sheridan et al. 2006), consequently making it a "normative benchmark" (Filatotchev et al. 2013, p. 970). However, we are lacking research on these topics in transition countries (e.g., Zattoni and Van Ees 2012; Kumar and Zattoni 2015), where China and Russia have attracted more research attention than other former socialist countries (Grosman et al. 2016). Second, a considerable number of empirical corporate governance research "has begun to cast doubt on whether there is a direct and universal link between governance practices and a firm efficiency" (Aguilera et al. 2008, p. 478) and especially whether this association holds in different national settings. Therefore, special attention in our research is devoted to the particular institutional context of a transition economy that influences the corporate governance practices in such economy, thereby shading light on this under-investigated institutional context.

The main goal of our research is to broaden our understanding of transparency and disclosure practices in transition economies by researching the sample of joint stock companies listed on the stock

exchange in Slovenia. We limit our research on public joint stock companies since these enables us to explore mandatory as well as voluntary transparency and disclosure practices. We observed the effectiveness of disclosure and transparency practices in terms of improvements made in the period from 1990's when transition from socialist socio-economic system has started until today.

Since particular corporate governance practices are effective only in a certain combination (Aguilera et al. 2008), we investigated the transparency and disclosure practice within a broader range of corporate governance practices by applying the SEECGAN Index. The index and underlying methodology were developed to address the unique social, political and economic context of the South Eastern European transition economies (Djokić et al. 2014; Tipurić et al. 2015). The research results presented in this contribution are part of the on-going research that started in 2014 (Djokić et al. 2014). The SEECGAN Index enables not only an in-depth study of the transparency and disclosure in an individual company but as well as comparable analysis with the research findings of those countries where the same index has already been applied.

Until now, we have been able to conduct comparative analysis with the published research results for Croatia. Slovenia and Croatia are both transition economies that present a large sub-category of emerging economies (Hoskisson et al. 2013). As new European states founded in 1991, these two countries have been in the last decades under the transition process to an independent state, the reorientation from the former Yugoslavia to the Western developed markets and the transition to a market economy (Lahovnik 2004). Even though Grosman et al. (2016) claim that Slovenia and Croatia are no more transition countries, since they both joined the EU, several indicators show that economic transition from routine to innovative economy and society has not been finished yet (Bekö and Jagrič 2011; Bušega and Dachin 2015).

We build our research on agency theory that is main underlying theory in the corporate governance research (e.g., Aguilera et al. 2008; Durisin and Puzone 2009). We take into consideration new developments of this theory, especially its basic assumptions (Aguilera et al. 2016) and some critiques about the under-contextualized nature of the

agency theory (i.e., closed system approach). Therefore, we based our research on the open systems perspective and organizational approach to corporate governance as proposed by Aguilera et al. (2008) that considers the context of different organizational environments. The open systems approach “treats organizational features as being interdependent with the diversity, fluctuations, and uncertainties of their environment, and reject universalistic context-free propositions” (Aguilera et al. 2008, p. 479).

The effectiveness of corporate governance practices will depend on the stakeholders’ selection of the strategically most appropriate governance practices as response to threats and opportunities within a particular organizational environment. Additionally, we applied institutional theory that is recognized as a promising one for the development of the corporate governance theory (Filatotchev et al. 2013; Judge 2008; Zattoni and Van Ees 2012; Waring and Edwards 2008). An increasing number of studies demonstrate that variations in institutional environments play a crucial role in explaining cross-national differences in corporate governance mechanisms (Aguilera and Jackson 2010; Aguilera et al. 2016; Schiehl et al. 2014) and the nature of transparency practices may be affected by institutional environment (Bauwhede and Willekens 2008; Grosman et al. 2016). Especially in the case of transition economies that are characterized by the lack of governance tradition, we find the concept of institutional complementarities (Filatotchev et al. 2013; Schiehl et al. 2014; Waring and Edwards 2008) to be a useful lens for exploring the effectiveness of transparency and disclosure regulations and practices and their impact on the overall governance quality in the specific context of a transition economy.

We believe that our research results can be useful not only for companies, policy makers and scholars in Slovenia, but also for other countries with the similar context. We find our research results to be of special importance for other transition countries where we can observe on one hand similar historical backgrounds but on the other hand different development of corporate governance mechanisms (e.g., Grosman et al. 2016; Hoskisson et al. 2013; Tipurić et al. 2016). Our research contributes to global understanding of corporate governance (Zattoni and Van Ees 2012) by identifying crucial transparency and disclosure mechanisms and practices that contribute to the raise of

corporate governance quality in a non-common law country with the prevailing concentrated ownership structure in public companies.

This chapter is structured as follows. The second section highlights the theoretical background relevant for our research. In the third section we present our research. We start with the research methodology and presentation of the institutional framework and regulations on transparency in Slovenia. It is followed by the explanation of the sample and data collection, and discussion of research findings on transparency and disclosure. We end the chapter with conclusions and directions for future research.

8.2 Theoretical Background

8.2.1 Agency Problem and Transparency

Several corporate governance research studies are based on a universal model outlined by the principal-agent theory (Fama and Jensen 1983). Its central premise is that shareholders and managers have different interests, objectives and different access to the specific information on a firm. Managers who are agents of shareholders (i.e., principals) have the opportunity to act in a way that benefits themselves, while shareholders bear the costs of such actions—these are the so called agency costs (Aguilera et al. 2008; Larcker and Tayan 2011). However, it has been noted that in many countries not only managers are those who can expropriate minority shareholders and creditors but so do the controlling shareholders, too (La Porta et al. 2000; Morck et al. 2005; Renders and Gaeremynck 2012).

According to Martynova and Renneboog (2010), the basic agency problems should be distinguished; agency problems arise between management and shareholders, between majority and minority shareholders, and between creditors and shareholders. The first type of agency problems arise due to the conflicts of interests between management and shareholders in companies with a dispersed ownership structure. In such companies, small shareholders cannot effectively manage the

company and have to delegate the control over the company to professional managers. The separation of ownership and control leads to a divergence of interests between professional managers and shareholders.

The conflict of interests is less severe in companies with a concentrated ownership structure where the controlling shareholders have strong incentives to monitor managers. However, the presence of a controlling shareholder may induce another type of agency problem referring to the potential opportunistic behavior of the large block-holder towards minority shareholders.

The third type of agency problems arises due to the potential conflicts of interests between creditors and shareholders. Managers can maximize shareholder wealth by increasing the risk of the projects they invest in, and redistribute wealth from creditors to shareholders.

Several mechanisms are proposed to resolve principal-agent problems such as monitoring by boards of directors or large outside shareholders, equity-based managerial incentives or the market for corporate control (Aguilera et al. 2008; Filatotchev et al. 2013; Larcker and Tayan 2011). Enhancing corporate transparency and disclosure are recognized as one of the most important corporate governance strategies to mitigate managers' self-serving behavior, to reduce agency costs and information asymmetry between insiders (i.e., management and majority shareholders) and outsiders (i.e., minority shareholders, creditors, and other stakeholders) (e.g., Bauwhede and Willekens 2008; Healy and Palepu 2001; Nowland 2008; Martynova and Renneboog 2010). The transparency strategy seeks to eliminate conflicts of interests by enforcing strict disclosure requirements on corporate policies and contracts directly related to managers (Martynova and Renneboog 2010).

Greater transparency and better disclosure of information enable corporate stakeholders to be better informed about a company (Patel and Dallas 2002) and have positive effects on the capital markets functioning (e.g., Bauwhede and Willekens 2008; Healy and Palepu 2001; Patel and Dallas 2002). Research revealed that companies with higher governance and transparency rankings are valued higher in the stock markets; this is especially true in less investor-friendly countries (Durnev and Kim 2005).

Weaknesses in governance structure and transparency are associated with lower quality of financial reporting, earnings manipulation, and fraud (e.g., Bauwhede and Willekens 2008). In the opinion of several authors not only disclosure of governance practices such as code compliance-related information are important for solving agency problems but so do also disclosure practices in general. Especially disclosures of corporate strategies, operations and finance are important components of the corporate governance quality (e.g., Healy and Palepu 2001; Nowland 2008; Sheridan et al. 2006). Research evidences revealed that the nature of transparency and disclosure practices might be affected by the characteristics of the institutional environment (e.g., Bauwhede and Willekens 2008; Grosman et al. 2016). That is why in the next section we discuss the implications of different institutional environments for corporate transparency and disclosure practices.

8.2.2 Institutional Environment and Transparency

Researches revealed that there were substantial variations in institutional environments that shaped the nature of agency conflicts and the governance mechanisms effectiveness (Aguilera et al. 2016; Schiehl et al. 2014). Formal and informal institutions modify the basic principal-agent relationship by providing different sets of incentives or resources for monitoring, value and normative understanding about the nature of a company (Filatotchev et al. 2013) in ways that require specific contextualization.

According to the opinion of several authors (Filatotchev et al. 2013; Schiehl et al. 2014) the effectiveness of governance practices depends on broad sets of complementariness among institutions within the particular social and political environment that differs across countries. The concept of institutional complementarities describe interactions among institutions resulting in synergetic effects among their activities (Filatotchev et al. 2013; Schiehl et al. 2014; Waring and Edwards 2008) and influencing “the adoption and effectiveness of firm-level governance practices” (Filatotchev et al. 2013, p. 979).

Several attempts to distinguish and describe different institutional environments and corporate governance systems can be found in the corporate governance literature. Two types of corporate governance systems often distinguished in the literature are the Anglo-American and the Continental European corporate governance systems (Aguilera and Jackson 2010). Short-term equity finance, dispersed ownership, stronger shareholder rights, active market for capital control, and flexible labor market characterize the Anglo-American corporate governance system. The Continental European corporate governance system is characterized by long-term debt financing, concentrated block-holder ownership, weak shareholder rights, inactive markets for capital control and rigid labor markets.

According to Larcker and Tayan (2011) two perspectives should be considered based on the role of companies in the society when distinguishing corporate governance systems, and that are the shareholder perspective and the stakeholder perspective. Within the shareholder perspective, a primary obligation of a company is to maximize shareholder value and corporate governance system should protect shareholders from being expropriated by managers (Larcker and Tayan 2011; Martynova and Renneboog 2010). Such shareholder-based system is the prevailing governance system in the Anglo-Saxon countries (Larcker and Tayan 2011; Martynova and Renneboog 2010) where the law strongly protects shareholders (Weimer and Pape 1999). Companies in the Anglo-Saxon countries are relatively widely held. This is why on the one hand less mechanisms shareholders can use effectively to directly influence managerial decision-making (Martynova and Renneboog 2010); but on the other hand “interdependence among institutions may lead to substitution among functionally equivalent corporate governance mechanisms” (Filatotochev et al. 2013, p. 980). Examples are takeover markets in the US and the UK, where the takeover threat presents a mechanism for disciplining the managers (Filatotochev et al. 2013).

The stakeholder perspective and the stakeholder-based system prevail in the most European and Asian countries (Larcker and Tayan 2011; Martynova and Renneboog 2010). From the stakeholder perspective, a company has a societal obligation that goes beyond the obligation to increase shareholder value. Effective governance should “support policies

that produce stable and safe employment, provide acceptable standard of living for workers, mitigate risk for debt holders, and improve the community and environment” (Larcker and Tayan 2011, p. 9). In countries with the prevailing stakeholder-based system, we can observe a significantly higher ownership concentration than in the Anglo-Saxon countries (Renders and Gaeremynck 2012). Concentrated ownership may reduce agency problems stemming from the separation of ownership and control. However, it may create new conflicts arising between majority and minority shareholders. Therefore, the main function of corporate governance regulations is to minimize the agency problems between majority and minority shareholders and between shareholders and creditors (Martynova and Renneboog 2010).

In the transitions economies of the Central and Eastern Europe, we find the combination of the elements of the Continental European capitalism with large controlling shareholders and the elements of entrepreneurial or founders’ capitalism of the USA (Berglöf and Pajuste 2005). Many transition economies face especially the agency problems between majority and minority shareholders due to a relatively high level of ownership concentration. The concentration of ownership in the hands of a few or even one block-holder enables such shareholders to exert a significant control and direct influence on the nomination and control of management team. Therefore, such management cannot be expected to be independent (Berglöf and Pajuste 2005; Tipurić et al. 2012).

Legal system and tradition also have important influences on the corporate governance system Larcker and Tayan (2011). Regarding legal origins, common-law and non-common-law (i.e., civil law) countries can be distinguished (Larcker and Tayan 2011). Non-common-law countries (e.g., Germany, Scandinavia, and French countries) are characterized by poorer investor protection, smaller and narrower capital markets and less widely held companies. Common-law countries (e.g., UK) afford more rights to shareholders, and creditors are more protected than civil-law countries (La Porta et al. 1998). In the common-law countries, we can observe especially information asymmetry and agency problems between managers and (majority) shareholders, while in the

non-common-law countries, information asymmetry and agency problems between minority and majority shareholders are mainly present. The research conducted by Bauwhede and Willekens (2008) revealed that the level of corporate governance disclosures was significantly lower in non-common-law countries than in common-law countries. The results can be explained by greater pressure that shareholders can put on managers in comparison to the pressure minority shareholders can exert on majority shareholders.

The results of a comparative analysis of the corporate governance regimes in 30 European countries and the USA show dramatic and positive changes in transparency standards in all observed countries (comparison was made for time period from 1990 until 2005) (Martynova and Renneboog 2010). The highest transparency index, that was based on the quality of information about a company, its ownership structure, and management available to investors, was calculated in countries of the English legal origin (the UK; the USA, and Ireland), and countries of the French legal origin, followed by countries of the Scandinavian legal origin and the German legal origin. The former socialist countries that accessed EU in 2004 showed the lowest transparency index.

The research findings of Durnev and Kim (2005) show that the choice of disclosure practices in a company is positively influenced by growth opportunities, the need for external financing, and the concentration of cash flow rights. These positive relations are found to be stronger in countries with weaker legal frameworks. According to the authors “good investment opportunities provide more incentives to improve governance practices among firms in countries with weaker legal framework ... firms in poor legal environments can enjoy high valuation if they adopt high quality governance and disclosure practices” (Durnev and Kim 2005, pp. 1487–1488). Researches, conducted in transition economies suggest that closer ties to foreign multinational corporations lead to improvements in transparency and disclosures practices of companies in these countries (Braguinsky and Mityakov 2015; Grosman et al. 2016).

8.2.3 Mandatory and Voluntary Transparency and Disclosure Regulations and Mechanisms

Transparency and disclosure regulations “intends to improve the quality of information about company and management” (Martynova and Renneboog 2010, p. 14). Companies have considerable possibilities as to when and how much information they disclose (Nowland 2008), while some disclosures are mandatory. Mandatory transparency and disclosures are those that are required by legislation or requirements of the stock exchange listing. Even though legal systems have a strong impact on transparency and disclosure practices, voluntary transparency and disclosures are gaining more importance, especially voluntary corporate governance codes. While mandatory disclosures are normally consistent across companies in the same jurisdiction, there can be substantial variation in decisions on voluntary transparency and disclosure practices. Studies show that decisions on voluntary transparency and disclosure practices are endogenously determined by weighing the costs and benefits of the additional disclosure (Healy and Palepu 2001; Nowland 2008).

The compliance with corporate governance codes and disclosure on corporate governance systems and practices (i.e., the “comply or explain” approach) is largely voluntary in most EU member countries. In the contrast to the “comply or explain” approach, the legislated mandatory governance model (i.e., the “one size fits all” approach) of which the most well-known is the Sarbanes-Oxley Act of 2002 (SOX) in the USA, prescribes the same corporate governance practices for all types of companies (Bauwhede and Willekens 2008; Luo and Salterio 2014; Renders and Gaeremynck 2012). Even though such regulations result in a significant increase of the amount of information available to the public (Nowland 2008), several scholars questioned the “one size fits all” approach and its impact on improving corporate performance due to many variations of the institutional context (e.g., Aguilera et al. 2008; Larcker and Tayan 2011; Weimer and Pape 1999) discussed in the previous section.

The main idea of the “comply or explain” approach is that the fundamental determinants of the type and severity of agency costs are companies’ ownership and control structures, which differ across countries and

industries. Therefore, corporate governance practices should reflect such differences (Luo and Salterio 2014). Codes present a set of voluntary best governance practices and are a form of the soft regulations (i.e., soft law) (Aguilera and Cuervo-Cazurra 2009; Zattoni and Cuomo 2008). Codes “tend to be adapted to the country’s economic environment and address the country’s most salient governance problems” (Aguilera and Cuervo-Cazurra 2004, p. 436). However, there are some evidences (e.g., Aguilera and Cuervo-Cazurra 2009; Collier and Zaman 2005; Cromme 2005) that codes facilitate to certain degree the governance convergence across countries due to several external forces (e.g., globalization, market liberalization, and powerful foreign investors). According to Cromme (2005) the code’s key function is transparency as “there can be no better form of control than transparency, for open explanation of management decisions is a major plus point for company credibility” (p. 364).

The “comply or explain” mandatory disclosure requirement was adopted by most stock exchanges and requires that the listed firms explain their non-compliance with the governance code in their annual report (Aguilera and Cuervo-Cazurra 2004; Cromme 2005; Luo and Salterio 2014). This way the code “helps companies exercise greater self-responsibility in their dealings with the capital market” (Cromme 2005, p. 364); the quality of transparency is suggested to be more reliable when the law or the stock exchange regulations include the “comply or explain” principle (Martynova and Renneboog 2010). According to Luo and Salterio (2014) the disciplining power of this approach is “the required public disclosure of governance practices that allows market participants to evaluate the effectiveness of the firm’s governance system and to make informed assessments of whether noncompliance is justified in particular circumstances” (p. 460).

The research findings demonstrate that the introduction of corporate governance codes has an important effect on the level of disclosures. Sheridan et al. (2006) found that the introduction of reports and codes of good governance in the UK resulted in a significant increase in the number of news announcements. Findings of several research studies indicate that publicly traded companies tend to comply with codes recommendations (Luo and Salterio 2014; Renders and Gaeremynck 2012) which might be due “to the market forces and pressures to comply

with legitimating practices or ‘doing the right thing’” (Aguilera and Cuervo-Cazurra 2004, p. 419).

Public companies have also a strong incentive to provide a clear justification for non-adoption of certain codes recommendation, since the best governance practices are generally recognized as value enhancing (Renders and Gaeremynck 2012). However, the research results of Nowland (2008) show that the introduction of the voluntary codes does not necessarily improve disclosure practices. Only voluntary codes that have specific sections designated to improving disclosure or information transparency have been effective in improving company’s transparency and disclosure practices. Similarly, the research on the UK listed companies suggests that that better transparency of company’s activities may be a result of the introduction of governance codes with the best transparency practices included (Sheridan et al. 2006).

8.3 Empirical Research

8.3.1 Research Methodology

The combination of the context-specific and organization-specific view of transparency and disclosure was applied in our empirical research. In the opinion of several authors such approach provides a better understanding of organizational effectiveness resulting from the interaction among country-level and firm-level forces (Aguilera et al. 2008; Larcker and Tayan 2011; Schiehl et al. 2014). The context-specific part of our research is discussed in the next section.

The organizational level was explored by applying the SEECGAN Index methodology (Tipurić et al. 2014), which enables the calculation of the transparency and disclosure index as well. The study on disclosure and transparency of Slovenian public companies was conducted as a part of research where the corporate governance quality was evaluated by applying the SEECGAN Index methodology (Djokić et al. 2014). The members of the South East Europe Corporate Governance Academic Network created the SEECGAN Index in 2014 in order to make possible the comparative analyses of corporate governance in the

South Eastern European countries. Such analyses can provide more accurate cognitions than comparisons with the rest of the European countries due to numerous historical, cultural, political and economic similarities among these countries (Tipurić et al. 2015).

The SEECGAN Index methodology is based on the evaluation of seven broad governance categories (Tipurić et al. 2014, 2015): (1) Structure and Governance of Boards, (2) Transparency and Disclosure of Information, (3) Shareholders' Rights, (4) Corporate Social Responsibility, (5) Audit and Internal Control, (6) Corporate Risk Management, and (7) Compensation/Remuneration. These categories are evaluated by the assessment of 98 attributes. The index score is calculated for each category and as an overall/total index. The maximum index score is 10 indicating the best possible practice, and the minimum is zero indicating the worst possible practice.

According to the SEECGAN Index methodology (Tipurić et al. 2015) companies can be classified in four groups based on the calculated (total or per category) index score: first-class ($7.5 \leq \text{index} \leq 10$), good ($5.0 \leq \text{index} < 7.5$), unsatisfactory ($2.5 \leq \text{index} < 5.0$) and poor companies ($0 \leq \text{index} < 2.5$). The application of the SEECGAN Index methodology enables us to explore the importance of transparency and disclosure as one component of corporate governance by comparing it with other CG components assessed. The methodology enables us to study in-depth the transparency and disclosure practices themselves as well. Both can be done on company and national levels. Finally, the methodology can be applied on international level by comparing the results among participating transition countries. Our study focuses only on the second category (i.e., Transparency and Disclosure of Information) where we collected the non-financial information based on 17 questions (Table 8.1).

8.3.2 Institutional Framework and Regulations on Transparency and Disclosure in Slovenia

The beginnings of the corporate governance in Slovenia can be traced back in the 1990s when the transformation of companies' ownership took place, based on the provision of the law on

Table 8.1 Questions about transparency and disclosure practices

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- Q1—Has the company developed and publicly disclosed its own Corporate Governance (CG) Code?
- Q2—Has the company adopted some official CG Code (CG Code of the Chamber of Commerce, CG Code of the Stock Exchange or similar)?
- Q3—Does the company disclose the Statute and/or Articles of Association (Incorporation) on its web page?
- Q4—Does the Company disclose the extent to which it is complying with its Corporate Governance Code (does it explain possible deviations from the Code)?
- Q5—Has the company adopted the Transparency Policy and the Information Disclosure Policy?
- Q6—Does the company disclose the Transparency Policy and the Information Disclosure Policy?
- Q7—Has the company adopted procedures for the disclosure of market sensitive information?
- Q8—Does the company disclose procedures for the disclosure of market sensitive information?
- Q9—Does the company website have all the information translated into English?
- Q10—Does the company disclose information on Related Party Transactions?
- Q11—Does the company disclose all periodic information (Annual, half-yearly and quarterly financial reports) in the legally binding period?
- Q12—Does the company disclose crucial strategy-related information relevant to its investors and stakeholders?
- Q13—Does the company publicly disclose information regarding the company's ownership structure on its website (top 10 shareholders, their names and % of shares as well as information on the number of other owners)?
- Q14—Does the company disclose information on other board memberships (when its board members sit on other corporate boards)?
- Q15—Does the company disclose a calendar of important events?
- Q16 – Does the company disclose information on special relationships (if any) between shareholders?
- Q17—Does the company have a special section on its web page dedicated to Corporate Governance or Investors Relations (where all interested parties and stakeholders can find financial data, ownership structure data, statute and articles of association, information on related party transactions, annual plans, CG Code etc.)?
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Source Tipurić et al. (2015)

ownership transformation that came into force in 1992. Companies whose equity source was social capital were transformed into companies with equity capital in private ownership. Transitions economies are subgroup of emerging economies where different patterns of institutional

development, and infrastructure and factor market development can be observed. Hoskisson et al. (2013) explored different clusters of emerging economies using data of the Global Competitiveness Report.

Slovenia and Croatia were both in the cluster of mid-range emerging economies with low level of institutional development and high level of infrastructure and factor market development. Slovenia was classified among those countries where a substantial development of institutional, infrastructure and factor market dimension could be observed. For Croatia, the findings of Hoskisson et al. (2013) showed a lower level of institutional development in comparison to Slovenia. Regarding the level of infrastructure and factor market development Slovenia and Croatia were much closer, with Slovenia displaying a slightly higher score than Croatia.

Besides the national corporate governance legislation and regulations that were passed in the 1990s and early 2000s, the implementation of EU directives and regulations importantly influence the governance practice in Slovenia after joining the EU in 2004. The legal framework in Slovenia has improved significantly in the field of disclosure and transparency of public companies in the last ten years. Mandatory disclosure and transparency is based on the provisions of the relevant legislation for public (listed) stock companies. In Slovenia, this is primarily the Market of Financial Instruments Act (ZTFI 2007), that includes all relevant EU disclosure directives and the Companies Act (ZGD-1 2009). ZTFI regulate the disclosure of regulated and inside information. The companies have the obligation to disclose regulated information that must be published on a company's official website or in another manner that enables a quick access to this information on a non-discriminatory basis to the public across the entire EU territory. According to the ZTFI (2007, Article 106) and (LJSE Guidelines 2013) the regulated information is especially: the annual report and auditor's report, half-year report, interim management statements, any change in the share of voting rights, any change in a major holding, information on the amount of own shares, changes to the total number of shares with voting rights, changes in the content of rights from securities, information on new issues of debt securities and inside information.

Since it is not possible to give a unique definition of inside information and very difficult to estimate the potential influence of inside information on the price of security, it is primarily the company's responsibility to determine "which piece of information constitutes price sensitive information in a particular case" (LJSE Guidelines 2013, p. 27). It is management responsibility to draw and implement a corporate communication strategy and rules (i.e., a Corporate Communication Rulebook) in order to prevent the abuse of inside information (Slovenian CG Code 2009).

The voluntary disclosure and transparency is based on non-binding guidelines and recommendations. Ljubljana Stock Exchange has drawn Guidelines on Disclosure for Listed Companies of Ljubljana Stock Exchange considering "temporary legislation, Slovene and international business practices, and similar guidelines effective in other EU Member States" (LJSE Guidelines 2013, p. 4). The main purpose of these guidelines is to provide support to the listed companies to "increase the level of their business transparency, and underline their visibility and openness, thus preventing information asymmetry" (LJSE Guidelines 2013, p. 4). These guidelines are non-binding guidelines; however, some of them are binding for prime and standard market companies.

The companies listed on the Ljubljana Stock exchange (especially prime market and standard market companies) are expected to largely follow the Slovenian Corporate Governance Code that was jointly created and adopted by the Ljubljana Stock Exchange, the Slovenian Directors' Association and the Managers' Association of Slovenia. It was introduced for the first time in 2004 and changed three times (in 2005, 2007 and 2009). The CG Code present an important step towards improving corporate governance practice in Slovenia (Djokić and Duh 2017). On December 2009, the version of the CG Code was introduced (i.e., Slovenian CG Code 2009) that was in power until the beginning of 2017 and was the valid code when our research was conducted.

The recommendations of the CG Code (2009) are divided in several broad areas of corporate governance: corporate governance framework, relations with shareholders, supervisory board, management board, independence and loyalty of members of supervisory board and management

board, audit and system of internal controls and transparency of operation. For many reasons, the year 2009 was an important pillar in the development of corporate governance in Slovenia. The Slovenian CG Code (2009) introduced the Corporate Governance Policy (CG Policy) and its content for the first time. The CG Policy is the governance framework drawn by a supervisory board and a management board wherein they commit and publicly disclose how they are going to supervise and run the company.

The Slovenian Companies Act (ZGD-1 2009) enacted the Corporate Governance Statement (in continuation: CG Statement) in the same year as well. Both the CG Code and the Companies Act brought important positive changes in the field of corporate governance in Slovenia (Djokić and Duh 2017). All the provisions of the Slovenian CG Code (2009) have the nature of recommendations, which are not legally binding. However, a public company must disclose any deviations from this code (or any other corporate governance code) in its CG Statement on annual basis and the reasons for them (i.e., comply or explain approach). This statement can be either a separate document or a part of an annual report (Djokić and Duh 2017). A new version of the CG Code was published at the beginning of 2017. However, we do not discuss this version of the CG Code in this contribution since its implementation in the companies' practice cannot be analyzed yet—the companies' annual reports have not been published yet (See more about the newest version of the CG Code in Duh 2017).

8.3.3 Sample and Data Collection

All companies listed on the Ljubljana Stock Exchange's prime and standard market were included in the sample. Namely, the Ljubljana Stock Exchange's equity market is divided into three segments (LJSE Markets 2015): (1) prime market, (2) standard market, and (3) entry market. Standard market is intended "for larger companies with a dispersed ownership structure, characterized by higher levels of transparency of their operations"; these companies meet the following disclosure standards: publication of quarterly statements, publication of declaration

of compliance with the corporate governance code, and compliance with the Ljubljana Stock Exchange's Guidelines on Disclosure for Listed Companies. Prime market is "a prestigious market intended for larger established companies renowned for their liquidity and transparency of operations". Prime market companies meet additional disclosure standards: reporting under International Financial Reporting Standards (IFRS), publication of quarterly statements, publication of declaration of compliance with the corporate governance code, reporting in English, and compliance with the Ljubljana Stock Exchange's Guidelines on Disclosure for Listed Companies.

We included in the sample all companies of the prime (nine companies) and standard market (13 companies), i.e. total 22 companies that were listed in June 2014. We decided to select these companies to be able to investigate mandatory and voluntary transparency and disclosure practices. We expected a higher companies' interest for voluntary transparency and disclosure due to many benefits including a reduced information asymmetry and agency costs that can lead to a lower cost of capital and higher firm value (e.g., Nowland 2008). The underlying SEECGAN Index methodology enables us to explore the quality of the transparency and disclosure practice. However, it does not enable a forensic identification of any disclosure that may be incorrect or fraudulent (e.g., Patel and Dallas 2002).

One of the primary sources of data were the annual reports that were identified in several rankings and indices as "the principal communication device available to companies" (Patel and Dallas 2002, p. 6). Annual reports are recognized as a good proxy for the level of voluntary disclosure provided by a company and are generally considered one of the most important sources of companies' information (Patel and Dallas 2002). Additional data and information were gathered from the companies' websites and other types of report and documents available on companies' websites.

8.3.4 Demographic Data on Companies in the Sample

Companies in our sample differ in their size measured by the numbers of employees. The majority of them can be classified as large corporations according to the criteria of the Companies Act—as a large company is defined the one with more than 250 employees as well as banks and insurance companies that are classified as large companies regardless of their number of employees. Since the majority of them exceed this criteria considerably, we defined other criteria at 1.000 employees (similar was done by Tipurić et al. 2015). There were 13 companies (59%) with more than 1.000 employees in the sample. The ownership structure of companies in the sample confirms some other observations on ownership concentration in Slovenian companies (e.g., LJSE Analysis 2015) and in transition economies in general (Berglöf and Pajuste 2005; Tipurić et al. 2012, 2016). Half of the companies in the sample had major shareholder with 30% or more shares; in seven companies (32%) the major shareholder has 50% or more shares. The primary activities of companies in the sample are diverse. The sample includes banks, insurance companies, production companies (in automobile, pharmaceutical and home appliance industry), trade companies, and publishing and newspaper companies.

8.3.5 Results with Discussion

The average value of the SEECGAN Index of the listed companies in Slovenia is 5.49, indicating that the average public company can be classified as the company with good (but not first class) corporate governance in terms of the applied methodology. Half of the companies in the sample reached an average value of SEECGAN Index greater than 5.25. The transparency and disclosure of information of companies in the sample is evaluated as good with the average category index being 6.62. This category is ranked as the second best corporate governance component; the category of corporate risk management is the best-evaluated

governance component (the average index 7.61). Even though the transparency and disclosure category is the best evaluated category in Croatia (Tipurić et al. 2015), the average index (4.91) for this category is lower in comparison to Slovenia.

Research results (Fig. 8.1; Table 8.2) show that the surveyed companies can be classified as first class (36.4%) and good (45.4%) in terms of transparency and disclosure practice. In less than one fifth of the surveyed companies, the transparency and disclosure practice is unsatisfactory. Transparency and disclosure practice in the Slovenian companies is of better quality than in the Croatian companies. Only 56.3% of the surveyed Croatian companies are first class and good in terms of transparency and disclosure; transparency and disclosure practiced can be described as poor for 12.5% of companies. However, the comparison should be made with caution, since the sample of Croatian companies consists of joint stock companies listed at the Zagreb stock exchange and

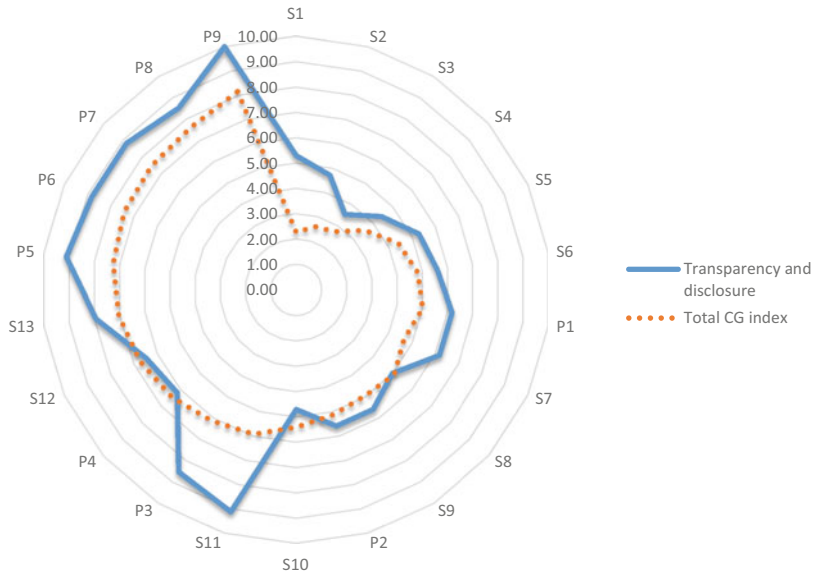


Fig. 8.1 Transparency and disclosure and the total index (Note P1–P_i—prime market companies [9 companies in total]; S1–S_j—standard market companies [13 companies in total]. Source Own)

Table 8.2 Transparency and disclosure SEEGAN Index for Slovenia and Croatia

SEEGAN index classification of companies	Slovenia—prime and standard market companies (in %)	Slovenia—only prime market companies (in %)	Slovenia—only standard market companies (in %)	Croatia ^a
First class	36.4	66.7	15.4	21.9
Good	45.4	33.3	53.8	34.4
Unsatisfactory	18.2	0.0	30.8	31.2
Poor	0.0	0.0	0.0	12.5
Total	100.0 (22 companies)	100.0 (9 companies)	100.0 (13 companies)	100.00 (32 companies)

Note ^aTipurić et al. (2015)

Source Own, supplemented with the findings of Tipurić et al. (2015)

does not include companies of the prime market (no company is listed). If we compare them with the Slovenian standard market companies, results for Slovenia are no more superior.

The research findings on the quality of transparency and disclosure measured by the SEECGAN Index methodology reveal the effects of both the mandatory regulations (e.g., legislation, stock exchange rules) and the voluntary recommendations (especially the code of good governance) on the governance practice in public joint stock companies. Especially in the case of the prime market companies (Fig. 8.1), we can observe the presence of high standards of transparency and disclosure introduced by various institutions supporting the relevance of the idea of “institutional complementarities” (Filatotchev et al. 2013; Waring and Edwards 2008). In continuation, we discuss the results for each surveyed attribute that are presented in Table 8.3.

According to the Slovenian CG Code’s (2009) recommendation on transparency a company should define the corporate communication strategy in its CG Policy dictating high quality standards with respect to the drawing up and preparation of accounting, financial and non-financial information. Research results show that only 59.1% of companies define Transparency and Information Disclosure Policy (Q5). This policy is defined in all prime market companies and only in 30.8% of the standard market companies. Even less companies disclose their policy (Q6)—only 36.4% of all companies in the sample; that is 61.5% of those, which defined such policy.

Similarly, the analysis of the Ljubljana Stock Exchange and the Slovenian Manager’s Association on the disclosure of the explanations of deviations from the Slovenian CG Code (2009) for the period 2011–2014 shows that among the most frequent deviations are deviations concerning the rules and communication strategy of a company (LJSE Analysis 2015). According to the ZTFI (2007, Article 106) and (LJSE Guidelines 2013) companies have the obligation to disclose the regulated information such as annual report and auditor’s report, half-year report, interim management statements. Research results show that all prime market companies and the majority of the standard market companies (84.6%) disclose annual, half-year and quarterly financial reports in the

Table 8.3 Results on transparency and disclosure for each surveyed attribute

Attribute/question	Share of companies displaying attribute (YES answer) in %			
	Slovenia			Croatia ^a
	Prime and standard market companies	Only prime market companies	Only standard market companies	
Q1	81.8	100.0	69.2	59.4
Q2	95.5	100.0	92.3	59.4
Q3	95.5	100.0	92.3	28.1
Q4	95.5	88.9	100.0	81.3
Q5	59.1	100.0	30.8	56.3
Q6	36.4	66.7	15.4	15.6
Q7	27.3	22.2	30.8	65.3
Q8	9.1	22.2	0.0	28.1
Q9	81.8	100.0	69.2	84.4
Q10	77.3	88.9	69.2	56.3
Q11	90.9	100.0	84.6	100.0
Q12	81.8	100.0	69.2	75.0
Q13	95.5	100.0	92.3	56.3
Q14	45.5	66.7	30.8	53.1
Q15	77.3	77.8	76.9	50.0
Q16	50.0	66.7	38.5	25.0
Q17	100.0	100.0	100.0	75.0
Total number of companies	22	9	13	32

Note ^aTipurić et al. (2015)

Source Own, supplemented with the findings of Tipurić et al. 2015

legally binding period (Q11). A special category of the regulated information are the inside information that has not yet been published. Only 27.3% of the surveyed companies (22.2% of prime and 30.8% of standard market companies) adopted procedures for disclosure of market sensitive information (Q7). Only some prime market companies disclose such procedures (Q8).

In comparison with the Slovenian companies, the Croatian companies are better regarding the analyzed attributes Q5, Q6 and Q11, when only Slovenian standard market companies are considered. Research findings indicate that in both countries a little more than half of the surveyed public joint stock companies and their key managerial and supervising

bodies are aware of the importance of defining and publishing transparency and disclosure policy. Regarding procedures for disclosure of market sensitive information and their disclosure (Q7 and Q8) the situation is much better in the Croatian companies than in the Slovenian ones. This situation implies that improvements are needed in this area, especially raising awareness of the importance of transparency and disclosure of information policy and its disclosure as well as educating managers and other key stakeholders on this topic (see also Tipurić et al. 2015, p. 175). Namely, the risk of the private internal information abuse can negatively influence the firm performance and value (Filatotchev et al. 2011).

Besides the mandatory regulations, the voluntary recommendations are of special importance for improving the quality of transparency and disclosure practice. Such recommendations are provided by the corporate governance codes. More than three quarters of the Slovenian companies in the sample disclose their corporate governance code (Q1). Most of them refer to one of the official codes (Q2). Almost all companies (88.9% of the prime and all standard market companies) disclose the compliance with the corporate governance code and/or explain the deviations from it (Q4). Even though disclosure of compliance with the chosen code is obligatory for the prime and standard market companies in Slovenia (ZGD-1 2009; LJSE Guidelines 2013), one of the surveyed prime market company does not disclose this compliance. Similarly, the research of the Ljubljana Stock Exchange and the Slovenian Manager's Association shows that the number of companies that use the Slovenian CG Code (2009) increased—from 63.8% in 2011 to 71.7% in 2014. The average compliance of a company (the average was calculated only for those companies that reported deviations) with the Slovenian CG Code (2009) was 89.8% in 2011, 90.6% in 2012, 89.9% in 2013 and 89.8% in 2014 (LJSE Analysis 2015). A smaller share of Croatian companies adopt and display the corporate governance code (59.4%) than the Slovenian companies (Q1 and Q2), even though more than 80% of these companies disclose compliance with the governance code (Q4).

The related-party transactions are recognized as one of the forms of expropriation of minority shareholders by the controlling shareholders in

contexts with concentrated ownership (Filatotchev et al. 2013). That is why the disclosures on transactions with associated persons are important components of companies' transparency in transition economies.

According to the ZTFI (2007, Article 10) and LJSE Guidelines (2013) a public company in Slovenia is obliged to disclose such transactions, even if this company is not a subject to prepare a consolidated annual report. Our research results show that more than three quarters of surveyed companies disclose information on related party transactions (Q10); that is the majority of prime market companies (88.9%) and more than half (69.2%) of standard market companies. The research results revealed better transparency practice in this area in the Slovenian than in the Croatian companies where only a little more than half of surveyed companies disclose such transactions. Improvements are needed in Croatia and Slovenia regarding transparency of third-party transactions in order to mitigate the primary agency problem between the minority and the controlling shareholders (e.g., related-party transactions) in the institutional context of the concentrated ownership (e.g., Filatotchev et al. 2013).

According to the Slovenian CG Code (2009), a public company should disclose in its annual report for "its members of the management board and the supervisory board their memberships on the managerial or supervisory bodies in non-related companies". The provisions of Companies Act (ZGD-1 2009) limit the number of memberships in boards—a person cannot become a member of a supervisory board if he/she has already been a member of a supervisory or a management board in three companies. Research results indicate that less than half of surveyed Slovenian companies disclose information on the board membership (66.7% of the prime and 30.8% of the standard market companies) (Q14). In Croatia, where the maximum number of memberships in supervisory boards is ten, more than half of public joint stock companies disclose membership in boards in other companies.

According to Tipurić et al. (2015) there are negative as well as positive aspects of membership in several boards. The negative aspect of several memberships is the potential lack of time for a high quality work on a board. The positive aspect can be in benefits that such memberships bring to relationships with companies' environment (e.g., in the case of

suppliers, better payment conditions) as well as new knowledge and skills that can be acquired by being a member of the other company's board.

An important channel of communication between a company and its stakeholders are company's official websites. According to the ZTFI (2007) companies must publish regulated information on their official websites or in another manner that enables a quick access to this information on a non-discriminatory basis. The CG Code (2009) recommends companies to use electronic media (e.g., a corporate website, the Ljubljana Stock Exchange Information dissemination system SEOnet) and to make their official websites as transparent as possible. Companies' websites should contain all the key information about the company and its activities. The research results show that with the exception of one standard market company all other surveyed companies disclose information regarding the company's ownership structure on their websites (i.e., top 10 shareholders, their names and percentage of shares as well as information on the number of other owners) (Q13). However, only half of them disclose information on special relationship between shareholders (e.g., family relationship, mutual ownership) (Q6). More than three quarters of surveyed companies (almost the same share of prime as well of standard market companies) disclose a calendar of important events (Q15).

Research results for Croatia show that public companies do not pay enough attention to disclosing information on their ownership structure (only 56.3% disclose such information) and on special relationship between shareholders (only 25% disclose such information). Half of Croatian public companies disclose a calendar of important events. Since the concentrated ownership structure is characteristic of the Slovenian and Croatian economy, transparency regarding the major block holders and special relationships between shareholders is an important input information in the decision making process of different groups of external stakeholders (e.g., capital providers), since it reveals major forces in companies functioning and development. Therefore, improvements are needed in this respect in public joint stock companies in Slovenia and Croatia.

According to the regulations and recommendations in Slovenia (i.e., ZTFI 2007; Slovenian CG Code 2009; LJSE Guidelines 2013) a

company's website should not be only a tool for distribution of information and for archiving data, but an interactive tool for communication with investors. For this reason, a company's website should include online presentations for investors. Research results show that all surveyed companies have a special section on their website dedicated to corporate governance and investor relationship; all interested groups of stakeholders can find financial data, ownership structure data, statute and articles of association, information on related party transactions, annual plans, corporate governance code and other useful information.

In Croatia three quarters of the surveyed public companies dispose with such section on their official website (Q17). Almost all Slovenian companies (all prime and 92.3% of standard market companies) disclose the statute and/or articles of association (incorporation) on their websites, whereas in Croatia only 28.1% of surveyed public companies (Q3).

In Slovenia public companies are recommended to clearly present their corporate strategies, as this will help to understand and evaluate correctly a company's activities such as investments, disinvestments, and capital increases (LJSE Guidelines 2013). According to Sheridan et al. (2006) the transparency of strategy and operations of a company importantly influence the accuracy of company's securities valuation. All prime market companies and 69.2% standard market companies in Slovenia disclose crucial strategy-related information relevant to its investors and stakeholders (Q12).

In Croatia three quarters of the public companies find it relevant to disclose such information. However, in the case of the Slovenian public companies an important question arises on whether formulated and disclosed strategies are in accordance with the basic purpose and goals, which should be defined in a company's statute. Such definition of goals and their disclosure in a statute is one of the Slovenian CG Code's recommendations. The results of the analyses (LJSE Analysis 2012, 2015) showed that non-compliance with this recommendation is one of the most frequent ones among companies listed on the Ljubljana Stock Exchange.

Capital markets are becoming increasingly global and institutional investors are looking to diversify by investing around the globe. Companies are seeking capital wherever the conditions are the most attractive.

LJSE Guidelines (2013) recommends the listed companies to inform the public in both Slovene and English languages and that this should be done simultaneously. Publications in the language of international finance ensure uniform informing of investors, widen the company's foreign investor base and increase transparency of operations. According to the LJSE Guidelines (2013), publishing in English (besides in Slovene language) is binding for prime market companies. Our research results show that all prime market companies and 69.2% of standard market companies have information on their websites translated in English (Q9). Similar results can be observed in the Croatian companies as well.

8.4 Conclusions

Research results show that the transparency and disclosure practice is of first-class and good quality in more than 80% of prime and standard market companies listed on the Ljubljana Stock Exchange. Especially the prime market companies in Slovenia put considerable efforts in fulfilling not only the mandatory but as well as the voluntary disclosure and transparency regulations and recommendations, thereby improving the overall quality of their governance practice. Our research results show that mandatory regulations are those that “force” companies to improve their transparency and disclosure practices, supporting the findings that “introducing (more strict) disclosure regulation is likely to affect the broader corporate governance systems because it reduces the private benefits of control of major block-holders and also helps investors to monitor the management better and at lower costs” (Martynova and Renneboog 2010, p. 20). Especially the regulation of stock exchanges are recognized in the literature as those that importantly influence the transparency and disclosure level. However, also voluntary recommendations play an important role in improving transparency and disclosure quality in Slovenian public companies. The findings of our research indicate that joint efforts and pressure in terms of legislation, regulations and recommendations of the government, the Stock Exchange, and directors' and managers' association affects governance practice in Slovenian

public joint stock companies thus supporting the concept of institutional complementarities (Filatotchev et al. 2013; Schiehl et al. 2014; Waring and Edwards 2008). This concept provides a useful framework for exploring the interactions among institutions that results in synergistic effects among their activities and influences the effectiveness of the firm-level governance practices.

At the same time, the forces from the companies' environment continuously and dynamically put considerable pressure on companies. Selected governance practices should enable an effective response to threats and opportunities within a particular organizational environment. Public joint stock companies that want to attract outside investors should disclose quality information on their governance system as well as on their strategies and operations. Companies should make sure that their transparency and disclosure practices go beyond mandatory requirements, and they should not depend on particular interest of the company's management, but should provide information to various groups of stakeholders in a way that enables equal informing. Complying with the mandatory requirements as well as with the voluntary recommendations that are based on the best transparency and disclosure practices help investors to make informed investment decisions, prevents information asymmetry and the possibility of insider dealing.

Our research revealed areas where improvements are needed, especially in companies with unsatisfactory transparency practice, and that are: the area of transparency policy and the information disclosure policy, the area of procedures for disclosing market sensitive information, the area of disclosing information on other board memberships, and the area of disclosing information on special relationship between shareholders (e.g., family relationship, mutual ownership).

However, that does not mean that there is no room for improving transparency and disclosure in companies that are classified as companies with first-class or good practice. Especially, the voluntary recommendation should be considered when taking measures for improving these practices in companies. An important measure that should be taken in this respect is raising awareness and educating the key stakeholders (especially top management) on the importance of enhancing transparency

and disclosure thus contributing to the overall quality of corporate governance. By increasing the level of companies' transparency and disclosure of information, the information asymmetry and agency costs can be reduced thereby leading to a lower cost of capital and higher company value. Making the company's governance system, goals, strategies, operations and managers' decisions (such as investments, disinvestments, acquisitions, capital increase) transparent improves company's credibility.

In this respect, we find important the monitoring of transparency and disclosure practices on a regular basis. Such monitoring can be done by the application of the governance index (e.g., the SEECGAN Index). It provides companies, stock exchange and policy makers with an important insight into the quality of particular corporate governance component and practices. On the level of the particular company, the results of an index indicate where the improvements are required. On the national level, such results can provide stock exchange and policy makers with the feedback information on how well the regulations work in practice. We find such monitoring to be of special importance in transition economies, where corporate governance as a professional and academic field is relatively young in comparison to Western European and the US.

The study has some limitations. One limitation refers to the sample: only prime and standard market companies were explored. In order to get broader insight into the transparency and disclosure practice in transition economies other categories of companies should be explored (e.g., entry market companies, non-listed companies). Another limitation is the problem of subjectivity in evaluating the attributes of companies in the sample that may not be completely eliminated. Although efforts were made for authors to be as objective as possible (also by additional comments to every attribute), it is possible that some errors occur (see also Mangena and Pike 2005).

Since detailed analyses of the surveyed companies show that differences in transparency and disclosure practices quality exist among companies, future research should address these differences, their causes and propose solutions for improving transparency and disclosure practices in the Slovenian public companies. In the future, one should compare the research results on transparency and disclosure among

South Eastern European countries that are involved in corporate governance research by applying the SEECGAN Index methodology. In our research we provide only preliminary comparison with transparency and disclosure index of the Croatian companies. Such comparative research would on one hand provide us with broader and deeper understanding of corporate governance practice in transition countries as well as provide us a basis for improving the transparency and disclosure practice, thereby also enhancing the overall corporate governance quality.

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