A REVIEW OF CORPORATE GOVERNANCE IN UZBEKISTAN

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ABSTRACT
This article reviews the composition of owners and the legal framework for the activities of limited companies formed from joint-stock companies in Uzbekistan. The review reveals that as a result of privatization in practice, large investors have accumulated controlling shares in Uzbek limited companies. Moreover, it was suggested that an effective structure of ownership must be formed to ensure adequate corporate governance.

Keywords: corporate governance, privatized companies, joint-stock companies, ownership structure.

INTRODUCTION

Organizing a business in the form of a corporation allows entrepreneurs to attract large amounts of investment, implement large business projects, and earn high returns. Walmart Inc., which ranked number one in the Fortune 500 rankings in 2020, generated annual revenue of $523.964 billion, almost equal to Belgium's gross domestic product in 2019 ($529.606 billion) (World Bank, 2020).

All of the features of a corporation are also common in joint-stock companies. Since Uzbekistan gained independence, joint-stock companies have been established and developed rapidly. Therefore, large corporate structures, which are organized as joint-stock companies, have been formed. Such corporations include Uzbekenergo, Uzbekyengilsanoat, Uzbekistan Railways, Uzdonmahsulot, Uzavtosanoat, Uzkimyosanoat, Uzbekneftegaz National Holding Company, and Uzvinosanoat-Holding Company, each of which occupies a separate sector of the economy. The total value of shares issued by 598 joint-stock companies established based on state-owned enterprises in the country amounts to 148.84 trillion soums (The State Enterprise 'Central Securities Depository', Republic of Uzbekistan, 2020). This total constitutes about 3% of the country's GDP in 2020 (World Bank Indicators, 2020). Currently, more than 900,000 legal entities and individuals have become owners of joint-stock companies as shareholders. They transfer their capital to a joint-stock company and, in return, receive a block of shares with a value equal to the amount of their contribution. Shareholders may not personally manage the activities of the enterprise, but each shareholder receives a profit commensurate with their contribution to the company. This benefit can be expressed monetarily or as a product or service. For example, shareholders may receive a share (dividend) in proportion to their share of the profits of the enterprise or make a profit by selling their shares at a higher price in the secondary market. The state, as a shareholder, can achieve the creation of a specific product or service in the market by setting the policy of the company. Governing a joint-stock company with a complex ownership structure is also complicated.

Joint-stock companies introduce a unique system of governance: corporate governance. This management system aims to ensure a balance between the interests of those involved in the activities of the corporation, such as shareholders, managers, staff, creditors, suppliers, customers, and the state. The general meeting of shareholders, the supervisory board, and the executive body are the main elements of this system. They are the governing bodies of the joint-stock company and control the activities of the company. Two types of control are formed in a joint-stock company. The first is joint-stock control, which is the ability of shareholders to make decisions about the general activities of a joint-stock company. The second is the economic control, which is the control of the enterprise over the current business activities. While the general meeting of shareholders and their representatives on the supervisory board exercise the first type of control, the executive body exercises the second type of control.

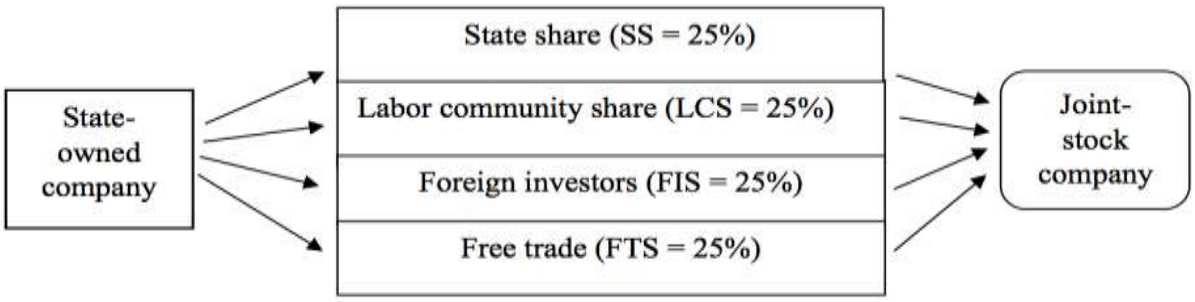
This article examines the problem of introducing effective corporate governance in joint-stock companies established as a result of the privatization of state-owned enterprises. It is believed that the methods of privatization used in the privatization of state-owned enterprises affect the formation of the ownership structure in these enterprises. Consequently, we focus primarily on analysis of the methods used in the privatization of state-owned enterprises in Uzbekistan.

ANALYSIS OF RECENT RESEARCH AND PUBLICATIONS

Although a great deal of research has been undertaken in the field of privatization and corporate governance, there is little research on the problems of corporate governance in enterprises established through privatization. It is known that in a joint-stock company, the shareholders appointment of the executive body and the supervisory board. A shareholder's voting power is proportional to their share of the total number of ordinary shares. As a result, shareholders with a large share have more voting rights than shareholders with a smaller share and have more influence over decisions. Some studies demonstrate that the role of the elected supervisory board and the executive body in determining the policy and strategy of a joint-stock company is significant, which necessarily affects the capital structure of the company and the effectiveness of corporate governance (Davies, McColgan and Hillier, 2005). There are different approaches to the relationship between ownership structure and corporate efficiency in joint-stock companies. The influence of large shareholders on the management and control of the company's activities is strong (Shleifer & Vishny, 1986). The fact that large shareholders control the profits of a joint-stock company also affects the dividends that shareholders receive (Jensen & Meckling, 1976). Moreover, they have more experience in the business than small shareholders because they have been involved in the company's activities for longer period of time (Stein, 1989). However, some research also shows that large shareholders can harm a corporation. For example, content consisting of large shareholders may lead to a violation of the interests of small shareholders – individuals or small groups (Anderson & Reeb, 2003). Morck et al. (1988) explain that in a society with such a structure, the existing risks are not fully taken into account as a result of pursuing profit and business expansion.

PRESENTATION OF KEY RESEARCH FINDINGS

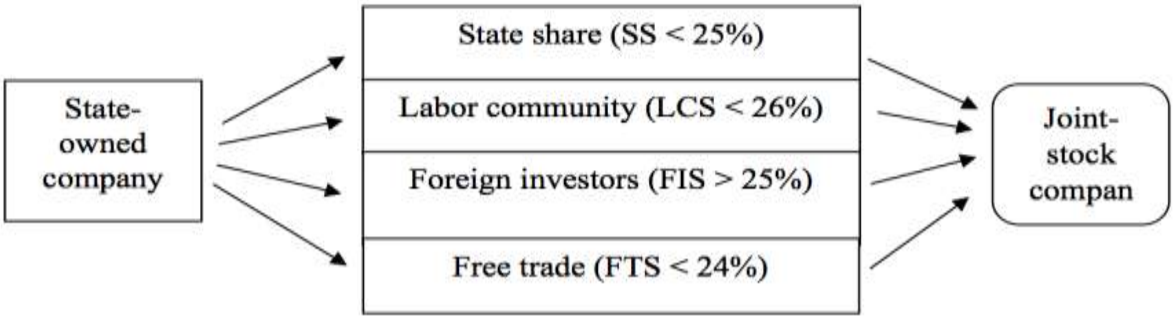
The formation of joint-stock companies in the country has become widespread since 1994. Such practice represents the privatization of state-owned enterprises in the following ways:
involvement of the population in the process of economic reform through the sale of state-owned securities via exchange trades, the reduction of the proportion of state-owned shares, and the establishment of open joint-stock companies;
competitive sales in the real estate market, primarily trade, household, utility facilities, and incomplete construction projects;
the attraction of foreign investments in the economy via tenders and auctions, investment auctions, and direct sales of property.
In the early stages of the formation of joint-stock companies, the creation of the charter capital of open-ended joint-stock companies allowed the sale of shares mainly in the following parties (method 1):
Figure 1. Distribution of shares in joint-stock companies formed by state-owned enterprises (Method 1)



Hence, the owners of the newly formed joint-stock companies were the state, the labour community, foreign investors, and local individuals and legal entities. They were entitled to equal participation in the charter funds of joint-stock companies (Figure 1) (Decree of the President of the Republic of Uzbekistan "On priorities for further development of the process of denationalization and privatization of property in the Republic of Uzbekistan", 1994)

Since 1997, based on the practice of privatization in our country, the above ratio of owners has begun to change. A separate decree of the Republic of Uzbekistan ‘On additional measures to develop the securities market and expand the participation of foreign investors in the stock market’ (1997) provides for the following distribution of shares of privatized enterprises in the formation of the charter capital of open joint-stock companies in which the state retains its share (method 2):
the state owns not more than 25% of shares;
labour collectives possess 26% of the shares;
foreign investors have the opportunity to purchase at least 25% of shares;
the rest are free trade.
According to the ratios, the upper limit of the proportion owned by the state and the labour community is the same as the lower limit of the proportion that can be sold to foreign investors. It is assumed that the state will retain more than 25% of the shares only in the sectors that determine the future scientific and technical capabilities of the country, and ensure the economic security of the Republic of Uzbekistan (Resolution of the Cabinet of Ministers of the Republic of Uzbekistan, 1997). This can be schematically illustrated, as shown in Figure 2.

Figure 2. Distribution of shares in joint-stock companies formed from state-owned companies (Method 2)



Since 2003, the government’s priority has been to stimulate rapid development of the private sector, radically increase its role and importance in the country's economy, and improve the system of corporate governance of privatized enterprises (Decree of the President of the Republic of Uzbekistan, 2003). As a result, the state share in the charter capital of joint-stock companies to be 25% or less was presumed to be inappropriate. Therefore, the state shares were auctioned mainly as private property and sold on stock exchanges. In 2003 and 2004, the gradual sale of state-owned shares in privatized enterprises in which the state held 25% or less of the charter capital started in the stock market.
The above data confirm that in the early stages of the reforms, no particular type of ownership was given priority in the transformation of state-owned enterprises into joint-stock companies. So far, 85% of the shares of established joint-stock companies were distributed to new owners in accordance with method 1 and 13% in accordance with method 2 (Table 1).

Table 1. Dynamics of the transformation of state-owned enterprises into joint-stock companies

Years	1994	1995	1996	1997	1998	1999	2000	2001	2002
Number of companies transformed into joint-stock companies	2,984	1,024	1,256	456	110	141	152	227	223
As a percentage of total	45	15	19	7	2	2	2	3	3
Years	2003	2004	2005	2006	2007	2009	2011	2013	Total
Number of companies transformed into joint-stock companies	76	28	3	19	-	-	-	-	6,699
As a percentage of total	1.1	0.5	0.1	0.3	-	-	-	-	100

These two methods were employed from 1994 to 1997. Therefore, privatization was implemented from 1998 to 2002 and constituted about 98% of the total number of joint-stock companies. Since 2003, no fixed share distribution ratios have been established during privatization. Instead, an individual approach is used based on the characteristics of each state-owned enterprise.

CONCLUSION AND RECOMMENDATIONS

The majority of joint-stock companies operating in Uzbekistan (71%) were established as a result of the privatization of state-owned enterprises. The methods of privatization used in the transformation of state-owned enterprises into joint-stock companies should have officially resulted in the state, the labour community, foreign investors, legal entities, and individuals having almost equal shares as the main owners of each company. However, there is a need to further expand the analytical database because the base of selected joint-stock companies is very small, representing only 2.5% of all joint-stock companies. Opportunities to expand the analytical database are limited because it is directly related to the principles of disclosure of information in joint-stock companies. In the implementation of the corporate governance model in the joint-stock companies of Uzbekistan, it is necessary to analyse the effectiveness of the elements derived from other models in the current conditions. It is also advantageous to analyse to what extent the interests of minority shareholders (small stakeholders) and the labour community are protected in the current structure of ownership.

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