



# occasional papers

in Public Administration  
and Public Policy

Volume III

No 4 • Autumn 2002

The *Occasional Papers* are published quarterly by NISPAcee and distributed together with the *NISPAcee Newsletter*. The series launches academic publications that discuss results of policy research in different fields of public administration. It provides a forum for the analysis and discussion of contemporary problems and possible solutions, models and methods of public administration and public policy with assessments of empirical evidence from regional experience in public sector reform.

The main goal is to enhance the quality and quantity of intellectual exchange among researchers, educators, scholars and practitioners dealing with major issues of public administration and public policy in the Central and East European regions.

## Content

Elmira Danelyan

**Learning a Response to Ethics  
Failure in the Public Agencies  
of Armenia /p. 3**

Lívia Zemanovičová,  
Martina Kubánová

**Corporate Governance Risk in  
the Slovak Republic /p. 29**

Copyright © 2002 by NISPAcee

## Editor

Bohdan Krawchenko, Ukrainian Academy of Public Administration, Office of the President of Ukraine, Kiev, Ukraine

## Deputy Editor

Juraj Sklenar, NISPAcee Secretariat, Bratislava, Slovakia

## Editorial Board Members

Ingrid Shikova, Information Centre of the European Union, Bulgaria

Ivan Maly, Masaryk University, Czech Republic

Michal Illner, Academy of Sciences, Czech Republic

Wolfgang Drechsler, University of Tartu, Estonia

Mzia Mikeladze, Georgian Technical University, Georgia

Gyorgy Jenei, Budapest University of Economic Sciences, Hungary

Golam Mostafa, Kazakhstan Institute of Management, Economics and Strategic Planning, Kazakhstan

Salih Murzaev, Academy of Management, Kyrgyzstan

Vladislav Domarkas, Kaunas Technological University, Lithuania

Pawel Swianiewicz, University of Warsaw, Poland

Agnieszka Pawlowska, Maria Curie-Sklodowska University, Poland

Gabriela Cecilia Stanciulescu, Academy of Economic Studies, Romania

Sergei Pushkarev, Ural State University, Russia

Milan Bucek, University of Economics, Slovak Republic

Stanka Setnikar-Cankar, University of Ljubljana, Slovenia

Dragoljub Kavran, Government of Serbia, Yugoslavia

## English Language Editor

Todd G. Williams, Acme Anvil Language Services, Hungary

## Submissions

Papers should be written on relevant public administration and public policy issues based on empirical research carried out in Central and East European countries. The papers should not exceed forty pages in length. If a paper is written in a language other than English, a three-page English summary should be submitted with a bibliography and a description of the length of the entire document. Each author may propose two reviewers for their submission, but the final selection of reviewers is at the discretion of the editor. Those authors whose papers are selected for publication will receive a modest honorarium.

**Editorial correspondence**, including manuscripts for submission, should be addressed to Mr. Juraj Sklenar, deputy editor, NISPAcee Secretariat, Hanulova 5/B, P.O.Box 163, 840 02 Bratislava 42, Slovak Republic, phone/fax: +421-2-6428 5557, e-mail: juraj@nisp.sk. Manuscripts should be sent in electronic form.

## Subscriptions

Subscriptions and limited additional copies are available without charge. Requests to be placed on the mailing list or for additional copies should be addressed to the deputy editor. Change of address notifications should be sent to the publisher at least four weeks in advance, including both the old and new addresses.

*NISPAcee Occasional Papers are published with the support of the Local Government and Public Service Reform Initiative (affiliated with the Open Society Institute), Nador ut. 11, 1525 Budapest, Hungary.*

**ISSN 1335-5945**

# Learning a Response to Ethics Failure in the Public Agencies of Armenia

**Elmira Danelyan**

American University of Armenia, Yerevan, Armenia

## Abstract

The present study explores an organisational learning strategies response to ethics failure in public agencies of Armenia. Many scholars have recognized the importance of ethics in government; moreover, there have been intensive debates going on around this issue for the last two decades. The great interest in this issue is warranted by the high costs (financial, political, administrative, and democratic) that ethics failure may entail. These costs may be detrimental not only to a given public agency, but also to an entire political system. In this sense, in newly independent countries like Armenia where democratic principles are new concepts, ethics failure may impact the public's faith in government with a subsequent lost of trust toward democracy as a political system.

This research is a replication of the study conducted by Gary Zajac and Ali Al-Kazemi in the public agencies of Kuwait in 1996. The research questions posed in this study were the following: first, how do public agencies in Armenia respond to ethics failure? Second, if and where organisational learning exists, how much effort is committed by the organisations to the learning process? Third, where organisational learning exists, what are the specific features of this learning? A vignette survey research study was conducted in 11 local self-government bodies, taghapetarans, of Yerevan. The questionnaire was constructed around three hypothetical vignettes, each of which presented one type of ethics failure common to public agencies. These were symptomatic failure (favouritism), malicious failure (misuse and theft of agency materials), and marginal failure (employee mistakes that harm innocent people). Each of the vignettes was followed by a set of questions designed to generate data on learning effort measure variables.

The findings of this study showed that public agencies in Armenia commit more than a moderate effort to learning from ethics failure - 61% of the maximum possible effort. This indicates that effort devoted to learning in Armenian agencies is higher than that of public organisations in Kuwait and the USA. However, Armenian data indicated that agencies sampled are quick to respond without thorough inquiry into the causes of the problem. This study also revealed that ethics in the sampled public agencies is perceived on a personal level rather than on an organisational level. Furthermore, the absence of ethics codes, training and educational programs, etc., in governmental organisations hinders broader perception of the full scope of government ethics. In sum, although public agencies in Armenia are moderately inclined toward learning from ethics failure, the overall perception of the role that ethics may play in government agencies is rather narrow.

## Introduction

The subject of ethics in government has become a matter of intensive debate among scholars of public administration over last two decades. This interest is growing because of several factors such as the growing role of public administration as a profession, recognition of the impact that ethics (or ethics failure) may have on citizen faith in government, as well as the role of ethics in the protection of human rights and dignity.

The issue of government ethics is perhaps the most controversial and complex concern in the study of public affairs and administration. Public officials and servants exercise significant discretionary power in the process of decision-making and implementation while managing public resources or making policy choices. Therefore, the issue of government

ethics in public administration is of great importance since ethical standards serve as checks and balances against arbitrary use of that public power.

The debate over ethics in government covers several issues. Some scholars touch the very core of the subject, that is, whether ethics in government is a matter of individual perception or is related to organisational structure and policies. Others discuss the possibility of development of appropriate moral standards for operation within public organisations. Sometimes, theorists go further in their deliberations to argue that there is nothing objective in the world, and therefore, there is no traditional morality or ethical standards, so everything depends on the situation. Whatever the direction of the debate over ethics in government, and whatever the difference in the views of scholars, one factor undoubtedly unites all of them: they all recognise that the problem of ethics in organisations (including public agencies) does exist, and more importantly, it needs better understanding.

Public organisations deal with ethics problems differently; some of them may introduce ethical codes and try to comply to the standards outlined in “rule-books” and punish those who deviate from these standards, some are inclined to deny or ignore the existence of such problems. Still others may try to learn from mistakes. One cannot, however, say that public agencies adhere to one path or another; usually there is a combination of the actions mentioned above. Accordingly, the results of these strategies are also different. Although ethical codes and training programs are very important, if there is an ethics problem, sole adherence to the ethics codes or punishment may bring an immediate effect but be ineffective in the long term: as a result, recurrence of the problem occurs. Ignorance or denial may produce even worse results since, if a problem is not dealt with timely, it may become ingrained in the day-to-day routine and become a customary occurrence. The most effective strategy, thus, is recognised to be an *organisational learning response*, i.e., constant investigation of an organisation’s core values, structure, and

policies to confront the problem efficiently and prevent recurrence.

The present study examines how public agencies in Armenia respond to ethics failure. This is a replication of a study conducted in 1996 by Gary Zajac and Ali Al-Kazemi in public agencies in Kuwait. Gary Zajac and Louis Comfort conducted a similar study earlier in the public health departments in the eastern United States and this study served as the basis for the Kuwaiti study. All three studies (in the USA, Kuwait and Armenia) are aimed at figuring out what the current strategies are for response to ethics problems in public agencies. According to Zajac and Comfort (1997), these strategies include such responses as ignorance or denial of the problem, punishment and learning. The authors argue that organisational learning strategies contribute more to organisational moral autonomy by correcting organisational causes of failure. Thus, all three studies are concentrated on organisational learning strategy as a corrective means for solving ethics problems in public agencies.

The research questions posed in this study are the following:

First, how do public agencies in Armenia respond to ethics failure? In other words, is their response characterized by organisational learning, by discipline applied to persons identified as being responsible for the failure, by attempts at denial or concealment of the problems, or by some combination of these?

Second, where organisational learning exists, how much effort is committed by the organisations to the learning process? That is to say, how seriously do the agencies appear to take such learning; is it comprehensive and exhaustive, or perfunctory?

Third, where organisational learning exists, what are its specific features (what does it “look” like) and how does this learning compare to organisational learning processes described in the literature?

The present study, like the Kuwaiti study, is a comparative study the findings of which will contribute to better understanding of organisational ethics learning practices; moreover, a comparison of Armenian data with the findings in the Kuwaiti and American

studies will allow us to view this research from the international perspective.

## Why Study Ethics in Government?

Students of public administration writing on ethics in government bring several practical reasons that support the need to study government ethics. As Huddleston puts it:

*...there are at least three good reasons to pay attention to ethical issues. First, we owe it to ourselves as citizens of a republic to insist on exemplary conduct by our public officials; "relatively good" or "no worse than usual" ought not to be considered acceptable grades when assessing the moral compasses of our political and administrative leaders. Second, even well-meaning public officials need guidance; clear-cut cases of theft and bribery excepted, there are very few simple "thou shalt" and "thou shalt not" rules in this area. Finally, thinking systematically about ethics in government involves thinking about the role of government in society and that is a useful and healthy thing to do (Huddleston 1987, emphasis added).*

Another author, H. F. Gortner (1991), substantiating reasons for growing interest in government ethics, finds that the subject of ethics in public administration should be stressed because the schools of public affairs and administration play the role of developing a "professional attitude" among public officials and servants. Furthermore, "if the democratic process is to function properly, government should remain strong and be able to address societal problems, and the citizenry at large should have faith in their government. Public bureaucracy must play a central role in creating the atmosphere or environment that encourages that trust and faith." (Gortner, 1991).

One of the pillars on which democracy rests is the rule of law, and deriving from this premise is the slogan "everybody is equal before the law." If a public official misuses his or her power in office for personal advantage,

then the rule of law and equality before law are violated. As P. Madsen and J. Shafritz (1992) state, "a public official's wrongdoing is destructive of the claim that in a democracy all individuals are equal." Mischief-making in public administration also impacts on the economic and social rights of citizens who become deprived of equal access to public goods. Moreover, promoting their own rather than public interest, government servants turn public office into a kind of "privileged access" (Madsen and Shafritz, 1992).

The scope of government ethics is wide enough. Besides mischief making, it embraces such problems as corruption, the "dirty hands" dilemma, hard choices, ethics of political campaigns, and patronage. In any of these cases, ethical violation entails extremely high costs that are financial, political, administrative, and democratic (Blumenstein, 1992; Zajac, 1996). Financial costs may include both money lost as a result of cheating or swindle, and expenses caused by investigating and remedying ethics problems. Political costs entail negative attitudes and feelings such as those that appear in the public after scandals and disclosures. An example of democratic cost is the loss of public faith in the "good intentions and operations of government" that results from widespread ethics failure (Zajac, 1996).

These costs underscore the importance of the government ethics studies, and justify the great attention paid by scholars to the problem of ethics failure. This is extremely important in respect to a transition country like Armenia since maintenance of government ethics, accountability of public officials and servants, and transparency of government actions are vital for consolidation of democracy to which Armenia is aspiring. Strengthening of government ethics is also indispensable for restoration of public trust toward government and public officials in Armenia. Moreover, this lack of confidence spreads not only over government as such, but also impacts the public's perception and attitude toward democracy as a political system creating distrust toward democratic principles in the public at large. Thus, the study of government ethics is even more important in fledgling democracies like

Armenia, where neither democratic principles, nor the economy are stable. For such countries, high political, financial, administrative and democratic costs that ethics failure may entail can be detrimental and even ruinous.

## The Theoretical Concepts of Organisational Ethics and Organisational Learning

Based on the literature and findings from a survey on organisational ethics conducted in 1994, Gary Zajac (1996) defines ethics failure as ... any behaviour of public servants or organisations that

- results in fraudulent use of public funds, materials, facilities, and so forth;
- results in conflict-of-interest in public decision making, wherein decisions are made in such a way as to advance the interests of a public servant(s) or agency to the detriment of the public interest;
- results in violations of individual civil or human rights or dignity; or
- results in injustice or harm to individuals, even where this outcome was unintended, and especially where it goes un-corrected (1996).

The author then goes on to explain that this definition is concerned not only with “managing the public purse,” but also with advocating public administration as a “conservator of just, compassionate, and progressive social order” (1996).

According to Zajac and Al-Kazemi (2000), organisations can respond to ethics failure in several ways. Perhaps the easiest response is to simply ignore, deny or conceal problems. Another common organisational response is to assign blame for the failure to specific individuals within the organisation and discipline them. This method of punishment is often considered to be necessary or legally correct and mandated; however, it serves as a disincentive to the free flow of information and often creates an atmosphere of distrust and restraint within an organisation. Although the punishment response can often result from organisational learning efforts, as Argyris (1982) states, it hinders creation of a spirit of

open inquiry within the organisation, which is essential for substantive reform. Finally, organisations can respond to ethics failure by attempting to inquire into the *organisational* causes of the problem and implement strategic organisational changes. Thus, organisational learning from ethics failure occurs when an organisation inquires into any of its features such as its goals, policies, procedures, culture, and structure to find out how these may have contributed to the ethics violation within the organisation (Zajac and Comfort, 1997).

Discussing the level on which ethics problems may occur, G. Caiden and N. Caiden (1977) argue that ethics failure encompasses problems at both the individual and the organisational levels. Individual-level failure may be a result of misconduct of a single person within the organisation. Organisational-level failure results when wrongdoing becomes widespread throughout the organisation and is rooted in its day-to-day life (Caiden and Caiden, 1977). Accordingly, several approaches are suggested by the scholars to eliminate or reduce the cases of ethics misconduct in public agencies. Some of them, those believe that the cause of ethics failure is the personal greed of an individual, suggest legislating more laws and impose more penalties (Madsen and Shafritz, 1992). Others, who find the roots of ethical misconduct in the organisation itself, attach more importance to organisational learning methods such as “ethics audits,” reinforcement of awareness (that ethics is an expectation within the public agency), application of ethics training programs, and introduction of ethical codes of conduct. (Madsen and Shafritz, 1992; Zajac, 1996). Finally, there are those who claim that the cause of the ethics violation lies somewhere between individual and institutional factors; that is to say, ethical wrongdoing in public agencies is a result of both human failure and organisational dysfunction so both people and places where people work should be considered and addressed when solving such a highly complex and “systemic phenomenon” as ethics failure (Madsen and Shafritz, 1992).

However, Zajac and Comfort (1997) put special stress on the institutional aspect of government ethics problems arguing that organisational learning is an effective means for correction of ethical misconduct in public agencies. In support of this idea, they state that organisational learning from ethics failure in public agencies is a form of organisational moral agency that promotes ethical public service (Zajac and Comfort, 1997). In their study of public health departments in the eastern US, they employed three streams in the literature to develop an exploratory model of organisational ethics learning. First, they reviewed literature concerning moral agency and learning by individuals and organisations to corroborate an organisational expression of *moral agency*; secondly, they resorted to organisational theory and public administration to devise a *typology of ethics failure* in public service; and finally, they worked out a model and a measure of organisational learning synthesizing the concept of moral agency and the typology of ethics failure with the dynamics of organisational learning (Zajac and Comfort, 1997).

Employing a citation from P. Jos (1990), the authors define moral autonomy as “the capacity for principled, reasoned action based on knowledge of the competing claims, traditions, theories, facts and contests surrounding a given ethical problem; facility at learning from previous lapses in ethical behaviour; and readiness to act consistently with ethical principles even under difficult conditions” (Zajac and Comfort, 1997). Then they conclude that a public agency demonstrates moral autonomy when it makes its choice of action based on a “reasoned consideration of alternatives” and selects those that serve the interests of the public at large rather than the narrow interests of any individual group. Thus, an organisation’s strategy of response to ethics failure indicates its “state of organisational moral autonomy,” that is, its capacity to give a constructive resolution to an ethics problem, advancing the moral development of the organisation and protecting the public interest rather than ignoring or denying the problem or punishing those who are to be blamed.

In their study of public health departments in the eastern US, Zajac and Comfort (1997) interpret ethics failure more broadly than the traditional concept of financial corruption in order to depict threats to the values of human dignity and rights, which are central concerns of a democracy. So, their definition of ethics failure includes “behaviour on the part of public servants or organisations that defrauds the government of resources, violates civil or human rights, or is otherwise destructive to justice or human dignity (Zajac and Comfort, 1997). For Zajac and Comfort, this definition serves as a basis for a typology of ethics failure in their empirical study, which they have derived from Ashforth (1992), Benveniste (1977), and Simon (1976).

Further, they identify several types of ethics failure. The simplest type is *marginal failure*, where simple organisational mistakes (i.e., record keeping mistakes) harm innocent people. Organisational characteristics that contribute to marginal failure include rules, procedures, and operational routines. Ethics failure results when agencies resist correcting such mistakes or do it very slowly. The second type of ethics failure is *malicious failure*, which represents the traditional concept of corruption. This type of failure results when public servants knowingly misuse public resources or authority for personal gain. Organisational characteristics that contribute to malicious failure include internal monitoring and control mechanisms, rules and procedures, and inadequate ethics training. Finally, the most complex type of ethics failure is *symptomatic failure*, which illustrates the failure of an organisation’s core policies, goals, values, assumptions, or culture and contributes to systematic behaviour that violates legal, civil, or human rights or results in unjust treatment of individuals. Such a failure is an indicator of deeper dysfunctions within the organisation, and is a problem not with a few bad employees but with the organisation per se.

Furthermore, Zajac and Comfort describe the process of organisational learning from ethics failure. According to them, learning from ethics failure occurs when an organisation examines its characteristics such as organisational structure, policies, and

procedures to find out how these may have led to ethics failure. Then the organisation gathers information about its shortcomings, which it later uses to plan and implement a strategy to change those features that were found to be conducive to ethics failure. The processes described above are embodied in the organisational learning model presented by Zajac and Comfort.

Other scholars such as Levitt and March (1988) present organisational learning from the perspective of organisational routines. They argue that learning is organisational to the extent that it is built into these routines:

*Organisations are seen as learning by encoding inferences from history into routines that guide behaviour. The generic term "routines" includes the forms, rules, procedures, conventions, strategies, and technologies around which organisations are constructed and through which they operate... Routines are independent of individual actors who execute them and are capable of surviving turnover in individual actors (Levitt and March, 1988).*

In their book *Organisational Learning: a Theory of Action Perspective* (1978), Chris Argyris and Donald Schon developed a background for identification and changing the cultural system of an organisation. Here their focus is on a different aspect of organisational learning, namely, how organisations learn or fail to learn. The authors describe organisational learning in the following way:

*When the error detected and corrected permits the organisation to carry on its present policies or achieve present objectives, the error-detection-and-correction process is single loop learning. Single loop learning is like a thermostat that learns when it is too hot or too cold and turns that heat on or off. The thermostat can perform the task because it can receive information (the temperature of the room) and take corrective action. Double loop learning occurs when error is detected and corrected in ways that involve the modification of an organisation's*

*underlying norms, policies, and objectives (Argyris and Schon, 1978).*

Argyris and Schon have developed two models, corresponding to single and double loop learning known as Model I (single loop learning), which is the most prevalent, and Model II (double loop learning), which is an alternative ideal. The organisations which operate under Model I deal with error correction by making adjustments and changes

*within a constant framework of norms for performance. It is concerned primarily with effectiveness; that is, how best to achieve existing goals and objectives and how best to keep organisational performance within the range specified by existing norms. In some cases, however, error correction requires an organisational learning cycle in which organisational norms themselves are modified (Argyris and Schon, 1978).*

An alternative to Model I, single loop learning, is Model II, double loop learning. In the organisations dominated by this model, double loop learning leads to "organisational inquiry that resolves incompatible organisational norms by setting new priorities and weightings of norms, or by restructuring the norms themselves together with associated strategies and assumptions" (Argyris and Schon, 1978). Thus, the double loop learning culture is the most "purely organic strategic culture possible, as it is built on the notion that constant adjustment in the culture is necessary and desirable" (N. Tichy, 1983).

In order to formulate the model used in their study of Health Departments in the eastern US, Zajac and Comfort drew upon Argyris's (1982) general model (Model O-II) of double-loop learning, as well as the work of other models of organisational learning and change, such as Beckhard (1975), Bennis (1966), Deming (1986), and Ishikawa (1985). So, their emphasis is on an organisation's ability to make a thorough inquiry into the organisational feature when an ethics failure occurs. Thus, in their empirical study, Zajac and Comfort employ a model, which



illustrates a process of organisational learning where:

- an ethics failure occurs within an organisation;
- the organisation identifies what type of failure has occurred;
- the organisation determines the seriousness and urgency of the problem;
- the organisation gathers information about and diagnoses the organisational causes of the failure;
- the organisation creates a strategy for organisational change based on the finding of the inquiry;
- the organisation identifies material, personnel, and other resources that can aid in the learning process;
- the organisation implements the change; and
- the organisation monitors and evaluates the outcomes of the learning process (Zajac and Comfort, 1997).

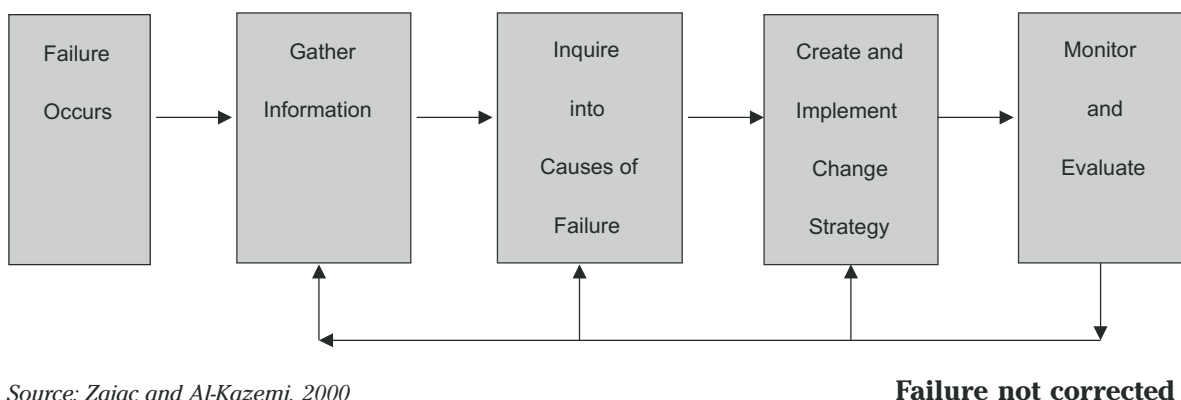
In the Kuwaiti study (2000), Zajac and Al-Kazemi have employed a little bit more improved and more concise version of this model (Fig. 1). Each of the steps in this model corresponds to one of the four variables employed in their study of Kuwaiti public agencies. The present study is also based on this model of organisational learning from ethics failure, and utilizes the same principle of fitting the steps in the organisational learning model to each of the four variables.

Although responsibility for ethical conduct rests on individuals, it is a fact that organisations are main agencies for “social control;” therefore, some kind of “institutional

foundation” for professional and ethical conduct is useful since “decisions made in government must supersede personal preferences” (J. Bowman, 1992). Several techniques are employed in order to deal with ethics issues in public agencies. Since this study is more concerned with ethics and learning on the organisational level, it is worth mentioning organisational development efforts as a means of achieving high ethical standards and behaviour. Among the mechanisms that have been used are ethics training, as well as an introduction of codes of conduct or ethics codes which contain formal statements of values and beliefs, internal ethics audits, appointment of an ethics ombudsman or creation of ethics boards, and other measures (Madsen and Shafritz, 1992). These techniques have been borrowed by the public service from the private sector, and as these two sectors differ in their purpose, goals, resources and in a wide array of other specific features, setting and institutionalisation of ethical standards in these two types of organisations may have different results (Madsen and Shafritz, 1992). In this regard, public organisations may have difficulties in achieving these standards because of lack of resources in terms of money and time, “an already confusing set of ethics laws, the problems of lack of professionalism and pride in the public workplace, and the absence of organisational mechanisms that can institutionalise ethics in government” (Madsen and Shafritz, 1992).

A survey conducted by James Bowman among public administrators in 1989 showed

**Figure 1**  
**Organisational Ethics Learning Process**



Source: Zajac and Al-Kazemi, 2000

that there are no agreed-upon standards or procedures to guide decision-making in most public agencies. Consequently, many agencies either ignore this fact or simply have no strategy for dealing with ethics problems (J. Bowman, 1992). Although most of the respondents in his study reported that there is no consistent approach to ethical issues, Bowman (1992) states that administrators do believe that ethics in the workplace can be “empowering.” Moreover, public managers accept that “properly designed codes of conduct can have a crucial role in fostering integrity in agencies” (J. Bowman, 1992).

Another scholar, Ritchie Bowner (1988), also stresses the importance of codes of ethics arguing that there is some evidence that a code of ethics does make a positive contribution to organisational behaviour. The author believes that “sometimes members of an organisation simply don’t know many of the ethical dilemmas they may encounter and how to think about them. A review of a code of ethics can be very helpful in generating advance consideration of problems and developing personal principles” (R. Bowner, 1988).

## Research Design

Like in the American and Kuwaiti studies conducted by Zajac and Comfort (1997), and by Zajac and Al-Kazemi (2000), in the present study a research survey has been employed. The organisational actions taken in response to all three types of ethics failure described above (symptomatic, malicious and marginal) have been examined within a purposive sample of eleven taghapetarans in Yerevan. Taghapetarans are local self-government bodies. According to the Constitution of the Republic of Armenia (RA) (article 105), taghapetarans, along with the community council, the avagani, manage community property and deal with several community issues. The avagani is an elected body comprised of 5-15 members and this body performs oversight functions, as well as establishes local charges and fees, while the taghapetaran is an executive body (RA Constitution, article 106). The head of the taghapetaran, the taghapet, is elected every three years and forms the taghapetaran staff immediately after being elected (RA

Constitution, article 105). The taghapetarans have been selected for sampling to provide the widest possible range of local government agencies. There are only twelve taghapetarans in Yerevan and it was possible to survey almost all of them (the twelfth taghapetaran was not included in the sample because it is very small). Moreover, the local government agencies are the closest to the citizens, and trust toward the government, on the whole, should be built on all government levels, but especially the local level since it is the first link in the chain of government levels.

The sampling has been performed with stratification of position and function within the agency. The sampled positions included three levels: 1) direct service providers, 2) middle-level managers, and 3) executives. For the comparability of the data, three departments of the same profile were selected in each of the taghapetarans. The stratification was done to find out whether the level of position (managerial or line) held by public servants has an impact on the perception of ethics problems and learning response to such failures. Altogether, ten public servants from each taghapetaran were selected: one on the executive level (the executive or deputy), three department heads, and six direct service providers (two from each of three departments).

The executive (or deputy) of each taghapetaran was interviewed personally. A self-administered research instrument was distributed to a random sample of 107 employees (ten questionnaires to each of the ten taghapetarans, and seven questionnaires to the smaller, eleventh taghapetaran). This survey produced a response rate of 96 percent.

The research instrument in this study is an Armenian translation of the survey questionnaire used by Zajac and Al-Kazemi in their Kuwaiti research. The questionnaire is constructed around three hypothetical ethics vignettes, which are designed to generate data regarding the nature and strength of organisational response to ethics failure. These vignettes correspond to the typology of ethics failure discussed above and illustrate ethics problems that occur frequently within public organisations. The first vignette

corresponds to *symptomatic failure* - widespread favouritism in evaluation and promotion of an employee. The second vignette represents *malicious failure* - employee theft or misappropriation of agency materials and resources. Finally, the third vignette corresponds to *marginal failure* - several mistakes done by employees that harm innocent citizens.

Each vignette is followed by a common set of questions designed to produce data on the Learning Effort Measure (LEM) variables, which correspond to the steps of organisational learning model described above. These LEM variables are: (1) information, (2) inquiry, (3) change, and (4) evaluation. Zajac and Al-Kazemi (2000) cite G. Cavanaugh and D. Fritzsche (1985) to argue that the vignette approach is a valid and innovative means of gathering empirical data on sensitive topics, which might otherwise arouse the suspicion of the respondents and provoke defensive responses. Thus, "the use of vignettes as a data generation device coupled with a series of questions relating to the vignettes asking how a respondent [or his organisation] would act has yielded a rich database" (Cavanaugh and Fritzsche, 1985).

The questions asked in response to each vignette, which correspond to each of the four LEM variables, employ either multiple response items, or standard, Likert-type scales. The multiple response items were used for questions concerning the information and inquiry LEM variables. Here the respondents were asked to report on the range of sources of information, and types of inquiry that their agency would undertake in response to the situations described in the vignettes, marking as many answers as apply. The standard, Likert-type scales (0-4) were utilized for the questions dealing with LEM variables change and evaluation. Here respondents were prompted to report the *extent* to which their agency would commit itself to attempt to change the organisation, based upon the findings of the inquiry, and the extent of organisational effort committed to monitoring and evaluating the outcomes of the organisational learning process. The questionnaire was translated into Armenian and reviewed by a number of bilingual

colleagues. A preliminary version of the translated document was pre-tested on a small sample of public employees during the pilot study.

For the comparability of Armenian findings with data obtained from the American and Kuwaiti studies, the findings of the Armenian study were subjected to a data reduction procedure borrowed from the program evaluation and organisational analysis literature. This procedure converts the raw responses to the questions about the level of effort committed to the steps in the learning process into a Learning Effort Measure (LEM), which shows the level of effort that public agencies commit to each of the four variables. The calculation was done in Excel. The number of actions reported on the multiple response variables, information and inquiry, was counted and the sum was divided by the maximum number of possible actions that could be reported in response to each question. No weighting was imposed on these variables. The resultant was multiplied by 100 to yield a percentage-based index of learning effort on these variables. The other two variables, change and evaluation, were calculated by standard scales and were taken at face value. The mode (the most frequently reported answer) for each of the four variables in all three types of ethics failure was calculated, too. All the above mentioned calculations were also done based on several factors, namely, the LEM was calculated from the perspective of different types of departments engaged in the survey such as functional (i.e., the Financial Department) and service delivery (e.g., the Utility Department) departments. Two position levels, managerial (executives and heads of departments) and line (direct service deliverers) were also measured as well as different levels of experience from 1 to 5 years and 5 or more years. This was done in order to find out whether these factors have any impact on learning effort committed by the agencies.

The LEM reflects the range of likely organisational effort that could be taken by public agencies in response to ethics failure. A high percent index of LEM (e.g., 80%) would be an indicator of a high-level of commitment to learning from ethics failures. This index

**Table 1**  
**Learning Effort Measures for All Variables and Types of Ethics Failure**

Type of Failure	Symptomatic Failure			Malicious Failure			Marginal Failure		
Country	Armenia	Kuwait	U.S.	Armenia	Kuwait	U.S.	Armenia	Kuwait	U.S.
<b>Variable</b>									
<b>Information</b>	30%	31%	56%	41%	29%	43%	34%	37%	43%
<b>Inquiry</b>	30%	22%	60%	35%	24%	51%	41%	32%	60%
<b>Change</b>	81%	55%	44%	88%	63%	36%	88%	75%	43%
<b>Evaluation</b>	84%	53%	53%	91%	59%	41%	89%	71%	44%
<b>All Variables</b>	56%	32%	56%	64%	35%	47%	63%	45%	50%
	Armenia	Kuwait	U.S.						
<b>Total - across all three failures</b>	61%	37%	51%						

**Table 2**  
**The Learning Measures Fitted to the Learning Model: Armenia, Kuwait, USA**

Model Step	Variable	Learning Effort Measure		
		Armenia	Kuwait	U.S.
Gather Information	INFORMATION	35%	33%	47%
Inquire Into Causes of Failure	INQUIRY	35%	26%	57%
Create & Implement Change Strategy	CHANGE	86%	49%	41%
Monitor & Evaluate	EVALUATION	88%	46%	47%

allows not only an estimate of the strength of organisational learning effort, but also makes possible a comparison of learning activities between and across different types of ethics failure, and draws parallels between different administrative systems.

## Findings and Discussion

The following tables present the summary of findings from the exploration of learning response to ethics failure in public agencies of Armenia, and comparison of this data with findings from American and Kuwaiti studies. Table 1 shows the learning effort measures for all variables, for all three types of ethics failure, in Armenia, Kuwait and the USA. At the bottom of Table 1, the overall learning effort measure across all variables and all types of failure for each of the three countries is shown. Table 2 fits the findings of this study

to the ethics-learning model presented above. The four learning effort variables - information, inquiry, change and evaluation - correspond to the four steps in the learning model - gather information, inquire into causes of failure, create and implement change strategy, and monitor and evaluate. LEM percentages are presented across all three types of failure, for all three of the countries.

## Overall Results

The main finding of this study shows that the agencies sampled in Armenia make a slightly more than moderate effort toward learning from ethics failure. Organisational effort devoted to learning across all three types of failure is 61 percent of the maximum possible effort that could be measured by this study. Table 1 indicates that public agencies in

Armenia commit more effort toward learning from ethics failure than public organisations sampled in Kuwait (37%) and the USA (51%). However, in neither country do public agencies commit much more than moderate efforts for organisational learning. The pattern of the overall tendency for all three types of failure in the study of public agencies in Armenia differs from that of Kuwaiti and American studies. Armenian data show that the most learning effort would be committed to the malicious failure (the second highest being marginal type of failure); the study of Kuwaiti public agencies suggests that the most learning effort would be devoted to the marginal failure (malicious failure is second), while for the American public agencies, the highest percentage of LEM index is detected in the symptomatic failure (the second highest index is for marginal failure).

### Information and Inquiry variables vs. Change and Evaluation variables

The Armenian study shows that percentage results of information (35%) and inquiry (35%) variables are close to each other; moreover, the percentage indices for the change and evaluation variables are also nearly the same (86% and 88% respectively). In other words, the public agencies in Armenia devote much more effort to the creation and implementation of change strategies, and evaluation and monitoring activities than to gathering information and inquiring into the causes of ethical problems. Kuwaiti data shows a similar tendency, though the difference between the two pairs of variables, information-inquiry and change-evaluation, is not as great as in the Armenian study. On the contrary, American data shows that the greatest amount of organisational effort is made toward inquiry into the causes of failure, while the least organisational commitment is devoted to the creation of change strategies.

The relative similarity of Armenian and Kuwaiti data may be explained by the history of public administration in these countries, both of which have gained their independence relatively recently (Kuwait in

1961, Armenia in 1991). The public administration systems in both countries were affected by previous regimes and their value systems. In the case of Kuwait, public administration was influenced by the Islamic values and Arabic tribal traditions, where greater emphasis is placed upon familial and clan ties, rather than to a broader civic interest (Zajac and Al-Kazemi, 2000). On the other hand, the Communist regime in Armenia (from 1920 to 1991) also had a great impact on public administration, giving much more importance to “belongingness” to the Communist party, rather than to professionalism or interests of people on the whole. Whatever the reasons, in both cases, the evolution of public administration systems were affected by values quite different from democratic principles, and that is why although both countries are intensively engaged in public administration system reform, the power of inertia still works. Because of this, public personnel decisions in Kuwait and Armenia (hiring, evaluation and promotion) are still driven not by objective, job-related criteria, but by social values and inertia that comes from the past.

Thus, the overall picture is that public organisations in Armenia (and to a lesser extent in Kuwait) are more inclined toward change implementation without *thorough* inquiry into the causes of the problem and a proper information gathering process. As Zajac and Al-Kazemi state, the inquiry phase of the overall learning process is crucial to determine organisational causes of the problem. Moreover, further organisational steps, implementation of change strategies, should be based on the results of that inquiry. Therefore, if the effort made toward inquiry is low, this may suggest that changes implemented may have a superficial character and may not “cure” the problem properly. In other words, high organisational efforts toward change action coupled with a low level of effort toward inquiry may indicate incomplete or incorrect problem analysis before the development and implementation of change strategies.

This pattern of the present study suggests that when and where learning effort to correct ethics failure is made, this process bears

characteristics of the single loop-learning model described above. The public agencies sampled in Armenia try to correct ethics problems without any change in core policies, goals and values. This type of change brings short-term organisational adjustment, and may result in an underestimation of the nature of the organisational problems studied here, ignoring aspects that may demand double loop solutions (Zajac and Al-Kazemi, 2000). In other words, moderate and non-comprehensive efforts toward learning from ethics failure in Armenian public agencies suggests that organisational learning is a type of *satisfying* behaviour. The organisation engages in an incomplete process of learning that satisfies only the limited and immediate demands of a problem, while it serves the established needs and interests of the organisation (Guy, 1991; Simon 1976). The *satisfying* response reflects an incomplete process of learning, which fails to fully examine and correct the ethical “lapse”, making recurrence more likely (Argyris, 1982). Furthermore, Christopher Hood (1974) has identified these types of organisational change as administrative failure. In his typology of administrative failures, this type of change is called “reorganisation: structural changes as symbolic responses, tokenism leaving substance untouched” (Caiden, 1994).

## **Correlation Between Learning Response and the Type of Ethics Problem**

This study also found that the strength of the organisational response depends on the type of ethics failure. Namely, the learning response and the complexity of the type of ethics failure seem to be inversely related. In other words, the most complex type of ethics failure, symptomatic failure, induces less organisational effort toward learning from ethics failure (56%) than do the other two types. On the contrary, with regard to simpler types of ethics failure, malicious and marginal, respondents reported a greater commitment to the learning effort from ethics failure (64% and 63% respectively). Thus, while logic dictates that more complex problems should produce more and thorough learning efforts, this was not found in the

study of Armenian public agencies. Public agencies in Kuwait show a similar tendency toward more effort committed to less complex problems. Conversely, American public agencies commit more learning effort to symptomatic failure (56%) rather than to malicious (47%) or marginal (50%) failure. These differences between the results of the American study, on the one hand, and Armenian and Kuwaiti, on the other may be explained by the history and traditions of American bureaucracy due to which a Weberian type of bureaucratic system with instituted procedures was established. In other words, in public agencies in the US, several procedures, including those related to investigation and inquiry, are rooted in the day-to-day life of an organisation, whereas in the Armenian and Kuwaiti public agencies, being in the process of reform, there is a lack of such routine procedures.

The low level of effort devoted to learning from symptomatic failure in Armenian public agencies may be an indicator of an overall passive attitude of public servants toward this type of ethics problem, which involves widespread favouritism in the performance evaluation and promotion of an employee. Public servants seem to perceive this type of ethics failure as a kind of problem that has always been there and defies solutions. In response to the question “To what extent do you think it is possible to change the sort of behaviour and attitudes reflected by this problem?” fifty percent of the respondents reported that it is possible to change this to *some extent* (10% reported *to little extent* and 5% *not at all*). Only about 34% of respondents found that it is possible to change widespread favouritism in their agencies *to a great extent*. Thus, about 65% of the public servants engaged in this survey find that such behaviour cannot be rooted out completely.

Such a view of this type of problem may be explained also by the peculiarities of the public agencies sampled. The executive heads of the taghapetarans, the taghapets, are elected leaders of their communities who are responsible for self-government in a given community. After being elected, taghapets form their staff to provide regular and quality services to the community population. There is another representative body of the local

government elected by the community population which is the community council called the avagani. However, the taghapetarans, the taghapet and his/her staff, carry out the executive part of community governance (Republic of Armenia Law on Local Self-Government, Article 5). Therefore, taghapets are perceived to be responsible for the proper functioning of the taghapetaran with the aim of provision of quality service; hence, they are free in their actions in the matters of employee performance evaluation and promotion. The implied logic is the following: if the taghapet is responsible for the regular functioning of the taghapetaran to serve the community, he or she would not make irrational decisions related to evaluation or promotion; otherwise, the taghapet would be blamed for the failure to deal with community problems and would not be elected next time. All this may be the reason why respondents view the symptomatic type of ethics failure as a “normal” state of affairs.

Such an attitude toward favouritism may also result from inertia (mentioned above); that is to say, favouritism (especially “party favouritism”) was a widespread practice during Soviet times, and this could have remained in the mentality of public servants in Armenia. Moreover, most of today’s local self-government bodies in Armenia (including taghapetarans) are situated in the buildings of former Regional Committees, which were executive bodies of the Soviet Armenia. This fact may have psychological effects not only on public servants, but also on the public at large, and contributes more to preservation of the old mentality. The specifics of an organisation’s internal culture may also have played a role in the formation of such an attitude toward favouritism. As Smircich (1985) states, the internal culture of an organisation “is a possession – a fairly stable set of taken-for-granted assumptions, shared meanings, and values that form a kind of backdrop for action.” Another scholar, Richard H. Hall (1972), supports this idea claiming that “...people come and go, but the culture remains robust.” So, once rooted in the culture of organisation, values and perceptions cannot be easily changed. On the other hand, one should keep in mind that Armenia is undergoing transition and regime

change, which also impacts organisational characteristics and behaviour. As V. Gabrielian (1999) has pointed out, one of the modes of regime transition employs *cadre organisation*. The author explains cadre organisation as

*“goal-oriented or... based on substantive rationality, as opposed to the formal organisation of bureaucracy. It [cadre organisation] is founded on commitment to goals of the organisation and commitment to the organisation itself. Legitimacy comes not from the rules, but from the ideology. Merit principles are not important, and recruitment is done on the basis of ideological orientation” (V. Gabrielian, 1999).*

Thus, organisational learning efforts are sensitive not only to the nature of the ethics problem, but also to the social, political and cultural context in which the public organisations operate.

Regarding malicious and marginal types of failure, both of them have a relatively high index of LEM (64% and 63% respectively) as compared to the LEM index produced by symptomatic failure (56%). But again, the percentage indices for information and inquiry variables are much lower than those of change and evaluation variables. For malicious failure, percentage indices of information and inquiry variables are 41% and 35% accordingly, while change and evaluation variables generated 88% and 91% indices respectively. Although this type of failure yielded the highest LEM percentage, one can see from these figures that public agencies still are reluctant to investigate the problem deeply – the inquiry variable has a 35% index. The same picture appears when examining marginal failure: information and inquiry indices are relatively low (34% and 46% respectively), while change and evaluate indicators are comparatively high (88% and 89% respectively).

However, there are characteristics that are similar in these two types of failures (malicious and marginal) and differ from that of symptomatic failure: the punishment strategies are far more widespread in malicious and marginal types of failure than they are in symptomatic failures. Thus, for malicious failure, about 75% of the

respondents chose to “require restitution from the employee”, about 44% found that the employee should be fired, and 18% stated that the agencies should “report the employee to legal authorities.” Furthermore, although 70% of the respondents reported that the problem and its causes should be examined, only 33% found that there should be examination of the ethical aspect of such a problem. The marginal failure produced almost the same responses: about 70% of the respondents think that the employee should be reprimanded, while the options of firing and/or transfer of the employee were chosen by 15% and 14% respectively. Similar to malicious failure, a rather high percentage of the respondents (82%) believe that the problem and its causes should be examined, while only 27% accept that the ethical aspects of the problem should be investigated. Thus, the implications from these indicators are the following: public agencies in Armenia are more inclined to punish a person identified as guilty for the occurrence of the problem, rather than to examine the *ethical* aspects of the failure. This is further evidence that the public agencies sampled are engaged in *satisfying* learning strategies. As Argiris (1982) states, such learning strategies (satisfying) are a by-product of punishment strategies. Furthermore, as mentioned earlier, organisational policies that emphasize identifying and punishing parties responsible for failures can discourage organisational learning efforts, even where such punishment is warranted.

Comparative reluctance to investigate ethical aspects of the problem may indicate a narrow perception of the concept of ethics in the public organisations of Armenia. For example, only 40% of the respondents think that the marginal type of ethics failure is an ethical problem to a *great* extent. 24% of the survey participants found that this type of failure is not an ethics problem at all, while 21% and 14% of the respondents reported that the marginal type of failure is an ethical problem to *some* extent and to *little* extent respectively. The issue of narrow perception of ethics concept was touched upon by Gary Zajac in his article “Beyond Hammurabi: A Public Service Definition of Ethics Failure” (1996). According to him

*Various scholars have noted the absence of a broader conception of ethics failure in empirical research on corruption. Evidence of a narrow definition of ethics failure can be found within public agencies. Zajac (1994) found that nearly 15 percent of respondents to a survey on organisational ethics learning volunteered that marginal failure is an ordinary management problem, with little or no ethical import. Further, among those respondents who acknowledged this as an ethics problem, one-third reported that punishment would be applied by their agencies to those responsible, a classic external approach to ethics failure. Organisational learning in response to such problems was seen as a companion to, rather than a substitute for, punishment strategies.*

In sum, public servants in Armenia lack awareness of the “many faces” of ethics failure. Their perception of what is defined as an ethics problem is rather narrow, so that some of the ethics problems (i.e., the ethics failure described in the third vignette) are viewed as simple managerial drawbacks.

Analysis of the data obtained from public agencies in Armenia did not show any essential differences between responses of participants from the perspective of different departments, position levels, and work experience. Perhaps the most significant insight in this sense is the difference in LEM indices between functional departments (in this case it was the Financial Department) and service delivery departments (in this study the Utility, Agriculture, and Urban Development Departments were surveyed). On the whole, all four percentage indices (for the four variables) from the Financial Department are about 5% less than overall LEM indices. This may not be a significant difference given that the data from the other departments (Utility, Agriculture, Urban Development) have no significant differences with overall LEM indices.

## **Other Factors Affecting Learning Response**

As to the other types of stratification, position level (managerial and line), and work



experience (0-5 years of experience, and 5 or more years of experience), the analysis did not indicate that these might have had an influence on the extent of learning effort committed by the public agencies in Armenia.

The present study also revealed that there are no ethics codes of conduct or other guidelines for ethical behaviour in the public agencies sampled in Armenia. Nor do public agencies use other strategies such as ethics seminars or internal ethics audits for the solution of ethics problems. This may suggest that public servants in taghapetarans may even not know what expectations are in ethical behaviour within a public organisation. This fact also can be considered as some evidence that ethics in the public agencies sampled is perceived on a personal level only since none of the taghapetarans as a public agency approaches this matter as an organisational issue. Otherwise, there would be some form of expression of organisational ethical standards in the form of codes, trainings, etc. This is not to say that employees of the organisations sampled behave unethically because there are no clearly defined codes or guidelines; however, this is an indicator of a personal rather than organisational mode in perception of moral obligations within public agencies.

Furthermore, for the public servants of the organisations sampled in Armenia, the study of ethics seems not to be treated as an important factor for effective and professional performance of public organisations. In this regard, comments from executive heads of taghapetarans interviewed personally may shed some light on the state of affairs concerning ethics in public agencies in Armenia. Eight of 11 executive heads commented that ethics is not so important as to waste time studying it. They further commented that there are more urgent problems such as scarce resources, small budgets, tax collection problems, or drawbacks in law on local self-government, etc., which hinder effective functioning of taghapetarans. So, it is unnecessary and useless to spend time and energy on such "unimportant" issues as ethics. Meanwhile, many students of public administration acknowledge the role of the leader in a public agency as an "ethical anchor" (H. Gortner,

1991), and "institutional embodiment of purpose" (Sleznik, 1957) thus emphasizing the example setting function of a leader who plays a critical role in goal setting, and influences the shaping of value preferences in an agency. Given all this, the overall indifferent attitude toward ethics among public servants may be explained by the attitude that the executive heads of their agencies have towards organisational ethics ignoring its importance in the successful management of public organisations.

## Conclusion

To summarize, the study conducted in a sample of public agencies in Armenia found that public organisations in Armenia commit more than moderate efforts toward learning from ethics failure: the Learning Effort Measure across all three types of failure for all four variables (information, inquiry, change and evaluation) is 61% of the maximum possible learning effort that this study could measure. This index is higher than that of the public health departments in the eastern United States (51%) and is greater than a similar index obtained from the study of ministries sampled in Kuwait (37%), indicating that public agencies in Armenia are more inclined toward learning from ethics failure than public organisations surveyed in the US and Kuwait.

However, specifics of the indicators generated by the Armenian study lies in the relatively high difference between indices produced by information-inquiry and change-evaluate variables: information-inquiry variables yielded much lower results (35% for both variables) than did change-evaluation variables (86% and 88% accordingly). This may show that public agencies in Armenia have an inclination toward making superficial changes; that is, changes that are implemented without thorough investigation of the ethics problem. This is an indicator of an organisational preference for single loop rather than double loop learning, which means that public agencies are engaged in change activities that leave the core values, policies, goals, etc., untouched while making organisational adjustments to the changing environment. The drawback of such learning may be recurrence

of the failure, as the causes of the failure have not been explored profoundly.

The Kuwaiti public agencies displayed a similar tendency of preference toward simple, single loop learning though the contrast between information-inquiry and change-evaluation variable pairs was not as high as it was in the case of Armenian public organisations: 33% and 26% LEM indices were produced by information-inquiry variables respectively, while change-evaluation variables produced indices equal to 49% and 46% respectively. The US public agencies, on the contrary, showed a higher propensity toward inquiry rather than toward change. Thus, in the USA, the highest LEM index (57%) was yielded by the inquiry variable, while the change variable produced a 41% index indicating low organisational effort devoted to change activities. Such differences in the reports of these three countries studied may be explained by differences in traditions, democratic experience and approaches to public administration. A relatively high level of effort committed toward inquiry in the US public agencies may be a result of longer history and evolution of public administration in the US, with a consequently more complex and scientific approach towards public administration. As for Armenia, ten years of independence is a fairly short period to go through evolutionary processes in order to establish traditions and get necessary experience. Rather, public administration in Armenia is suffering from post-communist inertia and lack of democratic as well as scientific traditions applied to public management.

Organisational efforts committed by public agencies in Armenia appeared to be sensitive toward the nature of the ethics problem. In other words, different types of ethics failure generated different learning efforts; more importantly, the complexity of the problem seems to be inversely correlated to the learning effort devoted by the public agencies. Thus, the most complex type of ethics failure, symptomatic failure, produced the least learning effort (56%), while more simple types of ethics problems, malicious and marginal failure, showed a higher commitment to learning (64% and 63%

respectively). Punishment strategies were chosen by the respondents much more often in the marginal and malicious types of ethics failure than in symptomatic failure. A relatively high percent (71-79%) of the respondents opted for punishment along with investigation of the causes of the problem; at the same time, the percentage of the respondents who reported that examination of ethical aspects is also needed was comparatively low (28-33%). Thus, this is perhaps an indicator of the narrow perception of the concept of ethics among public servants in Armenia; that is, there is little belief that problems described in malicious and marginal types of failure refer to ethics issues.

On the whole, the overall attitude of public officials and servants in Armenian local self-government bodies toward ethics in government displays widespread indifference to, ignorance in, and unawareness of the role ethics may play in government agencies. The absence of ethics codes, ethics training seminars and internal ethics audits contributes much to such an attitude toward ethics among public servants and officials. Coupled with the absence of Civil Service Law until recently (at this moment the Law has already been adopted), an ignorant attitude toward the importance of organisational ethics may bring in a great confusion among public servants on the part of their duties, responsibilities and rights. Introduction of ethics codes or ethics training programs would not, of course, correct all the ethical problems in Armenian government; however, ethics in government bodies should be made an expectation.

## Policy Recommendations

Based on the results of this study, several policy recommendations for public organisations in Armenia can be made.

First, public agencies in Armenia must become more aware of the role ethics may play in government organisations. To this end, ethics codes with clear definitions should be introduced in the agencies. Such codes should serve as guidelines for public servants in their day-to-day life, spelling out what is the expected ethical behaviour within the agency.

They also will prevent, rather than punish, unethical conduct.

Second, several ethics training programs should be developed and introduced to public agencies. Educational and training programs should involve public servants at all levels to be most effective. Educational and ethics training programs will enhance an understanding of the nature of ethical dilemmas and problems that may arise in a public agency. These programs should be a required for public servants at all levels since they will serve as promotional ethical practices and will reinforce ethical standards within the agency. Educational and ethics training programs should be developed and introduced in parallel with ethics codes; otherwise, the values and standards outlined in the codes of conduct will have little effect.

Third, public organisations should make sure to commit more attention to inquiry into the causes of the problem before planning and implementing a strategy change. Failure to make a complete investigation may cause recurrence of the problem thus complicating further solution of the issue in question. Generation and implementation of change policies must be based on the results of inquiry so that the change produced will have the expected outcomes.

The introduction of ethics codes, training programs, and more focus on the inquiry into causes of ethics problem will draw the attention of public servants to ethics concepts, deepening their perception of the scope of ethics. In other words, if the employees of the agencies sampled treated marginal failure as an administrative or managerial problem, after the changes proposed above, they would see it as an ethics failure.

Fourth, public organisations should have people responsible for dealing with ethics problem that might arise in the agency. Given the difficult economic and financial situation peculiar to all transition countries, the creation of a new position of Ethics Manager would be considered a costly and unjustified endeavour. However, the functions of the Ethics Manager may be given to another manager, such as the Personnel Manager, or all department heads or other managers may

share these duties. This will assist in a constant information gathering and analysis process, as well as in the development and implementation of change strategies with further monitoring, to cope with ethics problems in an organisation. They also may settle disputes and act in an advisory function in case of occurrence of several ethical dilemmas. Persons responsible for ethics should develop and review rules regarding standards of conduct, facilitate education and training programs providing information and other kinds of assistance, monitor agency ethics programs and review compliance.

Fifth, to deal with ethics problems, public agencies should place more emphasis on organisational learning as a corrective mechanism rather than relying on the personal ethical beliefs of public servants. Agencies should become organisational learning systems, which constantly gather and analyse information about ethics failure with consequent application of obtained results to create and implement change strategies. This necessitates more thorough investigation of the core beliefs and policies of the agency, and increases the ability to find new ways by which organisational integrity and the moral health of the organisation can be enhanced. Further monitoring of implemented changes is required to find out whether failure was corrected completely, and if the monitoring shows that the changes made in the agency did not remedy the ethics problem, further inquiry into the causes of the problem should be made. In sum, this process of organisational learning from ethics failure should bear a constant character, with permanent information gathering and analysis with further application of the results.

Sixth, public organisations should try to build an atmosphere of openness and employee participation in organisational change and reform efforts. This may encourage a more free flow of information, which is important for substantial changes in an agency. The process of information exchange should be extended to exploration and information search from other public organisations, possibly from other countries, in order to find out more efficient ways of dealing with ethics problems.

The implementation of these recommendations will contribute to the establishment of certain procedures bringing public administration closer to an ideal type with impartiality and neutrality. The establishment of Ethics Boards, as well as the creation of an atmosphere of openness and trust, will arouse feelings of being protected against arbitrary decisions among public servants thus advancing overall organisational efforts toward learning.

Also, further studies on ethics on the whole, and on learning response to ethics failure particularly, should be conducted on a different level of government, at the central government level in Armenia, in order to gain broader insights into the state of affairs regarding ethics issues in the higher levels of government in Armenia.

Further research on this topic should be continued to explore organisational ethics learning strategies within a variety of public administration systems. A similar study conducted in several countries of the FSUR (Former Soviet Union Republics) may flesh out similarities and differences in public administration systems that have the same legacy of the Soviet past.

## References

- Argyris, Chris. (1982). *Reasoning, Learning and Action*. San-Francisco: Jossey-Bass. Cited in Gary Zajac and Ali Al-Kazemi. (2000). "Administrative Ethics and Organisational Learning in Kuwait and the United States: An Empirical Approach." *International Journal of Public Administration*. (November): 21-52 and Donal Schon. (1978). *Organisational Learning: A Theory of Action Perspective*. Reading, MA.: Addison-Wesley. Quoted in Noel M. Tichy. (1983). *Managing Strategic Change*. New York: John & Sons.
- Armenian National Assembly. *Law on Local Self-Government*. July 1996.
- Ashforth, Blake E. (1992). "The Perceived Inequity of Systems." *Administration and Society*. (November): 375-408. Cited in Gary Zajac and Louise K. Comfort (1997). "The Spirit of Watchfulness: Public Ethics and Organisational Learning." *Journal of Public Administration Research and Theory*. (October): 541-569.
- Beckhard, Richard. (1975). "Strategies for Large System Change." *Sloan Management Review*. (Winter): 43-55. Cited in Gary Zajac and Louise K. Comfort. (1997). "The Spirit of Watchfulness: Public Ethics and Organisational Learning." *Journal of Public Administration Research and Theory*. (October): 541-569.
- Bennis, Warren G. (1966). *Changing Organisations*. New York: Mc Graw-Hill. Cited in Gary Zajac and Louise K. Comfort. (1997). "The Spirit of Watchfulness: Public Ethics and Organisational Learning." *Journal of Public Administration Research and Theory*. (October): 541-569.
- Benveniste, Guy. (1977). *Bureaucracy*. San Francisco: Boyd & Fraser. Cited in Gary Zajac and Louise K. Comfort. (1997). "The Spirit of Watchfulness: Public Ethics and Organisational Learning." *Journal of Public Administration Research and Theory*. (October): 541-569.
- Bowman, James S. (1992). "Government Ethics: A Survey." In Peter Madsen and Jay M. Shafritz (eds.). *Essentials of Government Ethics*. New York: Meridian.
- Blumenstein, Alfred. (1992). "Foreword." In Peter Madsen and Jay M. Shafritz (eds.). *Essentials of Government Ethics*. New York: Meridian.
- Caiden, Gerald E. (1994). "What Really is Public Maladministration." In Frederick S. Lane (ed.). *Current Issues in Public Administration*. New York: St. Martin's Press and Naomi J. Caiden. (1977). "Administrative Corruption." *Public Administration Review*. 37:3:301-309. Cited in Gary Zajac and Louise K. Comfort. (1997). "The Spirit of Watchfulness: Public Ethics and Organisational Learning." *Journal of Public Administration Research and Theory*. (October): 541-569.
- Cavanagh, Gerald F., and David J. Fritzsche. (1985). "Using Vignettes in Business Ethics Research." *Research in Corporate Social Performance and Policy*. (July): 279-293. Cited in Gary Zajac and Ali Al-Kazemi. (2000). "Administrative Ethics and Organisational

- Learning in Kuwait and the United States: An Empirical Approach." *International Journal of Public Administration*. (November): 21-52
- Constitution of the Republic of Armenia.
- Deming, Edwards W. (1986). *Out of the Crisis*. Cambridge, Mass.: MIT Center for Advanced Engineering Study. Cited in Gary Zajac and Louise K. Comfort. (1997). "The Spirit of Watchfulness: Public Ethics and Organisational Learning." *Journal of Public Administration Research and Theory*. (October): 541-569.
- Gabrielian, Vache. (1999). "Post-Communist Bureaucracies: Organisational Modes of Transition." *International Journal of Public Administration*. (January): 39-69.
- Gortner, Harold F. (1991). *Ethics for Public Managers*. New York; London: Greenwood Press.
- Guy, Mary E. (1991). "Using High Reliability Management to Promote Ethical Decision Making." In James S. Bowman (ed.). *Ethical Frontiers in Public Management*. San Francisco: Jossey-Bass.
- Hood, Christopher. (1974). "Administrative Diseases: Some Types of Dysfunctionality in Administration." *Public Administration*. (Autumn): 439-454. Cited in Caiden, Gerald E. (1994). "What Really is Public Maladministration." In Frederick S. Lane (ed.). *Current Issues in Public Administration*. New York: St. Martin's Press.
- Huddleston, Mark W. (1987). *The Public Administration Workbook*. New York; London: Longman Publishing Group.
- Ishikawa, Kaoru. (1985). *What is Total Quality Control? The Japanese Way*. Englewood Cliffs, N. J.: Prentice-Hall.
- Jos, Philip H. (1990). "Administrative Responsibility Revisited." *Administration and Society*. 22:2:228-248. Cited in Gary Zajac and Louise K. Comfort. (1997). "The Spirit of Watchfulness: Public Ethics and Organisational Learning." *Journal of Public Administration Research and Theory*. (October): 541-569.
- Levitt, Barbara, and James G. March. (1988). "Organisational Learning." *Annual Review of Sociology*. 14: 319-140. Quoted in W. Richard Scott. (1981). *Organisations: Rational, Natural, and Open Systems*. Englewood Cliffs, N.J.: Prentice-Hall.
- Madsen, Peter, and Jay M. Shafritz (eds.). (1992). *Essentials of Government Ethics*. New York: Meridian.
- Ritchie, Bowner J. (1988). "Organisational Ethics: Paradox and Paradigm." In Dale N. Wright (ed.). *Papers on the Ethics of Administration*. Utah, US: Brigham Young University.
- Selznick, Philip. (1957). *Leadership in Administration*. New York: Harper and Row. Cited in Richard H. Hall. (1972). *Organisations: Structures, Processes, and Outcomes*. Englewood Cliffs, N. J.: Prentice-Hall.
- Simon, Herbert A. (1976). *Administrative Behaviour*. New York: Free Press. Cited in Gary Zajac and Louise K. Comfort. (1997). "The Spirit of Watchfulness: Public Ethics and Organisational Learning." *Journal of Public Administration Research and Theory*. (October): 541-569.
- Smircich, Linda. (1985). "Is the Concept of Culture a Paradigm for Understanding of Organisations and Ourselves?" Peter J. Frost, Larry F. Moore, Meryl Reis Louis, Craig C. Lundberg, and Joanne Martin (eds.). Quoted in W. Richard Scott. (1981). *Organisations: Rational, Natural, and Open Systems*. Englewood Cliffs, N. J.: Prentice-Hall.
- Tichy, Noel M. (1983). *Managing Strategic Change*. New York: John & Sons.
- Zajac, Gary. (1996). "Beyond Hammurabi: A Public Service Definition of Ethics Failure." *Journal of Public Administration Research and Theory*. (January): 145-160. and Louise K. Comfort. (1997). "The Spirit of Watchfulness: Public Ethics as Organisational Learning." *Journal of Public Administration Research and Theory*. (October): 541-569 and Ali Al-Kazemi. (2000). "Administrative Ethics and Organisational Learning in Kuwait and the United States: An Empirical Approach." *International Journal of Public Administration*. (November): 21-52.

## Appendix A

### Research Instrument (English version)

#### Ethics vignettes

This section will present you with a set of hypothetical problem vignettes that involve ethics issues. These vignettes were not derived from any specific events that may have occurred in your ministry. Rather, they represent ethics problems that could occur in a public agency such as yours. More broadly, they represent general types of problematic ethics situations which have cropped-up in many public agencies worldwide. These vignettes were designed to apply to a variety of ministries which this study has sampled. Thus, it is important that you think about the *general features* of these vignettes, especially if you feel that none of these specific problems have occurred in your ministry. Finally, please respond to all three vignettes, even if they concern divisions of the ministry other than the one in which you work.

#### First Vignette

Many employees throughout the ministry are aware of the problem of favouritism in evaluation and promotion practices within the ministry. In other words, there is a well-founded impression that promotion within the ministry depends as much upon “who you know” as upon one’s job performance. This is a problem which is perceived as occurring throughout the ministry, at all levels and branches. As a result, employee morale and performance is suffering. Employees are beginning to feel that something must be done about this problem.

##### 1.1 What actions would your ministry take in response to this type of problem? (Please circle as many as apply).

1. Examine the problem and its causes
2. Examine the ethical aspects of such a problem
3. Investigate specific cases of such favouritism
4. Apply discipline where appropriate
5. Other
6. Don’t know

##### 1.2 In response to such a problem, from what parties would your ministry gather information regarding the problem? (Please circle as many as apply).

1. The aggrieved employees
2. Ministry officials named in complaints
3. Other employees who haven’t made complaints
4. Ministry officials not named in any complaint
5. The general public
6. Other public agencies
7. Other
8. Don’t know

##### 1.3 To what extent would your ministry attempt to gauge the seriousness of this type of problem before taking any action? (Please circle only one).

1. Great extent
2. Some extent
3. Little extent
4. Not at all, no such problems acted upon
5. Don’t know

##### 1.4 In response to such a problem, what measures would your ministry take to inquire into the causes of the problem? (Please circle as many as apply).

1. Reflect upon the fundamental values and assumptions which exist within the ministry
2. Evaluate the organisational climate within the ministry
3. Examine the ministry’s goals regarding promotion
4. Examine policies on promotion
5. Examine employee understanding of these policies
6. Examine procedures for creating job classifications
7. Examine criteria for promotion
8. Other
9. No attempt to examine causes of problem
10. Don’t know

**1.5 To what extent does your ministry implement the findings of the inquiry by taking the appropriate actions? (Please circle only one).**

1. Great extent
2. Some extent
3. Little extent
4. Not at all
5. Don't know

**1.6 To what extent does your ministry monitor and evaluate the actions taken in response to the problem? (Please circle only one).**

1. Great extent
2. Some extent
3. Little extent
4. Not at all
5. Don't know

**1.7 To what extent do you think it is possible to change the sort of behaviour and attitudes reflected by this problem? (Please circle only one).**

1. Great extent
2. Some extent
3. Little extent
4. Not at all
5. Don't know

**Second Vignette**

An employee of the ministry has quietly been using ministry resources, including office supplies, copiers, phones, vehicles and health supplies, to operate a small, private business. Over a period of several years, this has resulted in the misuse of several thousand dollars in ministry resources. This information comes to the attention of ministry officials.

**2.1 What actions would your ministry take in response to this type of problem? (Please circle as many as apply).**

1. Examine the problem and its causes
2. Examine the ethical aspects of such a problem
3. Report the employee to legal authorities
4. Fire the employee
5. Require restitution from the employee
6. Transfer the employee
7. Reprimand the employee
8. Other

9. Don't know

**2.2 In response to such a problem, from what parties would your ministry gather information regarding the problem? (Please circle as many as apply).**

1. The employee in question
2. The employee's supervisor
3. Other employees
4. Other public agencies
5. Other
6. No attempt to gather information
7. Don't know

**2.3 To what extent would your ministry attempt to gauge the seriousness of such a problem before taking any action? (Please circle only one).**

1. Great extent
2. Some extent
3. Little extent
4. Not at all, no such problems acted upon
5. Don't know

**2.4 In response to such a problem, what measures would your ministry take to inquire into the causes of the problem? (Please circle as many as apply).**

1. Examine ethics rules and policies on personal use of ministerial materials
2. Examine employee attitudes and knowledge of these rules and policies
3. Examine ethics training given to that employee
4. Overall examination of ethics training procedure
5. Examine detrimental internal financial controls
6. Other
7. No attempt to examine cause of problem
8. Don't know

**2.5 To what extent does your ministry implement the findings of the inquiry by taking the appropriate actions? (Please circle only one).**

1. Great extent
2. Some extent
3. Little extent
4. Not at all
5. Don't know

**2.6 To what extent does your ministry monitor and evaluate the actions taken in response to the problem? (Please circle only one).**

1. Great extent
2. Some extent
3. Little extent
4. Not at all
5. Don't know

**2.7 To what extent do you think that it is possible to derive some useful organisational lessons from investigating this sort of problem? (Please circle only one).**

1. Great extent
2. Some extent
3. Little extent
4. Not at all
5. Don't know

## Third Vignette

A new computer operator within the Bureau of XXXXX in the Ministry of the XXXXX has been making mistakes in data entry, resulting in several fines being charged to the wrong people. Although the victims of these mistakes petitioned the Bureau to correct the mistakes, they had to pay the fines anyway, which compounded financial hardships being experienced by some of them.

**3.1 To what extent do you think this type of problem is an ethics problem? (Please circle only one).**

1. Great extent
2. Some extent
3. Little extent
4. Not at all
5. Don't know

**3.2 What actions would your ministry take in response to this type of problem? (Please circle as many as apply).**

1. Examine the problem and its causes
2. Examine the ethical aspects of the problem
3. Fire the employee
4. Transfer the employee
5. Reprimand the employee
6. Other
7. Don't know

**3.3 In response to such a problem, from what parties would your ministry gather information regarding the problem? (Please circle as many as apply).**

1. The computer operator
2. The operator's supervisor
3. The affected citizens
4. Other citizens not affected by the problem
5. Other computer operators in the ministry
6. Other public agencies
7. Other
8. No information would be gathered
9. Don't know

**3.4 To what extent would your ministry attempt to gauge the seriousness of such a problem before taking any action? (Please circle only one).**

1. Great extent
2. Some extent
3. Little extent
4. Not at all, no such problems acted upon
5. Don't know

**3.5 In response to such a problem, what measures would your ministry take to inquire into the causes of the problem? (Please circle as many as apply).**

1. Examine computer policies or procedures
2. Examine employee attitudes and knowledge of professional ethical obligations
3. Examine training given to that operator
4. Overall examination of operator training
5. Examine policies for response to citizen complaints
6. Other
7. No attempt to examine cause of problem
8. Don't know

**3.6 To what extent does your ministry implement the findings of the inquiry by taking the appropriate actions? (Please circle only one).**

1. Great extent
2. Some extent
3. Little extent
4. Not at all
5. Don't know



**3.7 To what extent does your ministry monitor and evaluate the actions taken in response to the problem? (Please circle only one).**

1. Great extent
2. Some extent
3. Little extent
4. Not at all
5. Don't know

The research instrument was translated into Armenian and adjusted to the specific features of local self-government bodies sampled. Instead of the word “ministry,” the word “taghapetaran” was used. In the third vignette, along with computer operations, bookkeeping was also mentioned since it is still a widespread method of record keeping in taghapetarans. In the beginning of the questionnaire, there was a blank space to fill in position level. Two questions were added to the questionnaire:

**3.8 How long have you worked in the taghapetaran?**

1. 1 – 3 years
2. 3 – 5 years
3. 5 – 7 years
4. 7 or more

**3.9 What is the highest level of education obtained?**

1. Secondary school (middle school)
2. High school
3. College
4. Technical college
5. University

## Appendix B

### List of Sampled Taghapetarans

No	Names of Taghapetarans	Number of public servants interviewed
1.	Davitashen	10
2.	Ajapniak	10
3.	Arabkir	10
4.	Zeitun-Kanaker	10
5.	Shengavit	10
6.	Erebuni	10
7.	Nor-Nork	10
8.	Avan	10
9.	Kentron	7
10.	Malatia-Sebastia	10
11.	Nork-Marash	7

## Appendix C

### Learning Effort Measure for All Variables and Types of Failure: Functional (Financial) Departments vs. Service Delivery (Utility, Agriculture, and General) Departments

#### Functional Departments

Variable \ Type of Failure	Symptomatic Failure	Malicious Failure	Marginal Failure
Information	25	37	32
Inquiry	24	30	35
Change	51	83	83
Evaluation	74	86	83
All Variables	44	59	58

**Total across all three types of failure – 54%**

**Service Delivery Departments**

Type of Failure Variable	Symptomatic Failure	Malicious Failure	Marginal Failure
Information	25	37	32
Inquiry	24	30	35
Change	51	83	83
Evaluation	74	86	83
All Variables	44	59	58

**Total across all three types of failure – 60%**

**Appendix D**

**Learning Effort Measure for All Variables and Types of Failure:  
Managerial Positions vs. Service Delivery Positions**

**Managerial Positions**

Type of Failure Variable	Symptomatic Failure	Malicious Failure	Marginal Failure
Information	25	37	32
Inquiry	24	30	35
Change	51	83	83
Evaluation	74	86	83
All Variables	44	59	58

**Total across all three types of failure – 61%**

**Service Delivery Positions**

Type of Failure Variable	Symptomatic Failure	Malicious Failure	Marginal Failure
Information	25	37	32
Inquiry	24	30	35
Change	51	83	83
Evaluation	74	86	83
All Variables	44	59	58

**Total across all three types of failure – 61%**

## Appendix E

### Learning Effort Measure for All Variables and Types of Failure:

#### “New” Public Servants

Type of Failure Variable	Symptomatic Failure	Malicious Failure	Marginal Failure
Information	25	37	32
Inquiry	24	30	35
Change	51	83	83
Evaluation	74	86	83
All Variables	44	59	58

Total across all three types of failure – 61%

#### “Old” Public Servants

Type of Failure Variable	Symptomatic Failure	Malicious Failure	Marginal Failure
Information	25	37	32
Inquiry	24	30	35
Change	51	83	83
Evaluation	74	86	83
All Variables	44	59	58

Total across all three types of failure – 63%

New Public Servants (Working Experience 1 – 5 years) vs.  
Old Public Servants (Working Experience 5 years or more)

# Corporate Governance Risk in the Slovak Republic

## Empirical Survey on the Quality of Business Environment

Lívia Zemanovičová, Martina Kubánová<sup>1</sup>

### Abstract

Corporate Governance Risk is the risk that investment in a company will be undermined or damaged by actions that exploit weak or inadequate corporate governance mechanisms. Moreover, it is a good proxy for the quality of the business environment. The purpose of this study is to describe the present level of corporate governance risk, using the standardized methodology of Crichton-Miller and Worman, an opinion survey among managers of domestic and international companies present in Slovakia, and to sketch the development of the risk during recent years. An additional objective can be seen in identifying the most relevant issues that affect the risk. From the answers of 118 respondents, who were mainly managers of influential companies in SR, the average risk index is 10 points out of a possible 28. According to the scale, the risk of the country ranges in the upper zone of high risk for investors. The G7 countries rank between 21 and 28 points. However, there are many indications of permanent improvement in the situation. If we were to identify the three most crucial factors that increase corporate governance risk in the Slovak Republic today, they would be enforceability of the law, the low effectiveness of bankruptcies and the high level of corruption.

### Introduction

The globalization of world markets, the increasing amount of international capital flow and the extremely rapidly changing circumstances set new requirements on investment decision-making. Moreover, business relations become more complicated. While there were often only two parties in

early capitalism (creditor-bank vs. debtor-entrepreneur), many intermediaries are present today. The growing number of relationships between an owner who offers capital, and a company that uses it, indeed, increases the risk and mutual dependence of the parties involved. Parties often operate in different legal frameworks and cultural environments, and this involves additional risk and costs for involved parties. Investors consider several risks connected with investing in a foreign environment and create instruments to assess macroeconomic or political risks. This is especially true for emerging markets. Generally, they rely on the macroeconomic indicators of a country, a business sector and characteristics of the selected firm. They frequently complain about the non-existence of an indicator of the forwardness of the entrepreneurial environment. And this is the place where the Corporate Governance Risk Index (CGRI) fills the gap. It enables a structured assessment of the quality of the entrepreneurial environment like the quality of legislation, law enforceability, system of regulation institutions and the common business practices. It has emerged on the basis of recent investment experience in Central and Eastern Europe. The final index is comparable both in time and place. The Corporate Governance Risk (CGR) is the risk that investment in a company will be undermined or damaged by actions that exploit weak or inadequate corporate governance mechanisms. Moreover, it is a good proxy for the quality of the business environment.

The goals of the project were to evaluate the status of the CGR by an opinion survey among managers of domestic and international companies present in Slovakia,

<sup>1</sup> Lívia Zemanovičová, research fellow, Institute for Economic and Social Reforms, Bratislava, Slovakia  
Martina Kubánová, research fellow, Slovak Governance Institute, Bratislava, Slovakia

to compare survey results supplemented by other existing evidence and to identify reasons behind differences in perception of the CGR. The results should shed some light on what accounts for differences in perception of the CGR and why the perceived quality of the business environment differs. The results may be relevant for setting priorities in the course of the corporate governance reforms prior to EU enlargement.

The study is based mainly on the following two sources: the OECD Principles of Corporate Governance<sup>2</sup> and Crichton-Miller and Worman<sup>3</sup> methodology.

The OECD Principles of Corporate Governance is a general document which concentrates on those aspects of corporate governance that are linked to the separation of ownership and management. The Principles are intended to assist governments in their efforts to evaluate and improve the legal, institutional and regulatory framework for corporate governance, and to provide guidance and suggestions for stock exchanges, investors, corporations, and other parties that have a role in the process of developing a good entrepreneurial environment. Good corporate governance increases the confidence of foreign as well as domestic investors, and thus decreases the cost of capital and creates stable financial sources. The principles are addressed to the governments and parliaments that are responsible for creating a legal and regulatory framework, which is able to function well on the market. The OECD suggests five basic principles that should be considered.

1. The corporate governance framework should protect shareholder rights.
2. The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.
3. The corporate governance framework should recognize the rights of stakeholders

as established by law and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound companies.

4. The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.
5. The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

The essay of Crichton-Miller and Worman is based on the OECD Principles but it applies them to emerging markets so that corporate governance risk may become a quantifiable instrument to assess and compare investment alternatives throughout different countries and industries. The authors build on the fact that many investments have not succeeded in emerging markets, although the investors have used, besides microeconomic analyses, standard instruments assessing macroeconomic indicators and political risks. Crichton-Miller and Worman see that one of the reasons for underrating the risks stems from the fact that the entrepreneurial environment and its legal and regulatory framework are still evolving. CGR is thus higher than on the developed markets of G7, which the essay considers as the standard of comparison. The essay defines a set of criteria that enables measurement<sup>4</sup> of the corporate governance risk in such a way that the indicator may be used to determine the expected rate of return of an investment with respect to the aggregate set of risks. The CGRI answers the question as to how much the CGR in a given country or industry is higher than that in the developed economies of G7. Crichton-Miller and Worman define four key dimensions of corporate governance risk.

---

<sup>2</sup> Published in 1999 and downloadable from [www.oecd.com](http://www.oecd.com)

<sup>3</sup> Crichton-Miller, Worman (1999): "Seeking a Structured Approach to Assessing Corporate Governance Risk in Emerging Markets", the winning essay in the Essay Competition in honor of Jacques de Larosiere. The Institute of International Finance

<sup>4</sup> As the authors wrote, they attempted to quantify the qualitative characteristics of the environment, which is debatable from the vantage point of a scientific methodology. The validity of the results thus depends on the experience and skills of the evaluator.

1. Corporate Law – the existence of a set of relationships between the management of a company, its board of directors, and its shareholders is a precondition for future investors.
2. Legal processes – the ability to bring legal action, to settle commercial disputes through arbitration or courts, and to recover debts through legal recourse has to be guaranteed.
3. Regulatory system – to provide an acceptable investment climate, regulators must perform basic functions that need to be well defined through laws and commonly accepted industry practices. Fraud and abuse of rules exist in all markets but are more often widespread and prominent in emerging markets.
4. Ethical Layout <sup>5</sup> – even a formidable legal and commercial infrastructure will be eroded if a cultural tolerance to graft, criminal activity, and unethical behavior in business exists.

As an instrument to assess the risk, the authors used a questionnaire (see Annex) that is divided into four sections of seven questions. Possible responses are yes/no, and each positive answer in the first three sections equals one point. In the section entitled Ethical Layout, there is one point for every negatively answered question. The index may thus reach a maximum of 28 points, and the standard within the G7 countries lies between 21 and 28 points. On the emerging markets, the fact that these standards are not fulfilled and, thus, the entrepreneurial environment is bad, implies an increased risk that has to be taken into account by both financial and strategic investors. This risk significantly affects the given country's attractiveness and, thus, also the inflow of foreign investment. Crichton-Miller and Worman interpret the index of corporate governance risk as follows:

The paper is organized as follows. The first chapter deals with the sample of

**Table 1**  
**The Interpretation of Corporate Governance Risk Index**

Index	Risk
0 – 5	Very high
6 – 10	High
11 – 20	Modest
21 – 28	Low

respondents and the results in general. A detailed assessment of the 28 questions of the questionnaires is present in chapters 2, 3, 4 and 5 corresponding to the four sections of the research. Every chapter follows this structure:

- **Summary of the Results** – a table displays the average number of points assigned to the given aspect and the percentage of positive answers to each question (in the case of ethical overlay, the percentage concerns the negative answers because the questions in this sector are formulated in such a way that a “no” answer evaluates the corporate governance positively). The percentages in brackets correspond to the interviewee sample, which was done in an 8-month period.
- **Questions in Details** – here, the questions are put more precisely in such a way that was used during the interviews, and the respondents' commentaries are presented. This point is further broken down into three points:
  - **Question** – full text of the question as stated in the questionnaire.
  - **Assessment** – besides the number of positive and negative responses <sup>6</sup>, this part also includes our remarks on the formulation of the questions, in particular for methodological reasons, and we recommend considering these remarks when repeating the research or applying it in other countries.
  - **Comments** – here we state the questions more precisely, following the

<sup>5</sup> The first three elements are based on the OECD Principles, while the ethical overlay issue is a new contribution of Crichton-Miller and Worman who, however, built it on the Russian-specific practice. We left this section without “localising” it for the Czech environment in order to keep the comparability of the results.

<sup>6</sup> The overall number of responses need not always be the same, as some respondents did not answer all the questions. The number of all unanswered questions, however, did not exceed 0.1% of all responses and 1% of the responses on the given question.

commentaries from the source documents as were stated during the interviews, and present the comments expressed by the respondents. The commentaries do not attempt to define the actual state objectively; they are presented particularly because they highlight specific and often very real issues. And highlighting the issues that “people talk about” is one of the objectives of this research.

The conclusion resumes the main findings of the research, states the key bottle-necks of the Slovak entrepreneurial environment and gives limitations to the methodology used.

## Chapter 1 The Results in Numbers

We received 105 questionnaires and 13 questionnaires were filled in during the direct interviews. We adjusted the calculation of the CGRI, so that the ratio between anonymous

respondents and interviewees is the same as in the Czech Republic<sup>7</sup>. To adjust our results, we multiplied each answer from the direct interview by a factor of 2.85.

The majority of the respondents are from limited liability companies (51%), the rest joint-stock companies (48%) and others, e.g., NGO's (2%). The structure of respondents by size of the company is as follows: 9% small companies, 57% middle sized companies, and 34% large companies.

The basic result of our survey is as follows: the present CGRI in the Slovak Republic is 10 points. According to the Crichton-Miller and Worman scale, this represents the upper-bound value for the “high risk” category. The whole sample of answers is relatively dispersed from 3 (very high risk) to 26 (low risk). The most frequent result is 6, but it does not correspond to the average value or does not even approach it. The sample of interviewees shows a lower variance of answers, ranging from 5 (very high risk) to 16 (modest risk). The most frequent result 11 is very close to the average value 12, so this sample has signs of a normal distribution of results.

**Table 2**  
**Respondents and Questionnaires**

	SR	% SR	ČR	% ČR	Modifi- cation SR	Modifi- cation % SR
Total number of respondents	118	100	50	100	142	100
- direct interviews	13	11	13	26	37	26
- written questionnaires	105	89	37	74	105	74

**Table 3<sup>8</sup>**  
**Respondents by sectors**

Industrial production	79	69%
Services	12	10%
Retail and wholesale trade	4	4%
Transport	2	2%
Consulting and advisory services	1	1%
Construction	3	3%
Multiple sectors from those mentioned above	9	7%
Others	5	4%
Total	115	100%

<sup>7</sup> The study Corporate Governance Risk in the Slovak Republic is a part of an integrated research study of four Visegrad countries and was elaborated according to the study from the Czech Republic to make the results comparable.

<sup>8</sup> The number of respondents and that of the firms represented by them are not equal since in some cases we obtained two questionnaires from one company and in some cases the respondents did not report their background information.



**Table 4**  
**CGRI (in brackets is result for**  
**interviews only)**

Maximum possible points	28
Average points per questionnaire	10 (12)
Average points in the four sections	
Corporate Law (max. 7 points)	3.3 (3.8)
Legal Processes (max. 7 points)	1.4 (1.6)
Regulatory System (max. 7 points)	3.0 (4.0)
Ethical Overlay (max. 7 points)	1.9 (2.5)
Mean	9.5 (11.9)
Minimum result	3 (5)
Maximum result	26 (16)
The most frequent result	6 (11)

## Chapter 2

### Evaluation of Corporate Law

The purpose of the first group of questions was to characterize a legal framework necessary for the functioning of corporations. The questions focus on the wording of laws and other legal norms. Their enforcement is as yet not questioned. A foreign investor is, from the practical point of view, interested in whether the norms define sanctions for asset stripping or whether the norms ensure them the right to participate in the decision-making process on the authorization of additional shares, selling the company, and other important activities.

The respondents positively answered two out of seven questions. If only interviews are taken into account, the number of positively answered questions increased up to three and the percentages in most questions are higher. Possible reasons might be the time delay of about eight months between questionnaires and interviews as well as the more negative attitude of respondents in the case of anonymous research. In general, interviewees do not consider the legal framework to be the key problem of the Slovak Republic. What is more, in the process of approximation of our legislation to the legislation of the EU (one of the benchmarks of this research), a lot has already been done. Many laws were amended and also the evaluation from the entrepreneurial environment concerning the laws is relatively favorable. In comparison within this research, the Corporate Law is the best section with an average of 3.3 points. The

main problem concerning the corporate law in Slovakia may be the instability of the legal system, where laws are frequently amended which thus creates uncertainty and additional costs for entrepreneurs. The strongest agreement was reached for question 3 about shareholder voting rights. There is no doubt that shareholders can exert their rights without restrictions. The definition of the rights of all parties (Question 2) does not cause problems in general even though the rights of different parties are not defined in the same extent. Creditors are an example of a group with a weak legislative definition. On the other hand, 85 percent of the respondents agreed that the procedures of bankruptcy and insolvency are not defined clearly enough to ensure the orderly settlement of liabilities and independent (of managers) distribution of assets. Bankruptcies have been considered as one of the weakest elements of the Slovak economy for years. Even the recent amendment to the Bankruptcy Act has not changed expectations toward an improvement of the present situation.

#### 2.1 Registration of Claims upon Companies

##### Question

1. Is the registration of stock and other claims upon companies transparent and secure?

##### Assessment

Positive responses:	68	
Negative responses:	72	
Positive responses ratio:	48%	<b>(70%)</b>

**Table 5**

**Summary of the Results of the Corporate Law section (the numbers in brackets are the result of interviews only)**

<b>1.</b>	<b>Corporate Law</b>	<b>3.3 (3.8)</b>
	<b>Question (percentage equates to the ratio of positive responses)</b>	
1	Registration of claims upon companies	48% (70%)
2	The rights of all the parties	58% (77%)
3	Shareholder voting rights	83% (92%)
4	The disclosure of a disproportionate degree of control	39% (38%)
5	The quality of contracts	42% (46%)
6	Bankruptcies	13% (15%)
7	Material interests of the board members	42% (38%)

The respondents usually take into account not only the first part of the question which deals with stock, but also consider the other claims linked mostly with creditor - debtor relations.

#### **Comments**

According to the OECD Principles, the secure registration of stock is one of the basic rights of a shareholder. Furthermore, all investor rights to information concerning voting rights connected with shares and possible changes thereof concerns this question as well. The registration of shares is now in the competence of the Securities Center, a state-owned joint stock company that will be replaced by a central depository. This licensed subject would be entitled to create a clearing center. More problematic are the rights of minority shareholders and non-transparent transfers performed by the state. The situation will hopefully improve with the amendment of the Securities and Investment Services Act 483/2001. It shall make the institutional operation of the capital market more efficient, in particular concerning the securities records, and the clearing and settlement systems of securities transactions. It enacts the establishment of a cumulative account at the central depository.

The main problem in this question was seen in the registration of other claims resulting mostly from creditor-debtor relations. The majority of our respondents do not consider them to be transparently registered. The register of collateral is being prepared by the Ministry of Justice in

collaboration with the Chamber of Notaries. As we can see in the result from the interview sample, the situation has steadily improve during recent months, mainly because of the amendment of the Commercial Code and the new Securities and Investment Services Act.

## **2.2 Rights of the Parties**

### **Question**

2. Does the system of corporate law provide a clear definition of the rights of shareholders, trade creditors, employees, management, and different classes of lenders?

### **Assessment**

Positive responses: 83  
 Negative responses: 60  
 Positive responses ratio: **58% (77%)**

There is no doubt that the rights and duties are defined, but for some groups like creditors, minority shareholders and management these definitions are not as precise as for the other parties.

### **Comments**

The legal definitions achieve the level comparable to developed markets, except for the position of creditors and partially also the protection of minority shareholders, which has been improved by the recent Commercial Code amendment. The creditor position is the weakest point even after the changes in the bankruptcy legislation (see Question 6). Even the recent Commercial Code amendment was rather focused on shareholder rights. The least regulated group is management. The law provides freedom in their action. In the case

of state companies, this leads to problems that managers cannot be sanctioned for improper management and for stripping assets. The Commercial Code defines duties only for the Board of Directors. It seems that enforcement of these rights causes more problems. Section 2 focuses on this issue.

### 2.3 Asserting Shareholder Rights

#### Question

3. Do shareholder rights include unrestricted opportunities to vote in general shareholder meetings, elect members of the board, and approve extraordinary ownership changes or adjustments (e.g., share issues, granting of minority stakes, mergers, or sale)?

#### Assessment

Positive responses:	117	
Negative responses:	25	
Positive responses ratio:	83%	(92%)

#### Comments

The OECD Principles emphasize the balance between two contradictory principles - an active participation of all (including small) shareholders in the decision-making of the company on the one hand, while limiting possible obstructions stemming from endless questions and debates during general meetings on the other. Therefore, it is necessary to cope with the communication between shareholders and to create rules that will function at the general meetings that would balance both of these principles. This question is the most positively perceived one among all, and there were no comments, remarks or restrictions on the part of our interviewees. So, it seems that shareholder rights are well defined and also, according to the OECD principles, the legal definition contains all the important points.

### 2.4 Open Disclosure of Disproportionate Degree of Control

#### Question

4. Are structures which enable certain stakeholders to obtain a disproportionate degree of control relative to their stake openly disclosed?

#### Assessment

Positive responses:	55	
Negative responses:	85	
Positive responses ratio:	39%	(38%)

#### Comments

The OECD Principles build the recommendations on the thesis that pyramid structures and cross-ownership structures may be used to limit the possibilities of minority shareholders and that voting in consensus and other agreements between shareholders to pursue common objectives together would affect corporate governance and change the voting shares. Hence, it would be suitable if all such agreements were openly disclosed.

Cross-ownership and personal interconnections are common in the Slovak Republic and the obligatory disclosures of any action in consensus are not kept. According to our respondents, indications are available to big players on the market that allow them to detect such structures. Yet, a common entrepreneur does not have a chance to discover this. One positive example of cancellation of the validity of the General Assembly decision where some groups were dealing in consent is Investičná a Rozvojová banka (Investment and Development Bank).

A higher level of cross-ownership is a result of development after privatization. Some groups were interested in creating unclear ownership structures within companies in order to exceed the legal ownership limits (investment funds) or to hide practices on the edge of legality (tunneling, transferring debts to “dead” companies, etc.).

A specific characteristic of these structures is the involvement and role of the State (National Property Fund, Consolidation Bank and other institutions) and the privatization of state-owned companies. Because of legal restrictions it was/is not possible to sell more than 49% of shares of the strategic companies; therefore, the Slovak government offered these shares to investors along with managerial contracts including managerial rights. In the companies privatized through vouchers, a significant amount of shares are dispersed to such an extent that an owner with relatively few shares can control a company. Therefore, the control does not reflect the ownership share but it stems from the fact that transaction costs of the minority shareholders voting are very high. On the

other hand, there are some groups specialized in benefiting from the dispersion of the owners like Penta group<sup>9</sup>. To sum up, the disproportionate degree of control exist both in Slovakia as in the developed economies, but there is some difference in the degree of transparency of their disclosure.

## 2.5 Quality of Contracts

### Question

5. In contracting with companies in this country, does a contract (be it as a lender, other creditor, minority investor, joint venture partner, etc.) confer a set of rights which “one would reasonably expect to be conferred if the transaction took place in a G7 country”, and if not, are departures from reasonable expectations notified in clear documentation?

### Assessment

Positive responses:	58	
Negative responses:	81	
Positive responses ratio:	42%	(46%)

### Comments

This question should report on the quality of contracting defined by law and also on gentlemen’s agreements. For the first part, we shall add that, up to now, it has not been proven which system is better – either to have all the contracts defined by law (the continental system) or to provide space for individual agreement among partners (the Anglo-Saxon system). Therefore, the authors do not agree that a “yes” answer in this question really means lower risk for the country surveyed.

Our respondents do not provide a clear answer to this question. One part of the respondents thinks that in Slovakia it is better to have very detailed contracts and not to rely on common business practice. Therefore, because of lacking trust, we cover more relations in agreements than G7 countries do. Other respondents on the other hand hold an opinion that in G7-countries there are a larger number of relations covered by the contracts and this is because of more freedom in the legislation. Only the main things are enacted in the law. In Slovakia, the managers mostly understand that law enforcement is based on

relationships other than legislative and contractual. They do not have the feeling that they have to incorporate everything in the contract because if the other party breaks it, legal redress is difficult and slow to enforce. People rely rather on other forms to enforce their interests: payments in advance, etc. Contracts in G7 countries are more detailed, as they try to solve ex ante all the possible situations that can happen. It is not possible in Slovakia, because of the constantly changing legislation. Sometimes, the low level of legal experience of managers may have caused imperfect contracts. Today’s situation has improved if compared to 2 or 3 years ago when many contracts were concluded knowing that they would not be kept. These tendencies have gradually been diminishing because the numbers of those involved and long-term relations between them in the respective industries have stabilized, and confidence and the space for gentlemen’s agreements grows as the parties get to know each other.

## 2.6 Bankruptcies

### Question

6. Are bankruptcies and insolvencies managed through a clearly defined set of processes or procedures for the orderly distribution of liabilities, which involves the independent (of management) distribution of assets?

### Assessment

Positive responses:	19	
Negative responses:	120	
Positive responses ratio:	13%	(15%)

### Comments

The opportunity to exit the market is one of the most appreciated criteria of the efficiency of any given market. It is necessary to admit that it is very difficult to seize bankruptcies and insolvencies. Even G7 countries have problems doing it correctly. Another problem is the enforceability of such legislation, political will to pursue it and the general culture of entrepreneurship. A brilliant example of this is the case of the German construction giant Philip Holzman being saved by the State although it should have gone into bankruptcy.

<sup>9</sup> The financial company is focused on using legal gaps for their personal profit but within the legal boundaries.

On the other side of the ocean, bankruptcies are a common phenomenon. The recent bankruptcy of Enron illustrates the rapidity and effectiveness of the Anglo-Saxon way of bankruptcy.

Bankruptcies are definitely assessed as one of the weakest parts of the Slovak entrepreneurial environment. They were practically not applied for some period and it was in paradox caused by the valid legal norm. In consequence of the non-existence of effective bankruptcy and settlement, many companies were present at the market that would not have been able to survive in a competitive environment. The situation has been changing slowly during recent years. A survey conducted by INEKO<sup>10</sup> showed that as many as 38% of companies believe that the new Act brought nothing new as courts continue to work inefficiently; 22% of the companies do not utilize more efficient forms of collection of receivables such as payment orders and distrains. The Act is considered as an efficient tool for preventive improvement of the conditions of business relationships by 29% of companies. As much as 21% appreciate that various types of creditors have been made equal, and 14% of companies appreciate the opportunity to enforce their receivables as soon as within 30 days of the due date. There were many proposals on bankruptcies, but not many of them were solved until today. The Act on bankruptcy has some holes, e.g., if the creditor decides to remove the bankrupt estate's administrator and proposes another one, the judge is not obliged to confirm the next nominee. Open and unfinished processes are subject to the new rules, but the judges are afraid of using them because of the intervention of the Supreme Court. Another problem is corruption and manipulation of the executions. The position of judges is too strong, and that of creditors too weak.

## 2.7 Interests of Board Members

### Question

- Are members of a company's board required to disclose any material interest

in transactions or matters affecting the company?

### Assessment

Positive responses:	58	
Negative responses:	81	
Positive responses ratio:	42%	(38%)

### Comments

This stems from the above-mentioned ban that the members of a company's Board of Directors are not allowed to pursue their own interests at the expense of the company but they are not explicitly committed to disclose their private interests in relation to the company's activities. If owners require this, these requirements must be set in the company's Statutes or employment contracts. Absence of these statements in the law harms minority shareholders because they, as opposed to the majority owners, cannot exert enough influence on the Board.

The information duties in Slovakia, as well as in developed countries, are not sufficiently defined. There is no obligation, for example, to take these material interests into account in the annual report.

## Chapter 3

### Legal Processes Assessment

Of all the four surveyed areas of the CGR, the assessment of legal processes appears to be the weakest one. The aim of this chapter was to inquire into the efficiency of legal systems and to show whether it provides sufficient redress for investors, creditors or other parties involved that suffer harm. Potential inefficiencies have a vast impact on the shareholders position because it means that they cannot protect themselves effectively and fast enough against tunneling or the unfavorable use of earned profit either by the majority owner or the management. The situation is even worse for the enforcement of the rights of creditors. Furthermore, the question of effective law enforcement arises in this section as well as the possibility of the illicit influencing of judges.

Not a single question out of the seven was answered positively by the majority of the respondents. Most of the positive answers

<sup>10</sup> Marcinčin, A., Zemanovičová, L. (2001) : Slovakia: Improving Corporate Governance, INEKO, Bratislava

**Table 6**

**Summary of the results of the Legal Processes section (in brackets is result for interviews only)**

2.	Legal Processes	1.4 (1.6)
	Question (percentage means the positive responses ratio)	
8	Access to legal redress	21% (30%)
9	Speed of legal redress	1% (0%)
10	Cost efficiency of legal redress	8% (8%)
11	Arbitration	7% (0%)
12	Influence on court decisions	39% (50%)
13	Law enforcement	17% (31%)
14	Avoiding the verdict	44% (42%)

(44%) agreed that avoiding the verdict is complicated once the court pronounces it. 39% of respondents are persuaded that the decisions of the courts are not influenced by any of the parties in question. On the other hand, most of the respondents were in a consensus in their negative perception of a whole range of problems. Complete unanimity (99%) was shown in assessing the slowness of legal processes, which allows the debtors the comfortable transfer of propriety into another legal entity. A strong majority (93%) agreed that even if arbitration has several positive effects on rapidity and acceptability of conflict solution, its use in Slovakia is marginal. According to common opinion, the losing party would not accept the decision and meet the demands placed upon them by the commercial arbitration institution. They fear that such a decision would be either ignored or an appeal to the courts would be made anyway. Only 8% of the respondents perceive law enforcement to be cost efficient and slightly more than 20% believe in its accessibility at all. This negative perception of law enforceability is also proven by the Survey of economic elite opinion on actual questions of the Slovak economy development<sup>11</sup>. The legal framework of entrepreneurship, mainly law enforceability, clarity of the law, quality of changes in the law, real solution of bankruptcies and settlements, creditor – debtor relations and effectiveness of the executions are perceived negatively by more than 30% respondents.

Moreover, this all has a deteriorating trend. The respondents also recognized positive trends like the improvement of the protection of foreign investors. On the other hand, the protection of domestic investors should be on the same level. The Swiss-Slovak project court management has shown a spark of hope for our jurisdiction. It has accelerated the delays of court procedures and engaged only judges in decision making while assistants did the administration. Moreover, the Slovak entrepreneurial environment is improving because of external reasons (approximation of the legislation with the EU) as well as internal reasons (an increasing number of foreign companies who implement their entrepreneurial culture and habits and consolidation of domestic entrepreneurs with concentration on long-term activities and credibility towards all the partners). Furthermore, companies have found some tools to cope with the imperfect environment. New partners have to, for example, pay in advance or in cash.

### **3.1 Access, cost efficiency and the speed of legal redress**

Questions 8, 9 and 10 are linked to such a high degree that we will comment on them together

#### **Question**

8. Is access to redress through legal processes reasonably practicable for most business parties?

<sup>11</sup> "Survey of economic elite opinion on actual questions of the Slovak economy development". Institute for Public Affairs, Bratislava 2001

9. Is redress through legal processes reasonably speedy?  
 10. Is access to legal redress reasonably cost effective?

**Assessment**

Question

8            9            10

Positive responses:

30            2            12

Negative responses:

112           140           130

Positive responses ratio:

21% (31%)    1% (0%)    8% (8%)

**Comments**

Our interviewees do not have any negative experiences with enforcement of their rights; they already try to ensure them at the early stage of contracting or in the early stages of the legal process (executions, distraints). But it is commonly stated that legal redress is in fact not always accessible mainly to some groups like minority shareholders and creditors. At the same time, there are some groups with 100% enforceability (Penta group) of their rights. And it is often possible to corrupt the executor or the administrator of the bankrupt estate. The strongest agreement was reached in question 9 about the slowness of the legal processes. There are many cases not solved for years even. When one compares the costs and potential benefits of the whole case, it is often simply not worth the trouble, especially for small and medium sized companies. If it is clear that the company will not be paid for delivered goods or services, then it is better to destroy invoices and at least avoid taxation from such fictive earnings. Many smaller firms don't even try to obtain settlement. The most expensive way of redress is that of the courts; therefore, out-of-court settlements are more frequent. For larger companies, the costs of legal processes are not high, but the main cost represents time and the risk of asset transfer to another legal entity. Revenues from court decisions concerning minor issues rarely exceed costs.

The situation is improving very rapidly. The progress from the situation 2 years ago is enormous. It may be due to the changes in the mentality and Slovak entrepreneurial environment as a whole and the improvement

of the repressive tools. The positive example can be the Swiss-Slovak project court management in one district court in Banská Bystrica, which has accelerated the delays of court procedures and engaged only judges in decision making while assistants did the administration.

**3.2 Arbitration**

**Question**

11. Is there a strong tradition of effective commercial arbitration?

**Assessment**

Positive responses:            11

Negative responses:           131

Positive responses ratio:    8%            (0%)

In the context of Czech-Slovak history, this question is somewhat misleading. Commercial courts prior to year 1989 had a form of arbitration in the consumer-supplier relationship. Next to that, a strong tradition of effective arbitration existed during the "First Republic" (years 1918 – 1938). Traditions of this kind are not the subject of the question so the word tradition should have been left out.

**Comments**

The institution of arbitration is only emerging in the Slovak economy under the auspices of the Slovak Commercial and Industry Chamber, but only to a marginal extent. The core principle of arbitration lies in the fact that both parties respect and fulfill the requirements of the arbiter. The main advantages of the arbitration consist in a more flexible and speedier process of decision-making, cost savings, specialization of arbiters and a more private character of the process. In the Slovak situation, where the decisions of the court are often too slow and corrupt, this could be the ideal perspective, but it is very questionable how it would function. The cabinet of Prime Minister M. Dzurinda recently approved the Act on Arbitration. The former legal norm was not functioning, too restrictive and rarely used. The main problems were cited as the narrow extent of affairs submitted to the arbitration, the rigidity of choice of arbitration structures and non-standardized rules. The new norm enlarges the extent of affairs, provides liberalization of arbitration so that the

domestic as well as the foreign subjects can more frequently use it and it specifies mechanisms to enforce the decisions. The Act has not been approved by Parliament yet. On the other hand, international arbitration is used (the case of ČSOB versus the State).

### 3.3 Influence on court decisions

#### Question

12. Are court decisions largely uninfluenced by commercial, political, or improper considerations?

#### Assessment

Positive responses: 54  
Negative responses: 85  
Positive responses ratio: 39% (50%)

#### Comments

There are many elements to take into account. First of all, it is necessary to distinguish between big and well-known processes, which are mainly distorted by political impacts, and smaller ones. The majority of these big cases are influenced by commercial considerations and at the same time there is also an interconnection between politics and economy. The biggest cases are solved differently from smaller ones, which are mostly not influenced by any improper interests. In general, there is a mainly business influence on the court decisions and this is linked to the volume of money involved. Secondly, the biased result of a process is sometimes not due to any influence but judges still lack experience and the willingness to solve difficult commercial matters. In practice, they prefer adhering to the letter of the law and formalities rather than seeking to find the core of the whole matter and its solutions. The number of unfinished processes is on the increase and judges are being forced to deal with more and more cases simultaneously, which logically affects the quality of decision-making. Finally, some respondents consider judges as a profession clan, strong since the communist era, which is hard to punish and quasi impossible to reform by their own inner forces. The corruption in jurisdiction is often present at "lucrative affairs" like nomination

of the administrator of a bankrupt estate and arranging fees for speeding up or prolonging the lawsuit processes and bidding processes.

### 3.4 Law enforcement and avoiding the verdict

#### Questions

13. Does an effective system for ensuring respect and enforcement of legal decisions operate within the country?

14. Is it difficult to evade the consequences of legal judgements against business entities?

#### Assessment

Positive responses: 24 61  
Negative responses: 117 79  
Positive responses ratio: 17% (31%) 44% (42%)

#### Comments

The respondents consider that relatively effective tools in ensuring and enforcement of legal definitions are executions and distraints. For the executors, it is business on their own so they are motivated to achieve a good result. On the other hand, there still is a risk of corruption. Some companies used the services of agencies specializing in debt recovery. Almost half of the respondents think that after the final verdict, it is complicated to avoid bearing the consequences of the verdict. If there is a final decision of the court, then it is enforced. The problem is to arrive at this decision. It is easier to evade in the former stages of the legal process, to make obstacles, prolong the legal process, etc.

## Chapter 4 Regulatory System Assessment

As Crichton-Miller and Worman<sup>12</sup> mention, in order to have an acceptable investment climate, it is essential that regulators perform their main functions that need to be well defined through the laws and commonly accepted industry practices. Since we do not distinguish in detail between the legal definitions and its application by the regulator

<sup>12</sup> Crichton-Miller, Worman (1999): "Seeking a Structured Approach to Assessing Corporate Governance Risk in Emerging Markets," winning essay in an Essay Competition in honor of Jacques de Larosiere. The Institute of International Finance



**Table 7**  
**Summary of the Results of the Regulatory System section (in brackets the results for interviews only)**

3.	Regulatory System	3.0	(4.0)
	<b>Question (percentage means the positive responses ratio)</b>		
15	The regulator of capital markets	42 %	(78%)
16	Central Bank	71 %	(85 %)
17	Financial watchdogs	40 %	(77 %)
18	Insider trading	52 %	(31 %)
19	Fair competition regulation	44 %	(62 %)
20	Company records	15 %	(25 %)
21	Audit	31%	(42%)

in practice, the crucial point in each question is the perceived credibility of the regulator. A credible regulatory system in a given country shall be secured by regulators (be it the central bank, antitrust office, or capital market regulator) actively pre-empting possible out-of-law or economically dangerous activities and punishing such steps to the extent their competence allows them to. The regulatory system is closely linked to the issue of transparency and up-to-date information on business, as well as protection of business secrets. Questions on insider trading practices, reliability of company records and financial audits cover these issues.

Of the 4 parts of the questionnaire, regulatory system ranks second, with 3 out of maximum 7 points. Seven questions in this section investigate either the perceived credibility of different types of regulators, or general conditions or outcomes of the regulatory system (insider trading, company records or international audit standards). The most positively perceived regulatory institution is the central bank (71% positive answers). A narrow majority considers insider trading illegal or unethical (52%). Three questions were perceived slightly below average: regulator of capital markets, financial watchdogs and fair competition regulation (all between 40-45%). Worst results stem from low dissemination of international audit standards (31%), by now typical only for large or foreign firms, and from the weak quality of the company records (15%). The latter result is caused by not up-to-date or sometimes inaccurate company records (See the case study on Company Registers for

more details) that can promote an environment suitable for fraud. If only the results from interviews are taken into account, this section would receive a higher rating (4.0) and most of the questions would get a higher score, with the exception of question 18.

#### 4.1 The Regulator of Capital Markets

##### Question

15. Does the stock market regulator (in the case of the Slovak Republic the Financial Markets Commission) show evidence of consistent and impartial action?

##### Assessment

Positive responses: 53  
 Negative responses: 72  
 Positive responses ratio: 42 % (78%)

##### Comments

The newly established Financial Market Commission (FMC) has a very short track record since January 2001. In their answers, questionnaire respondents (late 2000) therefore referred to the decade when the Ministry of Finance (MF) itself played this role and received a very bad reputation. As noted by several interviewed persons, "instead of regulating, the MF has in fact killed the market." Interviewees (late 2001/early 2002) also could have expressed their perception of the FMC. Although establishing the FMC has certainly been a good decision, respondents feel that its real independence from the MF must be proven in practice and unless FMC is able to attract and employ the elite within the market, which it has not done yet, it is not supposed to achieve good results anyway.

## 4.2 Central Bank

### Question

16. Is the Central Bank, in its role as regulator of the banking sector, politically independent in its actions?

### Assessment

Positive answers:	98
Negative answers:	40
The percentage of positive answers:	<b>71 % (85%)</b>

### Comments

This question received the highest ranking in the section. As confirmed during the interviews, perception of the Slovak central bank has been twofold: conduct of the monetary policy in general has been considered reliable and professional, backed up by relatively sound results in terms of inflation and the exchange rate. On the other hand, bank supervision has been rather negatively evaluated mainly because of the recent case of Devin bank. The situation in this area is expected to improve substantially, however, after personnel changes in the central bank and the privatization of state banks. Results are therefore affected by the weight each respondent assigned to these two factors. The interviews were conducted after scandalous bankruptcy of the Devin bank, indicating political ties of central bank supervision in this case. Devin bank is the 4<sup>th</sup> bank that went bankrupt in the last decade in Slovakia. This number is relatively low (as compared to, for example, the Czech Republic) mainly due to a conservative bank license provision by the Slovak central bank. The Central Bank in Slovakia presents a relatively successful story of a regulator in a transition country. As expressed by one of our interviewees “since the very beginning, the central bank relied on international standards and rules, but could not have applied them strictly. Otherwise, it could have closed down most of the banks in the early 90’s. Nowadays, all these rules can be fully applied.”

## 4.3 Financial Watchdogs

### Question

17. Do there exist effective independent financial watchdogs possessing their own investigative powers and resources? (In the Slovakian case, e.g., financial police, tax offices, Supreme Audit Office)

### Assessment

Positive responses:	55
Negative responses:	82
Positive responses ratio:	<b>40% (77%)</b>

### Comments

Our respondents have questioned the efficiency and activity of most institutions – financial watchdogs. Although some institutions, e.g., financial police, are considered to be professional and to have enough competence, sometimes there is a discrepancy between them and the courts. Courts are perceived as the weakest part of the system. Recently, the MF introduced a new body in this field – the tax police. As the survey carried out by INEKO<sup>13</sup> reveals, the economic elite in Slovakia considers that this body creates a new duplicity with the already existent financial police. On the other hand, the Government expects more efficacy and success in the battle with economic criminality.

In the area of public finance (we are referring mainly to the state owned companies), most respondents referred to the Supreme Audit Office (SAO) and its activity, which has been criticized due to unsuccessful sanctions enforcement. SAO is accountable to the Parliament and in transition countries this constitutes a weak pressure. Another issue in this area is the real independence of these institutions. Once their budget can be influenced by either Parliament or government (via MF regulation of the state budget during the year) or their head can easily be removed, it is hard to expect independent and active functioning.

<sup>13</sup> Vašák, J.-Zachar, D.: “Survey HESO Q4 2001”, Institute for Economic and Social Reforms (INEKO), Bratislava. <http://www.ineko.sk>

#### 4.4 Insider Trading

##### Question

18. Is insider trading illegal or considered unethical?

##### Assessment

Positive responses: 71  
 Negative responses: 66  
 Positive responses ratio: **52%** (31%)

As mentioned in the Czech CGR report, in formulating the question the authors assumed that if something is considered illegal it is also considered unethical. Because such assumptions do not always hold, the answer to this question could be obscure. This is exactly what the Czech and also Slovak respondents felt. If the question inquired about the legality of insider trading, then the answer would clearly be positive. The misuse of confidential information is still taking place quite frequently and is considered to be evidence of special talent more than a case of an ethical lapse. So the final answer is negative.

##### Comments

Insider trading is illegal in Slovakia (see the Act on Securities and Investment Services and Commercial Code for details on abuse of information and business secrets). Yet, in practice it is considered to be a common and attractive business. Insider information is used for personal profit, but in our country it is in general still not perceived as a big problem as compared to say the USA. When considering possibilities for turnaround of this situation, we cannot rely on the equity market to bring about positive changes. Big players who could have brought this culture to the market are not active in the Slovak equity market. Mainly little players who don't have such a good culture are present (so called "investment boutiques").

#### 4.5 Fair Competition Regulation

##### Question

19. Are there regulatory bodies concerned with monitoring competition and improper commercial behavior that possess formidable powers of investigation and sanction? (In the Slovakian case, this is the Antimonopoly Office)

##### Assessment

Positive responses: 59  
 Negative responses: 76  
 Positive responses ratio: 44 % **(62%)**

##### Comments

Almost all our respondents recognized there is an institution – the Antimonopoly Office – possessing the power of investigation and sanction. But, the active or passive nature of the Antimonopoly Office has been criticized from several points of view: low independence, improper reactions in several cases, inefficient use of their competence and low sanction tools, just to mention the most frequent comments. The independence of the Antimonopoly Office has not been defined well in the past; this was improved with the recent amendment of the Act on Economic Competition<sup>14</sup> in 2001. But it shall take some time till the result occurs in practice as well. The Office possesses enough competence, but its sanctions are still low (if it levies a monopoly with a few million SKK sanction, it is a negligible sum) and also the regulator is often passive in its actions. There are cases of a bad or no (which may be sometimes equally bad) reaction on the part of the Antimonopoly Office. Our respondents mentioned the case of Internet providers vs. Slovak Telecom, the recent Slovak Telecom price increases, the UPC (cable TV provider) case, the Slovnaft oil-refinery merger with the gasoline company or the provision of state aid. The result is that there is not enough trust in the activity of this institution.

#### 4.6 Company Records

##### Question

20. Are company records maintained which are thorough, dependable, and up to date, with sanctions and safeguards against either the submission of inaccurate or untimely information or of tampering with those records?

(Disclosure quality should include an assessment of the quality of disclosure of financial and operating results, subsidiaries, shareholders and voting rights, members of the board and their remuneration, and issues such as contingent liabilities and risks.)

<sup>14</sup> Act on Economic Competition 240/1998 Coll. in the wording of amendment 121/2000. Available at <http://www.zbierka.sk>

## Assessment

Positive responses:	21	
Negative responses:	113	
Positive responses ratio:	15%	(25%)

## Comments

Transaction costs when doing business are highly affected by the level of access to timely and accurate information on companies. Most of our interviewees focused on the Company Register. Only a few considered the disclosure rules of the stock exchange. The Company Register in Slovakia suffers from slow operation and, before the recent amendment of the Commercial Code, also from imprecise legislative enactment. The amendment in force since January 1, 2002 solved many of the previous legal problems and increased the transparency of the process. Still, there is a lot of fraud based on inaccurate and information that is not current in the Register. As one of our respondents points out “we are still more informed about foreign companies than we are about Slovak companies.” The sluggish operation of the Register has been heavily criticized by all the respondents. At the same time, it is obvious that certain operations can be done within 24 hours, not in a couple of months (visible in the case of several companies who use a formal person to bankrupt the indebted company and who have built a prosperous business on their fast activity). According to the World Bank – USAID survey <sup>15</sup>, the Company Register is a place where firms often encounter corruption. Among the firms that interacted with the Company Register in Slovakia, 15% reported that they had paid some bribe, and less than 40% gave a favorable quality assessment. The year when registering companies were most likely to pay bribes was 1994. The Internet based Company Register only provides informative extracts and is updated every two weeks, not in the real time. Yet it is perceived as a benefit for companies with even more potential after it is improved in speed.

## 4.7 Audit

### Question

21. Are international standards of auditing adhered to as a matter of routine?

### Assessment

Positive responses:	43	
Negative responses:	96	
Positive responses ratio:	31%	(42%)

### Comments

International auditing standards are already a matter of routine in large and in foreign joint-stock companies. When talking about the market as a whole, the situation is reversed. As to the information value the audit reports provide for the business, full trust cannot sometimes even be given to the big 5 auditing companies. According to anecdotal evidence, they have given distorted audit results to some banks in trouble. For the smaller auditing companies, there is a risk of biased audit reports they produce for their major clients. The practice of “buying” audit results also exists. To present the latest development in this area, Slovakia has become involved in the international project “Strengthening of the National Accounting and Reporting System” organized under the auspices of UNCTAD and IFAD, and has been participating in the work of the International Accounting Standards Committee. A commission was established to develop, during the first half-year of 2001, an analysis of differences between Slovak and international accounting standards. Based on such an analysis, an amendment to the Act on Accounting and to Act on Auditors and the Slovak Chamber of Auditors <sup>16</sup> will be drafted in 2002. With an expected effective date January 1, 2003, harmonization of the legal standards of Slovakia in the field of accounting with EU directives as well as international accounting standards will thus be provided for.

<sup>15</sup> World Bank - USAID (2000): Corruption in Slovakia. Results of Diagnostic Surveys. Available at <http://www.government.gov.sk>

<sup>16</sup> Act on Accounting 563/1991 Coll. in wording of 336/1999 and 387/2001 and Act on Auditors and the Slovak Chamber of Auditors 73/1992 Coll. in wording of 228/2000 and 152/2001. Available at <http://www.zbierka.sk>

## Chapter 5 Assessment of Ethical Overlay

The legal and regulatory system, even if it be perfectly designed, applied and enforced, can be disrupted when in touch with a culture tolerating criminal activity, corruption, trespassing law and unethical behavior of economic agents.

The section “Ethical Overlay” is the second worst section in the Slovak part of the research with only 1.9 points out of a maximum of 7. None of the seven questions is perceived positive; the only one close to the average value is the perception of the role of criminal groups in the economy. Most negatively perceived is the failure to combat the organized criminal activity (12%), “wide perception of government officers” to expect bribes (14%) and the corruption rating by Transparency International (15%). If we consider single results from interviews, we can see they are sometimes more critical (questions 22 and 24) than the whole sample, but usually more optimistic. The interviewees do not think that extra fees for services occur in Slovakia more frequently than in G7 countries (77% positive perception) and also think that the role of criminal groups in substantial industry sectors is not significant (62% positive perception ratio). Slovakia ranked 51 – 54<sup>th</sup> in the recent 2001 ranking of Transparency International<sup>17</sup> with a CPI 2001 index of 3.7 (upper and lower bounds are

2.1 – 4.9). In 2001, there was a slight improvement in the CPI index for Slovakia, but it cannot be considered to be a trend tendency yet.

### 5.1 Combating the Organized Criminal Activity

#### Question

22. Are law enforcement and fraud investigative bodies perceived to be ineffective in combating organized criminal activity?

#### Assessment

Positive perception  
 (“no” responses): 17  
 Negative perception  
 (“yes” responses): 123  
 Positive perception ratio: 12% (8%)

#### Comments

Combating organized criminality is a difficult task *per se* and the corrupt environment in Slovakia makes it even harder. Our respondents almost unanimously expressed their discontent with weak or no results of fraud investigative bodies. They assign it mainly to the incompetence of investigators, but also to their links to mafia-like organizations and people involved in corruption activities. Organized criminal groups are not only seen as “cowboys” but also as financial criminals operating in both the public and private sector; abuse of EU funds and past asset stripping in the big state-owned banks and state monopolies name just

**Table 8**  
**Summary of the Results of the section Ethical Overlay (in brackets the results for interviews only)**

4.	Ethical Overlay	1.9	(2.5)
	<b>Question (percentage means the positive perception ratio)</b>		
22	Combating organized criminal activity	12 %	(8%)
23	Role of criminal groups	48 %	(62%)
24	Corruption rating	15 %	(0%)
25	Business violence	40 %	(46%)
26	Extra fees	41 %	(77%)
27	Tender processes	20 %	(39%)
28	Bribes	14%	(31%)

<sup>17</sup> see <http://www.transparency.sk> for more details

a few. This question ranked worst in the whole section, and is negatively assessed by both written and oral form respondents.

## 5.2 Role of Criminal Groups

### Question

23. Is there evidence of criminal groups (e.g., Mafia-like organizations) playing a significant role in controlling any substantial industry sectors?

### Assessment

Positive perception (“no” responses):	63
Negative perception (“yes” responses):	68
Positive perception ratio:	48 % (62%)

### Comments

Assigning a yes/no answer has been mainly influenced by the perception of the words “significant role” and “substantial industry sectors.” Some respondents have argued that mafia-like organizations control many restaurants and casinos, but not substantial industry sectors. Groups or people holding control over major companies use other ways of rights enforcement - rather by legal instruments. Though their activity may be considered legal, it is not, at the same time, necessarily ethical. On the other hand, some respondents were more critical and suspicious, claiming that one of the worst impacts of the recent Government (1994 – 98) being in power was that they let organized criminal groups enter big business through political connections. Privatization of many state-owned companies and banks is expected to improve the situation to some extent.

## 5.3 Corruption Rating

### Question

24. Is this a country ranked below 30<sup>th</sup> place within the Transparency International corruption rating system?

### Assessment

Positive perception (“no” responses):	20
Negative perception (“yes” responses):	110
positive perception ratio:	15% (0%)

### Comments

According to the recently published corruption index (CPI 2001) assessed by the international anti-corruption organization Transparency International, Slovakia ranked 51 – 54<sup>th</sup> with a CPI 2001 index of 3.7 points (upper and lower bounds are 2.1 – 4.9). The level of corruption represented by a CPI index of 3.7 is measured on a scale of 0 (a completely corrupt country) to 10 (country without corruption) in 91 assessed countries. Results for other Visegrad – 4 countries are as follows: the Czech Republic 3.9 (47 – 49<sup>th</sup> place), Poland 4.1 (44 – 45<sup>th</sup> place), and Hungary 5.3 (31 – 33<sup>rd</sup> place). Comparing the CPI index development over the period 1998 – 2001, Hungary ranks best and received a stable ranking around 31 – 33<sup>rd</sup> place with 5.0 – 5.3 points. Poland ranked between 39 – 45<sup>th</sup> places with around 4.1 – 4.6 points. The Czech Republic experienced the biggest fall in the CPI index over this period, falling from 4.8 points and 37<sup>th</sup> place in 1998 gradually down to 3.9 points and 47 – 49<sup>th</sup> place. As revealed by the World Bank – USAID<sup>18</sup> study, companies encountered bribery during 1998 – 2000 mostly at customs, import and export licensing, the Certification Authority, construction permits, and State Business Supervision. The bribes reported by companies ranged from 40 to 500,000 SK, with the largest bribes being paid in the areas of banking services, import and export licenses, courts, telecommunications and customs. The courts and banking services were the recipients of the highest average number of bribes and the highest median of bribes.

## 5.4 Business Violence

### Question

25. Does the country experience a material level of assassination, kidnapping, or threat to business figures each year?

### Assessment

Positive perception (“no” responses):	51
Negative perception (“yes” responses):	77
Positive perception ratio:	40% (46%)

<sup>18</sup> World Bank – USAID (2000): Corruption in Slovakia. Results of Diagnostic Surveys. Available at <http://www.government.gov.sk>

## Comments

Except for cases described by the daily press, it is not widely known what the real threats and harm to businessmen is. In practice, we can indicate that the unwillingness of people to enter some types of business (e.g., restaurants) is due to a worse situation in this sector than on average. Our respondents mentioned several cases when influential businessmen, lawyers or public officials were assassinated (former Minister and Slovak Gas Industry chief J. Ducky, directors of a footwear factory in Partizanske, etc.)

## 5.5 Extra Fees

### Questions

26. Is the country one associated with the payments of extra fees for services where such fees are not usual in the United States or EU (e.g., payment to enter a tender process)?

### Assessment

Positive perception ("no" responses):	54
Negative perception ("yes" responses):	76
Positive perception ratio:	41% (77%)

### Comments

Our respondents, based on their professional background, referred either to large tenders (privatization), or common tenders. Their experience can be generalized in the case of large tenders because all respondents *unisono* claim that fees for entering public tenders – big privatization deals – should even be higher. Thus, the important information should only be secured and offered to really serious bidders. Information security in G-7 countries is higher and fees are higher as well than in Slovakia in this regard. The experience concerning the smaller or common tenders is mixed. Most respondents say that only fees to cover tender preparation cost are paid, which is common anywhere. Some consider them too low, some too high and do not consider it fair that fees to submit a public tender are not returned to unsuccessful bidders. Written-form respondents also referred to extra fees

required for speeding up certain processes and for problem-free solutions. Such transactions would normally be carried out even without extra fees but at a slower pace, which could cost the companies dearly.

## 5.6 Tender Processes

### Question

27. Are the outcomes of tender processes and other open market auctions of commercially valuable rights felt to be biased, opaque, and likely to have been influenced improperly?

### Assessment

Positive perception ("no" responses):	26
Negative perception ("yes" responses):	108
Positive perception ratio:	20% (39%)

### Comments

As quoted in the Czech CGR report<sup>19</sup> "it is a custom, even in the most developed markets, that unsuccessful participants doubt the fairness of the tender outcome." To assess this question fairly, respondents had to assign weight to "general" or "average" tenders and to those mainly big cases focused on by the media. In general, big tenders were not considered to be transparent and performed in accordance with the legislation in the past, but this has significantly improved. What is hard to consider is the final decision between the remaining 2 – 3 best candidates. The biggest tenders are not formulated to fit the preferred candidate only, but in the case of smaller tenders, the practice is completely different. As confirmed by some respondents from small or medium sized companies, perception that tender outcomes are opaque heavily decreases their willingness to enter any tender.

Apart from classic tenders, the government provides business with a wide variety of export and import licenses. The Deputy Prime Minister for Economy recently prepared a new draft system of licensing. The main difference is that 84% of automatic licenses have been abolished, and for the rest of the licenses, 2 new categories were created:

<sup>19</sup> Kudrna, Z., Katzová, I., Sedláček, T., Vychodil, O.: "Corporate Governance Risk in the Czech Republic", 2000, Institute of Economic Studies, Faculty of Social Sciences, Charles University, Prague

automatic licenses with other than a quantitative limit, and non-automatic licenses on goods with quantitative limits. The latter shall be provided in auctions where the highest bidder gets the license. The new system also introduces transparency and efficiency measures. Processing license requirements should shorten from 30 or 60 days to 5 days. Furthermore, state administration bodies are obliged to publish all the data regarding license provision on the web (e.g., criteria and results of the license procedure, license commission members, list of applicants, list of applicants who were provided a license, reasons for not providing a license, etc.).

## 5.7 Bribes

### Question

28. Are government officers widely known to expect or require payment for either preferential or basic discharge of their powers?

### Assessment

Positive perception

("no" responses): 18

Positive perception

("yes" responses): 115

Positive perception ratio: 14% (31%)

### Comments

As with some other questions, respondents faced the dilemma of assigning weight to frequency of the issue or to its volume (big cases with media impact). Most of our interview respondents claim that it cannot be considered a general rule or general perception that government officers expect or require payments for either preferential or basic discharge of their powers. Anyway, this phenomenon is relatively widely spread in Slovakia. Also, due to slow speed and unwillingness, the officers indirectly "blackmail" the businessmen.

## Conclusion

The aim of this study was to identify the CGRI in the Slovak Republic, which is a proxy variable for accessing the quality of the business environment in various countries at various time periods. From the answers of 118 respondents, who were mainly managers of influential companies in SR, the average **risk index is 10** points out of a possible 28. According to the Crichton-Miller and Worman risk scale, the country ranges in the upper zone of **high risk** for investors. The G7 countries rank between 21 and 28 points. However, there are many indications of permanent improvement of the situation.

The study was elaborated according to the methodology developed by Crichton-Miller and Worman for Russia. There are, however, some limitations to the research. It was not possible to cover all the aspects of the business environment without losing the advantage of clear and simple methodology. In the case of the Slovak Republic, there are several methodological issues we consider worth noting. Firstly, it is important to note that the Slovak survey was done at two distinct periods. The questionnaires were sent out at the beginning of 2000. The interviews were conducted in October 2001 – January 2002 period. Secondly, when interpreting the answers, we were usually unable to properly distinguish between the "snapshot-view" and development over the past few years. This problem emerged in part II and III of the questionnaire, where changes and also some improvements were observed in recent years/months, but some respondents referred to longer tracks (thus abstracting from the recent positive development). If possible, we try to distinguish it in the comments. Thirdly, respondents could have approached the questionnaire giving major weight to the scope of the problem (high perception of big cases focused on by media) or to the frequency of a given problem in Slovakia. The latter approach, though less frequently used, may provide a better description of the overall situation in Slovakia. It usually shows that the general view is better than what the results of big cases might suggest (mainly in public procurement, tendering practices, etc.) as we adopt the opinion that in each country



the big cases are solved differently from the majority of average cases. When performing and interpreting results from interviews, we try to distinguish between the two approaches. Finally, the resulting CGRI for Slovakia is usually lower for the respondents replying only in written form than for the interviewees. This may be due to the fact that an interviewee spends more time reading the questions and formulating the answers, reasons and comments to the answers. Also, an opportunity to explain the question more properly to the interviewee could have had an impact. Furthermore, in anonymous surveys in general, the respondents tend to assign a more negative assessment of surveyed facts.

The level of the index of CGR in the Slovak Republic was evaluated at 10 points. Another question, however, remains as to what the 10 out of the 28 characteristics are that the respondents consider as functioning well relative to the developed markets. The table Evaluation of Questions (see Annex) shows that in a whole sample a clear positive agreement (100 – 80% of positive answers) was achieved only in one question and in another one the agreement exceeds 60% of the respondents. If we use the simple majority as the criteria for an agreement, we get 4 positively assessed characteristics. On the other hand, 10 characteristics were perceived as definitely negative (20 – 0% of positive answers) and another 6 as rather negative (40 – 20% of positive answers). There were 24 characteristics negatively assessed. After an 8 – month time delay, the sample of interviewees perceived 2 characteristics as clearly positive and another 7 as rather

positive. If we use the simple majority as the criteria for an agreement, we get 10 positively assessed characteristics. The numbers of definitely negative agreements declined to 6. Another 8 characteristics are perceived rather negatively. The number of questions answered negatively by the simply majority of respondents declined as well to 18. The characteristics are presented in the Table Evaluation of Questions (see Annex).

The questions in the questionnaire were divided into four sections that characterize four elements of corporate governance risk. One of the contributions of this methodology is that it brings structure into the complex and inter-related debate about corporate governance and enables the measurement of separate dimensions of this issue.

The worst assessed element, which at the same time increases corporate governance risk to the highest degree, is Legal Processes. Not even one question in this section was answered positively by more than a half of the respondents. In other words, this survey supports the claims of those who see the main barrier for entrepreneurs as an insufficiently functioning infrastructure of law enforcement. The best-assessed element is Corporate Law where two (three) out of seven questions were positively answered by a majority of respondents (interviewees).

The results are similar to other surveys conducted in the Slovak Republic like “Survey of economic elite opinion on actual questions of the Slovak economy development<sup>20</sup>.” If we were to identify the three most crucial factors that increase the corporate governance risk in the Slovak Republic today, they would be enforceability

**Table 9**  
**Evaluating of four sections**

Element	Average Points
Corporate Law	3.3 (3.8)
Legal Processes	1.4 (1.4)
Regulatory System	3.0 (4.0)
Ethical Overlay	1.9 (2.5)

Maximum number of points for each element is 7.

<sup>20</sup> Survey of economic elite opinion on actual questions of the Slovak economy development. Institute for Public Affairs, Bratislava 2001

of law, the low effectiveness of bankruptcies and the high level of corruption. These will be the problems of the Slovak economic reality for a long time.

This methodology has the potential to be used as an appropriate study of the complex issue of corporate governance. It well depicts the key problems of corporate governance in a given country and thus its conclusions can be further applied when approaching the issue.

## References

Act on Accounting 563/1991 Coll. in wording of amendment 336/1999 and 387/2001. Available at <http://www.zbierka.sk>

Act on Auditors and the Slovak Chamber of Auditors 73/1992 Coll. in wording of amendment 228/2000 and 152/2001. Available at <http://www.zbierka.sk>

Act on Deposit Protection Fund 118/1996. Available at <http://www.zbierka.sk>

Act on Economic Competition 240/1998 Coll. in the wording of amendment 121/2000. Available at <http://www.zbierka.sk>

Collective Investment Act 385/1999. Available at <http://www.zbierka.sk>

Commercial Code in the wording of amendment 500/2001 Coll. Available at <http://www.zbierka.sk>

Crichton-Miller, Worman (1999). "Seeking a Structured Approach to Assessing Corporate Governance Risk in Emerging Markets." winning essay in an Essay Competition in honor of Jacques de Larosiere. The Institute of International Finance

Improvement of the legal, regulatory and tax framework supporting business and investment. Document approved by the Slovak Government in August 2000. In the text referred to as "Framework (2000)". Available at <http://www.government.gov.sk>

Kudrna, Z., Katzová, I., Sedláček, T., Vychodil, O.: "Corporate Governance Risk in the Czech Republic", 2000, Institute of Economic Studies, Faculty of Social Sciences, Charles University, Prague

Marcinčin, A., Zemanovičová, L (2001): "Slovakia: Improving Corporate Governance", September 2001, INEKO, Bratislava

OECD Principles of Corporate Governance. Available at <http://www.oecd.org>

Securities and Investment Services Act 483/2001. Available at <http://www.zbierka.sk>

Survey of economic elite opinion on actual questions of the Slovak economy development. Institute for Public Affairs, Bratislava 2001

Statistical Yearbook of the Ministry of Justice (2000). Available at <http://www.justice.gov.sk>

Vašák, J.-Zachar, D.: "Survey HESO Q4 2001", Institute for Economic and Social Reforms (INEKO), Bratislava. <http://www.ineko.sk>

World Bank – USAID (2000): "Corruption in Slovakia. Results of Diagnostic Surveys". Available at <http://www.transparency.sk>

<http://www.government.gov.sk>  
<http://www.fov.sk>  
<http://www.ineko.sk>  
<http://www.justice.gov.sk>

## Annex

### *Evaluation of Questions*

<i>Questions</i>	<i>% of positive answers of the whole sample</i>	<i>% of positive answers of the interviewees</i>
3. Shareholder rights to vote in general meetings and elect members of the board are well defined.	83	92
16. The Central Bank is a politically independent regulator of the banking sector.	71	85
2. The definition of the rights of all parties.	58	77
18. Insider trading is considered to be illegal or unethical.	52	31
1. The transparency and security of the registration of claims upon companies.	48	69
23. No substantial industrial sector is controlled by any criminal group.	48	62
14. It is difficult to evade the consequences of legal judgements against business entities.	44	42
19. The Antimonopoly Office possesses powers of investigation and sanction.	44	62
5. The quality of contracts is comparable with that in the G7 countries.	42	46
7. Members of company's board are forced to disclose their material interests in the company's activities.	42	38
15. Impartial and consistent action of the regulator of the capital market.	42	78
26. Extra fees for services for which such fees are not usual in the US or EU.	41	66
25. Level of assassinations, kidnapping, or threats to business figures does not exceed that on the developed markets.	40	46
17. The effectiveness and independence of financial watchdogs.	40	77
4. The disclosure of a disproportionate degree of control.	39	38
12. Non-influencing of the court decisions by any improper interests.	39	50
21. The use of international standards of accounting.	31	42
8. The possibility of access to redress through legal process for all the involved parties.	21	31
27. Tenders are not biased, opaque, and likely to have been influenced improperly.	20	38
13. The enforcement of legal decisions is effective and respectable.	17	31
24. Transparency International corruption rating below 30th place.	15	0
20. Company records are thorough, dependable, and up to date, with adequate sanctions and safeguards.	15	25
28. Government officers are not known to expect or require payment for either preferential or basic discharge of their powers.	14	31
6. Bankruptcies are clearly defined and lead to the orderly discharge of liabilities.	13	15
22. Combating organized criminal activity is effective.	12	8
10. The access to legal redress is cost effective.	8	8
11. The commercial arbitration has a strong tradition.	8	0
9. The redress through legal process is reasonable speedy.	1	0







### **Information for Contributors**

The *Occasional Papers* are devoted to public administration and public policy issues based on empirical research carried out in Central and Eastern Europe.

#### **Papers**

Decisions about the publication of a manuscript are based on the recommendation of the main editor and an additional review process conducted by two appropriate specialists from a relevant field. The main editor and/or deputy editor selects these specialists.

Submissions should not have been published previously and should not be under consideration for publication elsewhere. Papers presented at a professional conference qualify for consideration. The submission of manuscripts that have undergone substantial revision after having been presented at a professional meeting is encouraged.

#### **Components of a Policy Paper**

##### **Presentation of the Issue**

What is the problem that requires action?

##### **Scope of the Problem**

What is the history and current context of the issue? How did it become an issue? Who is affected and how severely?

##### **Consultations**

What are the views or positions of groups who will be significantly affected? What are the concerns of other ministries/agencies who will be affected?

##### **Options for Consideration**

What three or four distinct options should be considered? What are their implications? What are their advantages and disadvantages?

##### **Additional Issues:**

Consistency with the government's priorities; the effectiveness of available options in addressing the issue; the economic cost-benefit; the effects on taxpayers; the impact on the private sector; environmental impacts; the fiscal impact on the government; the disproportionate impact on various groups or regions; the complexity and timing of implementation; public perception; and constraints raised by legal, trade, or jurisdictional issues.

##### **Recommendation(s)**

What is the proposed course of action? Why was it chosen over other possibilities?

##### **Implementation Issues**

What are the financial impacts of the proposed course of action? What are the implications for government operations? Will the proposal require regulatory or legislative changes? What is the proposed means of evaluation?

##### **Communications Analysis**

What is the current public environment? What are the key issues of contention, and how can they be addressed? What is the position of key stakeholders, both inside and outside the government, on the proposal, and what communication vehicles should be used for each? How does the proposal relate to government reform priorities? What is the objective of communication on this issue? What is the key message?

#### **Structure of a Paper**

##### **Title**

The title should be a brief phrase adequately describing the content of the paper.

##### **Abstract**

An abstract is a summary of the information in a document. The abstract should not exceed 250 words. It should be designed to clearly define the contents of the paper. The abstract should: (i) state the principal objectives and scope of the research; (ii) describe the methodology employed; (iii) summarise results and findings; and (iv) state the principal conclusions. References to literature, bibliographic information, figures or tables should not be included in the abstract.

##### **Introduction**

The introduction should supply sufficient background information on the topic and also provide the rationale for the present study. Suggested guidelines are as follows: (i) the introduction should first clearly present the nature and scope of the problem that was researched; (ii) it should provide an overview of the pertinent literature used; (iii) it should state the research methodology employed and, if necessary, the reasons for using a particular method; and (iv) the principal results of the investigation should be stated.

##### **Results**

This section should contain an overall description of the topic and present data gathered during the research project. The manuscript should utilise representative data rather than repetitive information. Data that will be referenced several times in the text should be provided in tables or graphs. All data, repetitive or otherwise, should be meaningful. Results must be clearly and simply stated as the section comprises innovative research findings for an international community of academics and practitioners.

##### **Discussion**

This section presents principles, relationships, and generalisations indicated by the researcher's findings. This should not restate information present in the results section, but should: (i) point out any exceptions or lack of correlation; (ii) define unresolved issues; (iii) show how the results and interpretations agree (or contrast) with previously published work; (iv) discuss the theoretical implications of the work, and any possible practical applications; and (v) summarise the evidence for each conclusion. The primary purpose of the discussion section is to show the relationships among facts that have been observed during the course of research. The discussion section should end with a short summary or conclusion regarding the significance of the work.

##### **Acknowledgements**

Assistance received from any individual who contributed significantly to the work or to the interpretation of the work and/or outside financial assistance, such as grants, contracts, or fellowships, must be acknowledged.

##### **References**

Only significant, published references should be cited. References to unpublished data, papers in press, abstracts, theses, and other secondary materials should not be listed in the references section. If such a reference is essential, it may be added parenthetically or as a footnote in the text. Secondly, authors should verify all references against the original publication prior to submitting the manuscript. Stylistically, authors should utilise the in-text parenthetical reference system with complete references alphabetised at the end of the text.

# occasional NISPAcee papers



## **NISPAcee Secretariat**

Hanulova 5/B  
P.O.Box 163  
840 02 Bratislava 42  
Slovak Republic  
tel/fax: +421-2-6428 5357, 6428 5557  
e-mail: [nispa@nispa.sk](mailto:nispa@nispa.sk)  
<http://www.nispa.sk>

