

## PROTECTION OF MINORITY SHAREHOLDERS IN B&H, CROATIA, MACEDONIA, MONTENEGRO AND SERBIA

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### **Abstract**

*Earlier studies indicate that Bosnia and Herzegovina, Croatia, Macedonia, Montenegro and Serbia, as well as other countries in transition, are characterized by a relatively high ownership concentration, which points to the presence of conflict of interest between majority and minority shareholders and possibility of abuse of minorities' rights. Accordingly, the paper aims to analyze and compare the legal measures of protection of minority shareholders in these countries, which will allow making conclusions on the current level of legal protection of minority shareholders and determining the necessary courses of action for its improvement. It has been widely accepted that company law and regulation of capital markets play a significant role in the development of financial markets, corporate governance and corporate finance and that by means of improving the legal environment it is possible to restrict the possibilities for expropriation of minority shareholders. In the paper we analyze and compare the relevant provisions of company laws in the observed countries. Unlike previous research on the quality of corporate governance in these countries that focused mainly on implementation of the OECD Principles, we focus on the pre-defined key mechanisms to protect minority shareholders with no aspirations to cover all aspects of the protection and seek to identify weaknesses in legislation. The results point to a relatively high level of protection of minority shareholders "on paper" in the analysed countries, but also to some weaknesses which vary from country to country.*

**Keywords:** corporate governance, legal protection, minority shareholders, transition countries.

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### **1. INTRODUCTION**

Earlier studies indicate that Bosnia and Herzegovina, Croatia, Macedonia, Montenegro and Serbia, as well as other countries in transition, are characterized by a relatively high level of ownership concentration. Although there is no accurate data on the ownership structure of joint stock companies (JSC) in Bosnia and Herzegovina (hereinafter: B&H), it can be assumed that there is a majority shareholder in most of the companies (ROSC, 2006). According to the results of research conducted in the Federation of Bosnia and Herzegovina (hereinafter: FB&H) in 2009, 78% of joint stock companies are characterized by majority or dominant ownership (Karić, 2009). The results of a research conducted in the Republic of Srpska (hereinafter: RS) in 2008 also point to the concentrated ownership, and according to it there is a majority shareholder or shareholder who owns more than 50% of the shares in 54% of the companies (Jeftić, 2008).

Studies conducted in the Republic of Croatia for the years 2004 and 2006 on a sample of public joint stock companies and in 2010 on a sample of non-financial joint stock companies show a high concentration of ownership in Croatian companies and its gradual increase in the past decade. An increase in the share of companies with dominant shareholder that owns 70% or more in the ownership structure is particularly being emphasized. According to data for the year

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2006, share of the largest shareholder in company's equity is 51.52% in average, and of the second-largest shareholder 12.37%, which in total represents a share of 63.9% in the hands of the two largest shareholders. In a relatively small number of companies (17.3%), the largest shareholder has a share in the capital of less than 20%, while more than 20% of companies have a dominant shareholder with a share of over 80%, and 52.8% of companies have a shareholder with a share of over 50% of the capital (Tipurić et al., 2008; Tipurić et al., 2011).

Studies conducted in the Republic of Serbia in 2006 also point to a high concentration of ownership, according to which in approximately 50% of the surveyed joint stock companies in real sector over 2/3 of the shares are held by one shareholder (Đulić, 2008).

Ownership concentration is an important internal mechanism of corporate governance, thanks to the active participation of large shareholders in management (Tipurić et al., 2008). However, large shareholders often represent their own interests in companies at the minority's expense. Corporate law has a difficult task in this case, since it needs to protect minority shareholders, but also try to keep the benefits associated with the presence of a controlling shareholder (Dammann, 2008). Vutt (2009) considers the protection of minorities to be a central problem of company law, and it is particularly important in the context of transition economies (Avilov et al., 1999).

It has been widely accepted that company law and regulation of capital markets play a significant role in the development of financial markets, corporate governance and corporate finance (La Porta et al. 1997, 1998, 1999; Pagano and Volpin 2005). By means of improving the legal environment it is possible to restrict the possibilities for expropriation of minority shareholders and reduce the agency conflict between majority and minority shareholders. Accordingly, there is evidence of a growing similarity in the systems of corporate governance regarding the level of legal protection of ownership positions and interests of minority shareholders, the role of boards in overseeing management and transparency (Tipurić, 2011).

The analysis and comparison of legal measures to protect minority shareholders which follow include provisions of company laws in Bosnia and Herzegovina, i.e. its entities FB&H and RS, Croatia, Macedonia, Montenegro and Serbia concerning the open joint stock companies of general type that are listed on the stock exchanges. Financial institutions and joint stock companies in majority state ownership are exempt since they are generally subject to regulation by specific laws. The provisions relating to the open joint stock companies listed on a stock exchange will be discussed, as the corporate governance standards apply to them (IFC, 2009), and only such companies have an incentive to take actions to solve the problem of protection of minority shareholders (Loderer and Waelchli, 2010).

Unlike previous research on the quality of corporate governance in these countries that focused mainly on implementation of the OECD Principles, the analysis that follows focuses on the pre-defined key mechanisms to protect minority shareholders with no aspirations to cover all aspects of the protection of shareholders' rights and seeks to identify the weaknesses in the legislation. Based on the analysis, the conclusions about the current level of legal protection of minority shareholders that the laws in these countries provide "on paper" and the necessary courses of action to improve their legal protection are being derived in order to improve their legal protection. When it comes to B&H, the analysis is carried out on the entity level due to the significant differences between the entity company laws, which include different board structures and mechanisms of shareholder protection (Mrgud, 2011).

## 2. LEGAL FRAMEWORK AND METHODOLOGY

In the last few years there has been a series of changes i.e. introducing new regulations in the area of corporate governance and investor protection in all of the five countries. Similar to the other transition economies, some of the changes come too late and their expected efficiency is lower than in case they were adopted at the beginning of the reforms (Mrgud, 2011). All the observed countries are subject to harmonization with the EU law. However, the scope of the mandatory provisions of the EU company law that the future member states must adopt in order

to harmonize its legislation with the *acquis communautaire* is relatively narrow, and several important aspects of corporate governance, company and securities law remains intact with the harmonization requirements, which means that many important issues in this respect are left to the member states' discretion (Soltysinski, 2004).

National laws recognize a series of measures aimed to prevent abuse of the principle of majority and to protect the minority. The rules for the protection of minority are broadly defined in the legal literature and it is not easy to set aside rules that are considered as rules designed to protect the minority. According to the *Methodology for Assessing the Implementation of the OECD Principles on Corporate Governance*, the *ex ante* and *ex post* mechanisms to protect minority shareholders are being distinguished (OECD, 2006). Similarly, Vasiljević (2007) lists two groups of measures that derive from the literature as preventive (out of court) and the judicial and administrative measures to protect minority shareholders, while the preventive measures consist in using the powers of minority shareholders at the shareholders' meeting and powers with respect to various forms of internal and external institutional control.

*Ex ante* provisions designed to protect minority shareholders which are considered as important include preemptive right to buy shares of new issues and qualified majority required for making certain decisions, including the approval of the majority of minority for transactions with related parties. The right of minority shareholders to convene a shareholders' meeting, cumulative voting when electing board members and the possibility that minority shareholders elect a certain number of members of the supervisory / management board, audit committee or similar body are also considered as potentially important mechanisms. If controlling shareholders decide to remove the company from the stock exchange listing, provisions that require or allow them to pay out the remaining shareholders at a price of shares determined by an independent assessment may be of a particular importance. However, provisions on disclosure and clearly defined obligation of loyalty of board members to the company and all its shareholders are referred to as being crucial for minority shareholders protection (IOSCO, 2009). *Ex post* rights provide redress in case of violation of *ex ante* rights and include individual, derivative and class actions, and enforcement and investigation by the regulator.

In the past decade, more indices that seek to measure and compare the level of protection of minority shareholders in various countries and regions in the world have been constructed, and they can serve as a starting point in the analysis and comparison of company laws in observed countries. In the Doing Business reports values of four indices constructed according to Djankov et al. (2008), which measure the protection of minority shareholders against self-dealing in transactions with related parties i.e. misuse of corporate assets by directors for achieving personal gain, are being published. Although the reports take into account regulations relevant to the life cycle of small to medium-sized companies, and indices are constructed on the basis of standardized scenarios with specific assumptions and, accordingly, do not include all aspects of regulation in the area of interest (in this case, all aspects of the protection of minority shareholders), the values shown may be useful for the initial analysis and comparison as they are based on the laws and regulations.

Table 1 shows values of the indices of investor protection for all the observed countries, including regional and OECD high income countries averages. Strength of investor protection index is calculated as the average value of three indices: extent of disclosure index, extent of director liability index and ease of shareholder suits index which cover the approval and transparency of related party transactions, liability of board members for self-dealing and possibility of shareholders to obtain corporate documents before and during the trial, respectively (DB 2013). Higher values of the indices indicate that national regulations provide better protection of investors against self-dealing. According to the strength of investor protection index, Macedonia is ranked as 19<sup>th</sup>, Montenegro 32<sup>nd</sup>, Serbia 82<sup>nd</sup>, B&H 100<sup>th</sup> and Croatia 139<sup>th</sup> out of 185 countries covered by the report (DB ECA 2013). In comparison to 2005, region of Eastern Europe and Central Asia has progressed in this area the most, approaching the OECD high income countries, which is also evident from the values of indices in the last report (DB 2013).

Table 1: Investor Protection in B&amp;H, Croatia, Macedonia, Montenegro and Serbia

Country / Region	Extent of disclosure index (0-10)*	Extent of director liability index (0-10)*	Ease of shareholder suits index (0-10)*	Strenght of investor protection index (0-10)*	Rank DB/185* (GCR/144)**	Protection of minority shareholders interes**	Rank GCR/144* *
Bosnia and Herzegovina	3	6	6	5,0	100 (80)	3,1	138
Croatia	1	5	6	4,0	139 (110)	3,6	120
Macedonia; FYR	9	7	5	7,0	19 (17)	3,5	123
Montenegro	5	8	6	6,3	32 (29)	4,2	65
Serbia	7	6	3	5,3	82 (65)	2,6	143
Eastern Europe and Central Asia	7	5	6	5,9	62		
OECD high income	6	5	7	6,1	61		

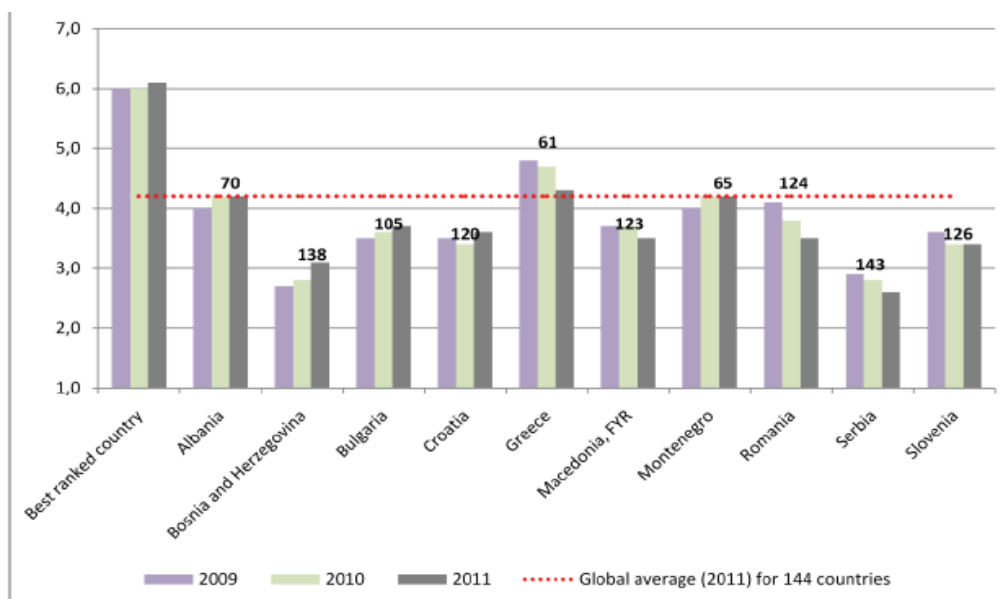
Sources: \*<http://www.doingbusiness.org/data/exploretopics/protecting-investors>;  
\*\**WEF (2012) Global Competitiveness Report 2012-2013*

According to Doing Business, with the reforms in 2009, Macedonia has increased investor protection by regulating the approval of transactions between related parties, increasing disclosure requirements in the annual report and making it easier to bring a lawsuit against directors in cases of harmful transactions between related parties (DB EECA 2013). On the other hand, there is no change in value of the strenght of investor protection index for Serbia after introduction of the new Law on Companies in 2012, and neither the last changes in Croatian Law on Companies did affect the value of this index for Croatia. The fact that no information is provided on the method of calculating index value for the B&H, which is characterized by different entity regulations, puts somewhat into question credibility of presented values.

Although competitiveness reports of the World Economic Forum publish data collected for the Doing Business reports in terms of the level of investor protection (DB 2013; GCR 2012-2013), they also publish values of their own indicator of protection of minority shareholders interests as well as ranking of countries in that respect (see Table 2.1. and Graph 2.1.). The indicator of protection of minority shareholders interests by WEF is based on responses to the question of the extent to which the interests of minority shareholders are protected by the legal system in certain country (1 = not at all protected, 7 = fully protected) which is a part of the annual survey of business leaders' opinions (Executive Opinion Survey) conducted by the WEF (GCR 2013).

What immediately becomes obvious is the extremely good ranking of Macedonia according to the DB 2013 and relatively poor ranking according to the GCR 2012-2013, while Montenegro is relatively well ranked in both cases. Unlike Macedonia and Montenegro which rank well above the regional average in the DB 2013, B&H, Croatia and Serbia rank significantly below based on the same report. Position of B&H can not be interpreted in terms of the DB with respect to a completely different entity regulations in this area and the lack of information on how this issue was resolved in calculation of the index, while 138<sup>th</sup> position out of 144 countries in the GCR indicates very little protection of the minority interest according to the opinion of business community. Croatia is unexpectedly low ranked according to both reports, and the DB clearly indicates a problem in the segment related to disclosure of related party transactions. Bearing in mind its modern legislation, Serbia is unexpectedly penultimate ranked by the GCR and has relatively poor ranking according to the DB report which points to problems in terms of the types of evidence that can be collected before and during the trial.

Graf 1: Protection of minority shareholders' interests



Source: Tipurić, D. (2012): Corporate Governance in South East Europe: towards good practice, key note speech, 2<sup>nd</sup> International Conference ECONOMIC SYSTEM OF THE EUROPEAN UNION AND ACCESSION OF BOSNIA & HERZEGOVINA, Vitez; Source of data: The Global Competitiveness Report World Economic Forum

Since the issues of regulating disclosure of related party transactions and ease of shareholder suits, are, in addition to corporate law, subject to other regulations, the analysis and comparison that follows will not allow a full insight into the reasons for this ranking. The analysis and comparison will include the provisions of company laws in five countries concerning the mechanisms of protection of minority shareholders identified as significant by the OECD and in the legal literature.

### 3. MEASURES OF MINORITY SHAREHOLDERS PROTECTION

#### 3.1 The pre-emption right

In all the observed countries, the existing shareholders' pre-emption right, i.e. the right to acquire new shares in order to maintain their share in equity is defined by the law and can be excluded or limited by a general meeting decision (in Serbia only in a case of the offer that does not require publishing prospectus). In Croatia and Serbia, making such a decision requires at least  $\frac{3}{4}$  of the votes of represented equity with special conditions for its validity (disclosure and a report on the reason in Croatia, reasons and justification of price in Macedonia and Serbia), in Macedonia and Montenegro  $\frac{2}{3}$  of the votes, and in FB&H – majority vote of the total number of voting shares. The law in RS does not provide for a special majority, but (along with the LoC in Montenegro) requires a statement of reasons and a rationale for the proposed issue price. In Croatia and the RS there is a possibility that the management (board) decides on the limitation or exclusion of pre-emptive rights pursuant to the law, which in Croatia requires the approval of the supervisory board (Art. 233, 308, 324-325, 341 LoC C; Art. 251, 253, 262, 278, 288 LoC S; Art. 213-215, 223 LoC FB&H; Art. 203, 208 LoC RS; Art. 31, 35, 53, 56 LoC MN; Art. 422, 425 CL M).

Legal provisions on pre-emption rights in Croatia and Serbia are in an appropriate way also applied when acquiring and disposing with the own shares, which is a recommendation of the General principles (1999). In B&H, Croatia, Montenegro and Serbia, these provisions are also applied to convertible bonds.

In FB&H, the decision by general meeting on the limitation or exclusion of pre-emption right will be considered a significant change in the company or shareholders' rights, which activates

provisions of the LoC on minority protection in decision-taking. Interestingly, in Croatia there is a possibility to determine that exercising a share-based right depends on whether the shareholder has held the share for a given time period (Art. 229 LoC C) and, as an example Gorenc (2004) describes a possibility for the statute to determine that the “pre-emption right is granted to shareholders who held shares over no less than two years”. There are no data on using this possibility in practice.

It is important to ensure a simple procedure for exercising the pre-emption rights, with that the ultimate efficiency of this mechanism depends on the financial possibilities of the right holder. Rules pertaining to the way and timeframe of exercising the pre-emption rights differ greatly between the countries. Only the LoC FB&H explicitly prohibits the transfer of pre-emption right to a third party, while the LoC MN is not explicit but forbids its transfer to the buyer in the event of a sale of shares. In Serbia and RS the laws set conditions with respect to the selling price at issuance with a view to exercising the pre-emption right. In Serbia and RS shares of a new issue are sold at market value (at least) as determined by the law i.e. relevant regulations (Art. 53 LOC MN; Art. 259-260 LoC S; Art. 207, 235 LoC RS). A significant means for shareholder protection in new issues includes the request for issuing shares at a price that is not lower than their market value with the precise definition of the concept.

### **3.2 The rights of minority shareholders in respect of convening and holding of the general meeting and cumulative voting**

Unlike the LoC FB&H which contains far fewer provisions in this regard, Croatian LoC contains detailed provisions on convening and holding of the annual general meeting and exercising shareholders' rights, which Gorenc (2004) interprets as the legislator's intention to protect the justified minority's interests by making it impossible for the majority to prevent attendance and decision-making at the meetings, as well as by preventing the obstruction of general meetings by minority. The time-limit for delivering i.e. publishing notification on convening the general meeting in Croatia, Montenegro and Serbia is at least 30 days and in FB&H only 20 days before the meeting, which is below the minimal requirement set forth by the Shareholders' Rights Directive (Art. 279 LoC C; Art. 36 LOC MN; Art. 365 LoC S; Art. 242 LoC FB&H). In none of the observed countries are shares blocked prior to the shareholders' general meeting.

Convening of the general meeting in FB&H may be requested by shareholder(s) with more than 10% of the total number of voting shares, in Macedonia and RS by shareholders with no less than 10% of voting shares (in RS on an issue proposed for the extraordinary meeting), and in Croatia, Montenegro and Serbia by shareholders who together have no less than 5% of the equity (a smaller share can be determined by the company statute). In practice, the 10% minimum may be too high a threshold, which will depend on the ownership structure of an actual company. In the event that the general meeting is not convened by the authorized convener upon request, in FB&H the one who submits the request is authorized to convene it directly. In Serbia and RS, the board is entitled to reject the request for convening an extraordinary general meeting, though only in cases provided for by the law. In Croatia, Montenegro, Serbia and RS shareholders who are authorized to request the convocation of general meeting are also entitled to request the inclusion of a new item to the agenda, while in FB&H, the right to change and amend the agenda is granted to shareholders with at least 5% of voting shares. In Macedonia every shareholder has that right before convening of the meeting, but when the assembly has already been convoked the right belongs only to shareholders who jointly possess one fifth of the total number of shares with a right to vote (Art. 278 LoC C; Art. 337, 372 LoC S; Art. 243-244 LoC FB&H; Art. 36-37, 40 LoC MN; Art. 385 CL M; Art. 268, 275 LoC RS).

The laws in all the observed countries require a qualified majority for making certain crucial decisions at the general meeting. In Croatia and Serbia and in one case Montenegro (Art. 24 LOC MN), the law requires a majority of at least  $\frac{3}{4}$  of the represented equity, wherein in cases provided for by the law, the statute may require even higher majority and/or fulfilling additional requirements, while in B&H, Macedonia and Montenegro it is necessary to have a  $\frac{2}{3}$  majority of the represented voting shares. Legal solutions in FB&H require a qualified majority for a

considerably smaller number of crucial decisions. Interestingly, according to the Law in Macedonia changes in the statute are adopted unanimously. The unanimous consent protects minority shareholders, i.e. it gives them a right to veto, but in practice may cause other kind of problems. With respect to Croatia, provisions on the necessary qualified majority for decision-making should be viewed in context of the fact of leaving the determination of quorum to the statute, which in practice can be relatively small (Mrgud, 2011).

Joint-stock companies in B&H, Macedonia and Serbia are subject to the mandatory rule “one common share, one vote”. In Croatia, it is prohibited to issue shares which, for the same amount of equity pertaining to them, grant different voting right at the general meeting i.e. plural voting is prohibited. In Montenegro the company’s statute may provide that certain classes of shares do not provide voting rights, while in Macedonia that is allowed only for preferred shares (Art. 169, 208, 477 i 511 ZTD; Art. 251 LOC S; Art. 199 ZPD FBiH; Art. 198, 203 i 285 LOC RS; Art. 32, 54 LOC MN; Art. 280 CL M).

With respect to companies whose shares are traded in an organized securities market, there is no possibility for limiting the number i.e. the percentage of individual shareholder’s vote in any of the countries. In Croatia, however, special limitations of exercising the right to vote apply to companies with mutual shares of 25% to 50% of the equity, which cannot make use of rights from the part of the share that exceeds 25%.

In Macedonia, Montenegro and Serbia shareholders are entitled to vote in writing without attending the meeting, and in Croatia if contemplated by the statute. With the exception of FB&H, it is possible to give power of attorney to vote by electronic communication, and there is a possibility (obligation in Montenegro) that the statute provides for voting by electronic communication without attending the meeting. The legislator in Montenegro goes a step further, and in case of interferences in electronic communication it requires the session to be interrupted by the chairman and continued after eliminating the interferences. It should also be noted that LoC C includes detailed provisions on exercising voting rights through financial institutions and shareholders’ associations, and in Serbia on voting through proxy including banks, with a view of preventing possible abuses (Art. 274, 277, 291-292 LoC C; Art. 36, 39, 39b LOC MN; Art. 400, 400a LC M; Art. 335, 340-341, 344 LoC S).

In FB&H, voting in absence is allowed only for the open JSCs, under the conditions and in the manner provided for by the company statute in accordance with Securities Commission’s regulations. Since there are still no Securities Commission’s regulations on this issue, it should be considered that such a way of voting is not possible. Voting could only be achieved by means of filled-in and signed voting ballots submitted to the company by mail, fax or e-mail prior to the date of general meeting (Art. 249-252 LoC FB&H). In RS it is not allowed to vote by mail. Giving proxy electronically under the condition of ensuring the statement authenticity could only be allowed by the memorandum of association or company statute (Art. 278 LoC RS).

In Croatia, RS and Serbia it is allowed to grant special rights and benefits to founders (in Croatia to individual shareholders) or to third persons, which has to be indicated in the memorandum of association or in the company statute (Art. 175, 256 LoC C; Art. 267 LoC S; Art. 183 LoC RS). Pursuant to the LoC C, the benefits may also include special rights in the company control, such as the right of delegating supervisory board members (Gorenc et al., 2004). In Montenegro the Law allows and regulates shareholders agreements on voting (Art. 39a LOC MN).

In B&H and Montenegro members of open JSCs’ boards are appointed at the general meeting by means of cumulative voting. Cumulative voting will be used in Macedonia and Serbia if provided by the statute. In Croatia general meeting decides upon the appointment of supervisory/management board members by the majority of votes, and there is no institutionalized protection of minority with respect to the appointment of supervisory board members (Barbić, 2006). The legal solution can be changed by the statute. However, in Serbia and RS a vacant position in the board is filled in by co-opting. On the contrary, in Montenegro the Law explicitly requires election of a new board of directors in the event of a resignation or termination of performing the functions of a member. The Croatian law provides for the possibility of appointing

supervisory board members by the court (Art. 256-257, 272.c-272.d, 275 LoC C; Art. 344 CL M; Art. 42 LOC MN; Art. 384, 386, 436 LOC S; Art. 262 LoC FB&H; Art. 300-302 LOC RS).

The effectiveness of cumulative voting as a mechanism that allows minority shareholders to elect their “representative” into the board will depend on the board size i.e. on the number of members being elected and the number of voting shares that the minority holds (IFC, 2009, p 96). According to the data from 2006, the average number of supervisory board members in Croatian JSCs is 5 (Tipurić et al., 2008). In more than a half of JSCs covered by the research in FB&H from 2008, the number of supervisory board members is 3, and only in 3 companies it is 7 or more (Karić, 2008). When the above-described is viewed in the context of the fact of high ownership concentration, the conclusion of small practical significance of this mechanism is inevitable.

The solutions present in some jurisdictions under which minority shareholders with a given percentage of share in equity have the right to directly elect their representative in the board, or which limit representation of the controlling or significant shareholder in the board (e.g. majority of independent board members requirements) seem more acceptable in the given circumstances, particularly in the context of conclusions on the need to strengthen the role of board by increasing the number of independent members (Tipurić et al., 2011).

As a rule, minority shareholders have the right to propose candidates for election to the board. In FB&H and Montenegro, the right to propose candidates for membership in the supervisory board is granted to shareholder(s) with no less than 5% of voting shares. In Serbia and RS, candidates for the election of board members are proposed by the existing board, shareholders (with 5% share in Serbia) or the appointment committee. In Croatia, supervisory/management board members the election of whom is decided upon by the general meeting are proposed by the existing supervisory/management board, which was criticized in literature, since it leads to a closed system where majority shareholders elect majority of board members, who will subsequently propose new board members, etc. (Gorenc et al., 2004). In order to protect minority, all shareholders in Croatia are entitled to submit their proposals on the election of supervisory/management board members, which have to be decided upon prior to taking the decision on the supervisory/management board’s proposal, if they are supported by shareholders with no less than 10% equity represented on the general meeting (Art. 280 LoC C; Art. 261 LoC FB&H; Art. 42 LOC MN; Art. 384, 434 LoC S; Art. 300-301, 308 LoC RS).

In B&H, for the possibility to submit a request for the appointment of a special committee i.e. an audit commissioner a share of no less i.e. over 20% in the equity is required, in Serbia 10% for the special or extraordinary audit, and in Montenegro only 5% share in equity for the appointment of representatives which will examine company’s operations and accounting. The costs of such examination in Montenegro go to shareholders who demanded it, except when the results indicate that there is a good reason for the costs to be borne by the company. Additionally, a shareholder in FB&H with at least 10% of voting shares can request an audit of the semi-annual and annual statement and of the JSC’s financial operations. The FB&H solution differs greatly in that in the event that the general meeting rejects the proposal for appointing an external auditor for this purpose, the auditor will be appointed by the SC (Art. 32 LOC MN; Art. 455-456 LOC S).

### **3.3 Other rights intended for *ex ante* minority protection**

Company laws in all the observed countries include provisions on the sequence of distribution of profit, way and limitations in paying dividends, whereby there is no obligation to pay minimum dividend. Decisions on paying dividends are typically taken by the general meeting. In Serbia and RS, management board can be authorized to do so. The decision on using the profit in Croatia is taken by the management and supervisory board (executive directors and management board), and the Law strives to protect minority shareholders’ right to dividend in potential attempts by majority to overfill the company’s reserves (Barbić et al., 2006). In FB&H, as a prerequisite for making a decision on payment, conditions in terms of the ability of fulfilling obligations from operations and minimum market value of assets are set, which raise a number of questions regarding the value determination and interpretation of certain terms (Vilgorac and



Dizdar, 2000). Less than 10% of companies covered by a recent research in FB&H paid dividends over the past 3 years (Karić, 2009).

In B&H, Croatia, Montenegro and Serbia there are cases provided for by the law when minority shareholders can request the buyout of shares from the company. In FB&H the shareholders' right exists for general meeting decisions that result in significant changes in the company or shareholders' rights, and which encompass new issues of shares, bonds convertible to company shares or with pre-emption right to company shares, limitations or exclusions of pre-emption rights and changes in form, company split, merger with or acquisition of another company or vice versa. However, cases of restructuring or reorganization of companies with majority state capital are excluded (Art. 255 LoC FB&H).

In Montenegro, RS and Serbia, a shareholder has this right in cases of changes in the statute i.e. memorandum of association (and potentially other decisions in RS and Serbia) that affect his rights, company reorganization (in Montenegro limited to cases of disproportionate allocation of shares with regard to the ownership structure and dissatisfaction with the exchange ratio of shares and compensation in cash) and disposal with high-value assets. Similar to the FB&H, shareholder in Montenegro also has this right in case the general meeting limited or excluded pre-emptive right to shares or convertible bonds by its decision. In Croatia, this right is limited only to some cases of splitting and re-shaping the company into a limited liability company or public company, and signing a contract on running the company business or transfer of profit with affiliated companies. (Art. 492, 550.j-k, 562, 575 LoC C; Art. 22v, 22g, 32a LOC MN; Art. 474-475 LoC S; Art. 330, 435-436 LoC RS).

There are certain conditions for exercising buyout rights. In Montenegro voting against the decision is required, in the RS and Serbia voting against the decision or refraining from voting and a shareholder who has this right cannot challenge the company decision on which he bases it. However, in Serbia the right belongs to a shareholder who did not attend the meeting as well. In Montenegro and RS prior notification of the company on the intention to exercise the right is required, in FB&H a statement on the opposition entered into minutes before the voting starts, while in Serbia the request may also be submitted after the meeting. Similarly, in Croatia the right to severance pay in case of split is conditioned by a statement of opposition to the decision entered into minutes, and the right is also granted to a shareholder who did not attend the general meeting if he was prevented unlawfully, if the general meeting has not been convened properly or if the subject of decision-taking was not properly disclosed (Art. 32a LOC MN).

In FB&H, buyout of shares is performed at the fair market value for the period starting from the day of announcement to the day of general meeting, whereby the important issue of the way of determining the fair market value of shares in this relatively short period of time has not been regulated. In Montenegro and RS, companies are required to buy out shares at the market value, which is calculated on the day of passing the decision, ignoring any expected increase or decrease in value as its consequence. However, unlike the Montenegrin Law that insists on the average market value at that specific date, the Law in RS determines the market value as an average price regularly published on the stock exchange or another regulated market in the period immediately preceding the day for which it is determined, and which is not shorter than 3 nor longer than 6 months. In the event that shares are not traded regularly, or that there is no regulated market, the market value in RS is determined based on the estimated value of company assets using appropriate methods. In Serbia, the buyout is made by the highest of the precisely defined values: accounting, market or estimated (Art. 255 LoC FB&H; Art. 32a LOC MN; Art. 51, 259, 475 LoC S).

Deadlines for making the payment vary, and the longest is the one in FB&H (3 months). Besides, a company in FB&H may be allowed to fulfill the obligation from the request only partly within the described timeframe, with a further period of 6 months to pay the rest in case determined by the law (Art. 255 LoC FB&H; Art. 32a LOC MN; Art. 51, 259, 475 LoC S).

Generally, in all the observed countries requirements regarding disclosure and transparency are considered as relatively high. However, it seems that there is a need for "deep transformation in the attitude of all participants to the very idea of transparency" (Đulić, 2008) i.e. companies

need to recognize their own interests in it, but there also must be a greater demand for information by investors.

As for the conflict of interest rules, in FB&H the obligation of reporting a conflict of interest to the supervisory board exists for its members and members of the management with the exclusion from the decision making in the first case and the written consent of the supervisory board as a condition for participation in such a business relationship in the second (Art. 270, 279 LoC FB&H). The LoC in Montenegro requires from the board members to adhere to the principles of good faith and to act with the due diligence applying the rules of profession, and also to use their powers only for the benefit of the company which includes avoiding conflicts of interest between them and the company. Board members in Montenegro are obliged to report to the shareholders' meeting any benefit or privilege that they have in the company, besides the compensation for their work (Art. 44 LOC MN).

In Serbia and RS it is precisely determined what will be considered a personal interest. Conclusion of the legal transactions in cases of conflicting interests is allowed if they are approved, in good faith and with the knowledge of all the material facts related, by a majority vote of board members who have no interest in that business, and in case there is no such majority, by a majority vote of shareholders who do not have personal interest in it. The general meeting is informed on the approval of the board and the legal transaction. It is important to mention that in RS a shareholder, among other things, cannot vote at the shareholders' meeting when deciding on the approval of transactions which involve conflict of interest between him and/or related parties and the company, and on the exclusion of the pre-emption right for the shares being issued in a private offering in which he and/or a related party is a pre-known buyer (Art. 61-71, 362 LOC S; Art. 33-39 LOC RS).

Unlike the others, Croatia is one of the few countries in the Eastern Europe and Central Asia region which still allows voting of the board members who are in a conflict of interest, and one of the few countries in the world that does not require any disclosure of transactions with related parties (DB, 2011).

### **3.4 Ex post mechanisms of minority protection**

The LoC FB&H does not recognize the possibility of a direct and/or derivative lawsuit by an individual shareholder or a minority group in case of opposing the decisions of the management and supervisory board. Notwithstanding, there is a possibility of applying for a compensation on behalf of the subsidiary by a shareholder representing at least 10% of the equity or less if provided by the statute (Art. 50.a LoC FB&H).

Croatian LoC provides a possibility for the shareholders holding at least 10% of the equity to require from the company to submit a request for compensation against its founders, members of the organs and individuals who have used their influence in the company i.e. benefited from the harmful acts. At the suggestion of the same qualified minority i.e. a shareholder with a share of at least HRK 8,000,000.00 there is a possibility of appointing special company representatives by the court, whereby the costs are covered by the company. In order to protect the minority, the company has no right to waive claims for damages or to settle for a period of 3 years. Additionally, in the case of company not submitting the request, while the facts determined by the law being present, the court on the qualified minority (at least 5% of the equity or HRK 4,000,000.00) proposal appoints special representatives who are required to submit a request on behalf of the company if they consider that there are chances for success in the dispute (Art. 252, 272, 272.k-l, 273, 273.a, 494, 501-502 LOC C).

In addition, shareholders in Croatia are "authorized to submit a claim for the damages they suffered if different from the damages caused to the company", whereby "damage caused to the company due to the reduction in share value, which also harms a shareholder, does not entitle the shareholder to demand a compensation" (Gorenc et al., 2004).

However, the significance of the solutions described is greatly reduced by the provisions that set the obligation for shareholders that requested submitting the claim from the company to solidary compensate the company for the costs in excess of what is obtained in the dispute, i.e. to

compensate the company for all of the costs arising from the dispute in case of the rejection of claim, if the company fails in its claim for damages or succeeds only partially. This generally has a discouraging effect on the minority shareholders posing such a request. Special protection is provided to shareholders in case of a group of companies (Art. 252, 272, 272.k-l, 273, 273.a, 494, 501-502 LOC C).

Company laws of RS and Serbia recognize individual and derivative shareholder suits, and specify persons who have duties to a JSC: controlling shareholders, company representatives, directors and board members, internal auditors, and persons with a contracted authority to manage the company affairs. In Serbia and RS each shareholder has the right to bring an individual suit on their own or on behalf of more persons acting together, while shareholders who hold shares representing at least 5% of the equity have the right to file a derivative lawsuit on behalf of the company against any person with duties to the company for damages caused by their violation (Art. 61-71, 77-80 LoC S; Art. 31-42 LoC RS).

The LoC MN also recognizes both individual and derivative shareholder lawsuit. Each shareholder in Montenegro, regardless of their share in equity, has a right to sue in his name and on behalf of the company the responsible person in the company that is liable for irregularities in management or company operations. Understandably, if obtained the compensation in this case belongs to the company, and the shareholder is entitled to reimbursement of costs (Art. 30 LOC MN). The preconditions for filing a derivative lawsuit in Montenegro, RS and Serbia are capacity of a shareholder and company's refusal of the request for filing a lawsuit or failure to comply with the request within 30 days (Art. 30 LOC MN; Art. 61-71, 77-80 LOC S; Art. 31-42 LOC RS).

Also, each shareholder (or its successor) in Montenegro has a right to file a lawsuit at the Commercial Court in cases determined by the Law: unlawful act of the company or act outside its authority; majority shareholders discriminate against minorities; violated shareholders' rights; minority shareholders deceived by persons who control the company (board of directors or controlling shareholders). Also, the right to initiate proceedings exists if there is evidence that the company's operations are run or the board of directors uses its authorities in a way that threatens the rights of that or the other shareholders, not respecting his or their interests as shareholders, although such operations are done in good faith. In that case, a shareholder represents the interests of all the similarly threatened shareholders. The court in case of a founded complaint can remove imperfections, make a decision on compensation to shareholders, and in the enumerated cases may order the purchase of shares by other shareholders or the company itself, at a price which shares would have if there had not been irregular operations (Art. 30 LOC MN).

In the event that members of the management body fail to remedy the irregularities in cases determined by the Law, shareholders in Macedonia are entitled to request compensation for damages from the members of the management body (Art. 362, 408-414 LC M).

Shareholders in B&H, Montenegro and Serbia have a right of submitting a claim in the court in case of company not fulfilling the obligation of share buyout, and in Montenegro, RS and Serbia a right to lodge a request for an assessment of share value by the court. When it comes to the LoC MN, it should not be forgotten that the purchase price is determined as the average market value of shares on the day of making decision, and in case of inability for that price to be established due to the absence of trade, the Law leaves the possibility of starting a dispute. In Croatia, there is a possibility of court determining the severance in a squeezeout at the request of minority shareholder. In the case of the value/severance being determined by the court, the decision applies to all the disagreeing or minority shareholders (in Montenegro is only if that value is greater). Additionally, company laws of Serbia and RS include provisions on the company termination and other court measures at the request of minority shareholders who own at least 20% of the company equity (Art. 32a LOC MN; Art. 469, 476 LoC S; Art. 31-33, 39-42, 319, 337 LoC RS).

Croatian LoC contains detailed provisions on the reasons, authorizations, claims and effects of challenging and voiding of the general meeting decisions. A general meeting decision may be challenged by filing a suit against the company in cases specified by the Law, among other things, in case a shareholder tried to provide for himself or someone else benefits at the expense of the company or other shareholders by means of voting at the meeting. The authorization for

bringing a lawsuit in that case has every shareholder. Otherwise, it belongs to a shareholder who participated at the general meeting and declared their opposition in the minutes, and to the other shareholders only in cases prescribed by the Law (Art. 280, 308, 355-366.a, 532, 550.k, 562 LoC C).

Gorenc (2004) considers this option as insignificant due to the multiple conditionalities, narrow scope of application and difficulties in interpretation of terms. Conditions being set here are usually not met in practice because the shareholders, especially minority, do not participate in the general meeting or are represented by financial institutions that do not have a practice of stating the opposition to the minutes. The law determines the cases when the decision of the general meeting can not be disputed, and among them is a violation of the right to use electronic communications in voting due to a technical fault with the exception of cases of gross negligence or intent, and violations of certain provisions related to disclosure and providing statements. In the context of good reasons, Gorenc (2004) points out that violations of procedures designed to protect minority shareholders are the absolute reason for contesting the general meeting decision. The right to file a lawsuit against the company in order to nullify the general meeting decision belongs to every shareholder.

Additionally, shareholders in Croatia holding at least 5% of the equity (or HRK 4,000,000.00) can file a suit to challenge a decision on profit distribution if it decides not to distribute profit to shareholders although reasonable business judgment with respect to the circumstances tells otherwise. The decision to increase the equity may be challenged by the each shareholder if pre-emption rights are excluded in whole or partly, and the (minimum) price determined is inappropriately low.

Similarly, in B&H and Serbia, the right to challenge and annul the general meeting decisions with the court is regulated by the laws, including conditions which are mainly voting against the decision or lack of presence due to irregularities in convocation. The laws of Serbia and RS also contain special provisions for contesting and voiding of the decisions in certain cases (Art. 256, 285 LoC FB&H; Art. 376-381 LoC S; Art. 293-297 LoC RS).

In Montenegro a shareholder who voted against or did not attend the shareholders' meeting which adopted a merger agreement, a decision on division or on separation with the establishment of one or more new companies has a right to demand from the court to cancel the contract or decision if the essential provisions of the restructuring procedure were not followed (Art. 22a, 22v, 22g LoC MN). Shareholders in Montenegro are entitled to file a suit for annulment of decisions of the meeting of shareholders in the following cases: non inclusion of the issue on which the decision was taken in the agenda in accordance with the Law; non registering acts or decisions for which there is such obligation; non respecting the legal provisions on convening and holding of the shareholders' meeting; decision non compliance with the LoC, statute and other regulations. Shareholders in Montenegro have a right to initiate proceedings for the annulment of a decision on voluntary liquidation in short proceedings before the court (Art. 24a, 41 LOC MN).

Shareholders in Macedonia also have the right to contest decision of the general meeting before the court. According to the Law, the decision may be contested by a shareholder who attended the meeting and declared his objection in the minutes; a shareholder who did not participate at the meeting because he was not allowed contrary to the law and/or the statute (meeting not properly called, issue not properly announced); and any shareholder, if the resolution was adopted with the intention for shareholders who voted for to gain benefit for themselves and/or for a third party, at the expense of the company and/or other shareholders (Art. 362, 413 CL M).

When it comes to judicial protection in non-contentious proceedings, in Croatia, Montenegro, RS and Serbia there is a possibility of making recourse to the court in case requests of minority for convening the general meeting are not met, and, with the exception of Montenegro, when requests for including of new issues in the agenda are not met and for the appointment of special auditors. In addition, in Montenegro, RS and Serbia one can go to court if the general meeting is not held within the prescribed period, in Croatia one can require the recall of members of supervisory board if an important reason exists, and in Serbia the court may order the company delivering answers to questions posed in the assembly and appointing of a temporary company representative.

For the appointment of auditors by the court in Serbia and RS it is enough to make it likely a violation of the law or the memorandum in contrast to the conditions set by the Croatian legislator concerning the existence of a reasonable suspicion of irregularities or gross violation of the law or statute. Given the simultaneous existence of provisions designed to protect the interests of the company, it seems that there is no need to set the last condition (Art. 278, 298, 300, 305.a, 500 LoC C; (Art. 40 LOC MN; Art. 338-339, 343, 397, 456-457 LoC S; Art. 269, 275, 325-327 LOC RS).

#### 4. CONCLUSION

The analysis of legal measures to protect minority shareholders points to a relatively high level of protection of minority shareholders "on paper" in the analysed countries, but also to some weaknesses which vary from country to country. Generally, mechanisms of protection exist, but the actual protection depends on their proper functionality which is, in one part, determined by the whole subset of rules that make one mechanism functionable.

The legislation in FB&H somewhat lags behind and abounds with ambiguities. Only in FB&H and Montenegro pre-emption right is not freely transferable. In FB&H cases of restructuring or reorganization of companies with majority state capital are excluded from the provisions on shares buyout including filing a complaint with the competent court to the disadvantage of minority shareholders in these companies. Concerning the buyout, the Law in Montenegro insists on the average market value at the day of making the decision. In FB&H and Croatia there is no possibility of filing derivative lawsuits. Croatia is one of the few countries in the region which still allows voting of the board members who are in a conflict of interest.

Even though pre-emption rights are recognized by all the five legislations, only in Serbia and RS the laws set conditions with respect to the selling price at issuance with a view to exercising these rights which is considered important in protecting minorities. In terms of the right to ask for convening of the general meeting or adding issues to the agenda, all the legislations set certain thresholds which in some cases may be too high. In practice, it will depend on the ownership structure of an actual company. Generally, we conclude that set thresholds for the realization of the rights of qualified minorities are often not adapted to conditions of a very concentrated ownership.

We also conclude on the small practical significance of cumulative voting as a mechanism that allows minority shareholders to elect their "representatives" to the board, since its effectiveness depends on the size of the board and, again, the number of shares in the hands of minority. The solutions present in some jurisdictions under which minority shareholders with a given percentage of share in the equity have a right to directly elect their representative in the board, or which limit representation of the controlling or significant shareholder in the board seem more acceptable in the given circumstances.

And, in the end, for the exercise of shareholders' buyout rights and the right to challenge the decision of the assembly, conditions in the form of voting against the decision or refraining from voting and stating the opposition in the minutes of the assembly are usually set and also not usually met in practice.

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