

**ETHICS, ACCOUNTABILITY AND GOOD GOVERNANCE**  
**”A Perspective from an Emerging Market Economy ”**

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The core of the transformation of totalitarian regimes and centrally planned economies into democracies and market economies is the transformation of power and the creation of new power relations. This requires fundamental changes in the existing institutional environment. However, the need for building and cultivating an appropriate legal framework as well as an informal (ethical) infrastructure of the market has been underestimated and in some respects even neglected. In the CR, the main reason may be attributed to a perceived need to proceed with marketisation of the economy as quickly as possible. Moreover, as a part of the dominant ideology, which has gained a strong public support, the general public has been continuously educated (misled) by the reformers that market forces shall resolve everything. To some extent, this approach may be considered justifiable at the early stages of political and economic transition when it was necessary to generate sufficient political support, to safeguard irreversibility of democratic changes, and to lay foundations to a market economy. However, insisting on unregulated market forces in general means misinterpreting liberal economic theory. There are severe practical consequences of such approach, which may be viewed as the main failure of reformers in the CR: lack of trust and, paradoxically, low respect for private ownership which in some groups of population may even lead to discreditation of private ownership as such.

*Transformation of power*

Power includes military power, political power, economic power, cultural power, the power of information, technological power, gender power, individual position in an organisation or in society or just the power to put a stamp on a document. Essential among these is public power. Public power is vested in or granted to individuals, groups and organisations. The ideal is that such power must be exercised in the best interest, the benefit or well-being of those affected by actions and decisions taken. Depending on the position of the individual or organisation, power is exercised over different publics and on different levels: e.g., employees, taxpayers, voters, customers, shareholders, members of families, communities, sections of populations, future generations, the environment, etc. Keeping power under control is a challenge for any free society.

In the CR, transformation of power has been accompanied by a shift in the understanding of power from a negative concept to a more positive one. While the negative concept is based on the image of one party treating the other unfairly, the positive one is associated with competence, strength, and authority. In this context augmented by high expectations related to democracy and a free market, the underestimation of necessary checks and balances should be understood. From this perspective, Czech reformers, supported by society at large, have overestimated the positive understanding of power, have left a large space to discretion, and have created only weak, if any, checks and

balances. A recognition that without these checks and balances society cannot function properly has become widely shared only recently. Consequences may be observed in the Czech business environment and society in general.

### *The new institutional framework*

The main institutional change is the change in the ownership rights. Since private ownership serving entrepreneurial purpose was almost liquidated in the previous system, privatisation of state owned enterprises is crucial. This change in ownership rights is accompanied by the emergence of complex contractual relationships. Freedom of choice of new economic actors to enter contractual relationships with other actors is replacing previous enforced hierarchical direction with no or very limited choice. Another unknown factor significantly co-forming the new institutional framework is information asymmetry. Instead of symmetry in a weak information access (except for the political and economic elite), information asymmetry has become widespread. Last but not least, unevenly distributed transaction costs should be stressed. While in the previous regime these costs were either unrecognised or evenly distributed among population, in the new environment they play an important role and significantly influence performance of individual economic actors and of the economy as a whole.

Further I shall briefly focus on corporate governance as a predominant way of exercising newly acquired ownership rights in the Czech business environment, and on some new institutions which emerged as a result of profound changes in ownership. The common feature of these institutions is agency relationship which did not exist in the previous system (It was unclear who were principals and who were agents). I shall take various perspectives, since the quality of these institutions depends on the legal system, enforcement of law and functioning of courts, as well as on unwritten standards and business culture.

### *Czech Model of Corporate Governance*

It stands to reason that at the early stages of transition, the aforementioned checks-and-balances-lacking national approach has caused serious shortcomings, such as very weak protection of small shareholders, insufficient disclosure, and concentration of ownership in the hands of irresponsible owners. This way power has become a tool for exploitation of companies (in the Czech environment this phenomenon is called tunnelling of organisations) rather than serving as a business tool, which is typical for Western cultures.

Using the paradigm of agency theory, we may state that at the early stages of privatisation the principal-agent relationship was clearly dominated by agents (executive managers were insiders with information and good business contacts). Further, conflicts among various groups of stakeholders have emerged. The most severe one between majority and minority shareholders, which resulted in marginalisation of small shareholders, may be attributed to the so-called „third wave of privatisation” (ownership concentration). The most typical conflict for the current stage of development is that between owners and creditors. The rights of creditors are not respected equally as those of

owners. Most recently, even employees of some badly performing/badly managed companies have become creditors with delayed /not paid wages.

Comparing current practice with the early stages of corporate governance structures' and models' development, we may state that internal mechanisms of governance have been considerably improved, notably since 1996. However, some important problems still remain: minority shareholder rights are still inadequate; responsibility and accountability of board members is still unclear; and financial (and other) disclosure is still insufficient. Moreover holding companies, which are closer in CR to collective investment vehicles than genuine commercial groupings, have escaped stringent regulation so far.

Good corporate governance rests, however, on more than just a sound legal framework and enforcement mechanism. Soft features, such as widespread acceptance of common standards of behaviour, codes of conduct, education and training for board members, are equally important. Improvements in this area are being pursued by the Securities Commission and the business sector itself (the Czech Institute of Directors).

### *Conclusions*

Privatisation of the formerly state-owned enterprises may be viewed as the crucial institutional change. Experience demonstrates, however, that privatisation cannot be perceived as an instant conversion from central planning to an idealistic model of a market economy. It is just the beginning of a long process of institution building. Transition to more effective systems of governance may be jeopardised if left to market forces alone. Instead, it must be accompanied by robust regulatory measures, such as strengthening of the legal framework and the regulation of the financial sector, especially of capital markets.

There seems to be a consensus that the first step in institution building should be a rigorous legal infrastructure. The challenge here is not only that the new laws be passed but also correctly interpreted and fully enforced. The crucial problem, however, is to better understand the nature of the market economy, its determinants and its limitations. Obviously, this is not only a question of theoretical arguments and principles but also, and more importantly, of results of the functioning of the market. Given the circumstances, the inevitable stage of „learning by doing” has to be followed by the next step „learning from mistakes” (whatever their reason).