INSTITUTIONAL COHERENCE AND THE EVOLUTION OF CORPORATE GOVERNANCE IN POLAND

| Abstract |

Goal – the purpose of the article is to present the significance and role of institutional coherence in the development and evolution of corporate governance in Poland.

Research methodology – a review of the literature on examining the specificity of knowledge about the role of institutional coherence in the development and evolution of corporate governance in Poland and analysis and assessment of the changes in good practice codes in Poland.

Score/results – a systemic approach to the issue of corporate governance reveals that it is a collection of both formal and informal institutions. Through mutual interaction, corporate governance rules lead to the emergence of a relatively stable and predictable environment in which enterprises and their stakeholders can operate.

Originality/value – analysis of good practice codes in Poland reveals that the process of their adjustment to the current social and cultural norms, as well as to the expectations of the market, can be positively evaluated, as evidenced by the fact that their new editions continue to be published. The provisions which appear in good practice codes year by year adequately reflect the needs and expectations of the market.

Keywords: good practice codes, corporate governance, formal institutions, informal institutions, optional rules.
1. Introduction

Corporate governance is among the most dynamically developing themes in the field of social sciences. Depending on the research perspective, corporate governance is perceived either as an element of a larger system of interdependencies – encompassing the legal and financial systems – or as a subsystem of the relationships among various areas, combining elements of law, politics, economy, and society. In the narrow sense, corporate governance is very often understood as a segment of commercial law, a set of legal provisions regulating the systems and the functioning of joint stock companies, or – broadly speaking – as a set of recommendations and good practices according to which such companies should operate. An even wider perspective takes into account not only the aforementioned areas: legal regulations, “soft laws” and their applications, but also the entire institutional system that accompanies them. In this article, we use the above interdisciplinary understanding of corporate governance. Not only does it reflect the multilayered and multidimensional nature of the issue in question as well as its importance for economic, political and social life, but it also indicates the interactions between these systems, identifying their interdependencies.

The purpose of the article is to present the significance and role of institutional coherence in the development and evolution of corporate governance in Poland. The theoretical section provides clarification of the terms used further below, e.g. institutions, institutional coherence, and corporate governance. The empirical part contains analysis and assessment of the changes in good practice codes (an instrument of corporate governance) in Poland, in the context of their adaptation to the applicable social and cultural standards as well to market expectations, i.e. the expectations of various groups of stakeholders of companies under corporate governance systems.

2. Institutions and institutional coherence

Institutional analyses are common in many social sciences, including law, sociology, economics, and political science. Each of these fields has developed, for its own needs, a different definition of institution. Table 1 contains examples of how the term is defined in the areas of law, economics, and sociology. It can be noticed that the definitions intertwine and complement each other. In the literature, institutions are perceived as: principles, constraints, thinking pat-
terns, points of balance, structures, means to certain ends, organisations, signs and symbols. Encyclopaedically, a legal institution is a set of legislative norms jointly regulating a given social relation (e.g. the institution of marriage, the institution of ownership, or the institution of market contracts). By law, what is subject to regulation is a specific social relation between at least two entities. These regulations comprise certain rights and obligations prescribed by law. Such a collection is what constitutes an institution in the legal sense [Borkowska, Klimczak, Klimczak, 2019: 71]. From a sociological perspective, the material scope of an institution is wider than from the legal perspective. This is due to the fact that the expressions of the norms and patterns which govern the activity of groups and communities stem not only from the law, but also from tradition or religion. Economists assume that institutions are moral principles, customs, individual mentalities, as well as legal and social rules, which have been shaped throughout history and which provide a basis for economic processes. Institutions organise, control and influence economic processes in such a way that they proceed smoothly and with due regard to the interests of all the partners.

Table 1. Definition of institution in social sciences

<table>
<thead>
<tr>
<th>Science</th>
<th>Definition</th>
</tr>
</thead>
</table>
| Law       | • Institutions are groups of normative pronouncements which constitute a certain whole from the viewpoint of a specific social relationship;  
            • Institutions are sets of norms or groups of activities contained in legislation.      |
| Sociology | • Institutions are systems of rules, convictions, norms, and organisations which together form a certain regular pattern of social behaviours.  
            • Institutions are patterns of behaviours and perceptions imposed upon an individual by the community, which have been established through experience and have come to be regarded as worth following. |
| Economics | • Institutions are sets of fundamental political, social, and legal principles which comprise the structure of production, distribution, and exchange.  
            • Institutions are the rules of social game, the developed constraints which impact human interactions. As a result, they determine the structure of exchange stimuli in the political, social, and economic spheres. |

Source: Borkowska, Klimczak, Klimczak, 2019: 84.

1 The subject literature offers numerous definitions of the term institution. For example Sławomir Czech proposes eight explanations, adding that his conceptualisation does not exhaust the topic, but allows for noticing a wide analytical usefulness of this notion [Czech, 2019: 32].
The primary role of an institution is to reduce uncertainty by developing relatively constant principles of behaviour for individuals and economic entities. Thanks to them, the behaviours of individuals become more predictable, whereas the risk and transaction costs which accompany exchange are decreased. While initially exchange was direct in nature and relied on informal institutions, nowadays transactions require more advanced institutions since they occur remotely, impersonally, or involve large numbers of contractors. When trust between the contracting parties is lacking, co-operation is only possible via institutions. Today, reduction of uncertainty requires appropriate rules or guidelines, i.e. formal institutions, both economic and political [Rudolf, 2014: 157].

A system of institutions constitutes a multi-level, multi-faceted structure of laws, rules, and norms which in every society impacts people's decisions and behaviour [Gruszewska, 2017: 38]. Therefore, an institutional system consists of both formal and informal institutions [North, 1990: 4, 36]. As John Carey remarked, “not all written rules serve as effective constraints on political behavior, and, conversely, […] not all effective constraints on social behavior are written rules” [Carey, 2000: 737].

Formal institutions are comprised of all kinds of legal and constitutional norms which are developed by legislative bodies and whose role is to regulate economic and political relations [North, 1990]. The legal literature refers to this kinds of institutions as civil law (ius civile). The state guarantees that such law is respected. Among formal institutions, a significant role is played by property law and contract law. Formal institutions encompass the system of property laws, (normative civil) law, and (public, social, real sphere, and financial sector) regulations. These usually function as part of a hierarchical structure, including the constitution as the superior legal norm, various collections of legal acts, administrative, technical, and economic rules [Fiedor, 2015: 94].

Informal institutions are social principles and norms observed by members of certain groups when these strive to pursue common objectives. They include codes of conduct, conventions and norms of behaviour which emerge during interactions between individuals. Informal institutions are deeply embedded in the culture of a given society [Wilkin, 2016]. Sometimes they come into existence as a result of the historical process of generation-to-generation transfer (through learning and imitation) of knowledge, values, and other factors which influence human behaviour. Informal institutions can also be created as supplements and additions to formal rules and can, moreover, be contradictory to formal institutions [Helmke, Levitsky, 2004: 727]. This is because informal
rules may be established in order to circumvent formal rules or to perform actions which are unpopular or illegal. The key difference between informal and formal institutions is that the former remain in the private sphere (but apply to the entire community), whereas the latter are centrally designed, implemented, and enforced [Williamson 2009: 372].

Although modern economies attach great importance to legal norms and regulations, social norms, which can be supplementary to them, must not be forgotten. Empirical studies show that informal rules are a social pillar for the credibility of concluded contracts, a factor which reinforces formal property laws, and an element of the social order which permanently lowers transaction costs [Williamson, 2009]. In scientific research, the role of informal institutions should not be reduced to that of the “missing variable”. Instead of just assuming the existence of informal institutions, it is preferable that the borders between formal and informal rules, as well as their efficiency and mutual interactions, are clarified [Grzymala-Busse, 2010: 331]. Informal institutions play a vital part in co-ordinating economic activity through mechanisms of trust, reputation, and business networking [Kostro, 2004: 75–80].

Institutions do not come into being in isolation from other institutions, but are formed in relation to organisations that exist alongside them, and are continuations of those that existed before them [Gruszewska, 2017: 39]. Formal and informal institutions interact with each other both at the stage of their creation and in the course of their operation. There are several types of relationships between formal and informal institutions [Bentkowska, 2020: 26]:

1) Formal institutions are complemented with informal ones. This happens, for instance, when agreements are not sufficiently regulated to ensure their appropriate execution, but people adhere to the rules of honest conduct, thanks to which agreements are complied with;

2) Informal institutions are consistent with formal institutions, reinforcing their effect. For instance, when agreements are adequately regulated, people also strive to act with integrity. Harmony between these two types of rules determines long-term economic success.

3) Formal institutions directly interfere with informal rules. This is the case, e.g. when legal provisions prohibit corruption, but society approves of bribery and resorts to offering financial advantages to public officials in order to unlawfully accomplish goals. In such a situation, when a legal provision does not play its regulatory function, it can be socially perceived as ‘dead letter’, something that exists only ‘on paper’.

147
4) Formal institutions can be modified by informal ones. This occurs when there is a discrepancy between them. If this is the case, the regulation which is inconsistent with informal institutions can eventually be altered.

5) Informal institutions can lead to the creation of new formal institutions. For instance, whenever members of society condemned theft, as law developed, misappropriation of someone else’s property came to be banned and later punished.

Mutual adjustment of institutions is necessary for a system to be a source of relatively coherent stimuli that have an effect on economic activity. Svetozar Pejovich proposed a theory known as ‘the interaction thesis’, according to which mutual influence among formal and informal institutions is the key factor behind economic stability and the rate of economic growth [Pejovich, 1999: 171]. If formal institutions are in conflict with informal norms, their enforcement will be costly, which will cause a rise in transaction costs and a reduction in wealth creation capacity. And conversely, where formal norms are in line with informal ones, the cost of implementing the former will be relatively low and they will be accepted, supported, and subsequently developed, thus decreasing transaction costs and organising resources in such a manner that they are conducive to wealth creation [Fuentelsaz, González, Maicas, 2019: 8]. Informal institutions may impede the positive effects of new formal rules, but they can also mitigate some negative effects of inappropriate formal institutions [Chavance, 2010: 60–61].

Informal institutions are the original pattern for the construction of formal ones. Rules which arise in the course of long-term activity and experience, become widespread and, with time, may assume a formal character. This happens slowly and gradually. Thanks to repeated activities and uniform codes of practice under specific circumstances, patterns of behaviour may become established. Society must also be convinced of the efficiency of these solutions and of the need for their formalisation. The subsystem of formal institutions undergoes gradual change as it adjusts itself to the changes in the real sphere. This process leads to the creation of a sustainable system, under which most group interests are respected [Gruszewska, 2017: 43].

Efficient design of good institutional solutions must ensure that the two institutional subsystems mutually strengthen and complement each other – the so-called institutional coherence and complementarity are of the utmost importance. Firstly, the principles of operation laid down by informal and formal
institutions must be similar and non-contradictory. Only coherent institutions can permanently co-exist and provide a stable foundation for business activities. Secondly, institutions must be complementary. Not only must they not be mutually exclusive, but they also have to complement one another where necessary. In an area where a legal norm is lacking, an informal norm which will regulate this area should arise. If, for instance, because of legislative gaps, property rights are not protected, appropriately developed informal institutions which exclude dishonesty and promote trust or mutual understanding can take over the role of formal rules [Bentkowska, 2020: 37].

3. Corporate governance as an institutional system

Corporate governance is perceived as a solution applied “[…] at the system level and which defines the framework of the operation of companies that are part of the institutional order” [Aluchna, 2015: 9]. A corporate governance system comprises legal regulations, the activity of government departments, company bodies, managerial staff, investors, as well as all the other stakeholders [Cadbury, 1999: 12–19]. Weimer and Pape take the view that it is “[…] a more or less country-specific framework of legal, institutional and cultural factors shaping the pattern of influences which stakeholders exert on managerial decision-making” [Weimer, Pape, 2006: 152].

Among the factors which determine the shape of corporate governance, Weimer and Pape mention [Weimer, Pape, 2006: 152]:
- the concept of a company which is prevalent in a given country,
- the principles and structures of boards of directors/supervisory boards,
- the ownership structure,
- the impact of passive shareholders on management processes,
- the dependencies between the salaries of managers and the results of companies,
- the time horizon of economic relations between shareholders; the existence or lack thereof of an external market for control of corporate activity,
- the significance of stock exchange for an economy.

Tom Cannon, who offers a systemic perspective on corporate governance, limits the number of factors which influence corporate governance systems to only four [Cannon, 1994: 165]:
• legal and institutional system,
• rules governing ownership and ownership structures,
• operating principles and structures of boards,
• social pressure.

This proves that the division into formal and informal institutions can be useful when analysing corporate governance systems. Some of the institutions which are part of corporate governance have a formal character and their establishment is mandated by the existing law. This group includes: general meetings of shareholders, boards of directors, supervisory boards, company management, some of the board committees, their statutes, company staff, their representatives on boards, and trade unions. Also, the so-called good practice codes belong to the category of formal institutions. These codes can be treated as an example of an institution created in order to reduce uncertainty, since they emerge as a response to growing uncertainty, mainly felt by small investors, but also by society as a whole. They primarily apply to large companies because in their case uncertainty is particularly acute and harmful. Codes of good practices ensure increased social control over companies, requiring of them that their activities are transparent and that their decisions are more rational, etc. This kind of control should result in greater social trust in companies, as well as in their management and control systems. Increased trust, in turn, usually leads to overcoming the reluctance of investors, particularly smaller ones, enhancing their willingness to purchase stocks or shares [Rudolf, 2014: 158].

Informal institutions are those which, to a large extent, influence the diversity and individual character of companies, which is not without an effect on the achieved results. Among informal institution are, e.g.: moral and ethical principles, traditions, culture, propensity for opportunistic behaviour, etc. [Rudolf, 2014: 157].

Reports by the OECD stress that “corporate governance is only part of the larger economic context in which firms operate that includes, for example, macro-economic policies and the degree of competition in product and factor markets. The corporate governance framework also depends on the legal, regulatory, and institutional environment” [OECD, 2004: 12]. Despite the lack of binding authority, the developed standards of corporate governance are based on the existing legislative framework, which confirms the fact that it is perfectly justified that they should be adhered to [OECD, 2005: 60]. At the same time, the proposed
recommendations result from economic stimuli which determine the direction in which corporate governance regulations evolve. Understanding, acceptance, and recognition of these recommendations are crucially important for their implementation. Unlike in the case of normative acts, legal sanction has been replaced with the force of argument and the substantive accuracy of proposed recommendations. Entities which implement corporate governance guidelines in particular countries can adjust those guidelines to the socio-economic, legal, and cultural circumstances of the economies in which they operate.

On a company level, corporate governance aims to improve the efficiency of entities through providing conditions conducive to improving the quality of co-operation among various interest groups involved in their operation. A corporate governance system offers a structure by means of which it is possible to set company goals, identify the means of their implementation and methods to verify the accomplished outcomes. Good corporate governance is meant to stimulate company bodies and managerial staff to attain objectives whose realisation is in the interest of a wide range of stakeholders. At the level of an economy, an efficient corporate governance system “helps to provide a degree of confidence that is necessary for the proper functioning of a market economy. As a result, the cost of capital is lower and firms are encouraged to use resources more efficiently, thereby underpinning growth” [OECD, 2004: 12].

Due to the recommendations proposed in good practice codes, corporate governance systems are becoming key institutions which determine the development of the capital market and play a significant role in the modern free market economy [Godlewska, Pilewicz, 2018: 86]. What is more, the recommendations are of evolutionary nature, which means that they should be modified to keep up with the changing reality in order to fully answer the needs of the stakeholders. The effects of the evolution of corporate governance are also noticeable in Poland, as is exemplified by amended good practice codes.

4. Evolution of good practice codes in Poland

Corporate governance good practice codes are sets of recommendations aiming to indicate appropriate standards for corporate governance systems. They are not legal provisions and have no binding authority. They are collections of guidelines which are intended to help fill the gaps between legislative acts and market mechanisms [Blejer-Gołębiowska, 2012: 56].
By pursuing the basic objective of protecting the economic interests of the investors that have entrusted their capital to joint-stock companies, they enable market actors to hold enterprises accountable for their policies, simultaneously preventing overregulation and bureaucratisation of the capital market. This benefit is highlighted by K.A. Lis and H. Sterniczuk, who argue that in the case of a low level of governance formality and a considerable role of informal norms and traditional values, introducing formal regulations and strict laws may increase the cost of governance and make law abidance more onerous, consequently leading to a decreased interest in the public market [Lis, Sterniczuk, 2005: 21].

In Poland, good practice codes have a nearly twenty year history, as illustrated by Table 2. Among the initiators of good practice codes are: institutions supporting the transformation of the Polish economy and state, the stock exchange, associations of entities offering financial products and services, organisations and institutions representing the interests of customers, and other market institutions, with input from academic experts.

Table 2. Evolution of codes of good practice in Poland

<table>
<thead>
<tr>
<th>Date of publication of the document</th>
<th>Authors of the document</th>
<th>Title of the document</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gdansk Institute for Market Economics (IBnGR)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>White Book of Corporate Governance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2002</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Polish Corporate Governance Forum</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Corporate Governance Code</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2002</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Polish Corporate Governance Forum</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Good Practices in Public Companies 2002</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Polish Corporate Governance Forum</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Good Practices in Public Companies 2005</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Chamber of Fund and Asset Management and the Chamber of Commerce of Pension Societies</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Code of Good Practice for Institutional Investors</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Warsaw Stock Exchange</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Best Practice for WSE Listed Companies 2007</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2008</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Institutional participants and experts from the academic community</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Canon of Good Financial Market Practices</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
The corporate governance recommendations included in good practice codes undergo periodical analysis and, should the need arise, are modified. As a result, they enable “[…] efficient management, effective supervision, respecting shareholder rights, and transparent communication with the market”\(^2\).

Good practices of stock exchange listed companies “[…] as a set of corporate governance rules and principles of conduct which have a major impact on the relations between listed companies and their market environment are an important component of building the competitive position of these companies, significantly contributing to increasing the attractiveness of the Polish capital market” [GPW, 2021: 3]. To attain this goal, they must meet the current needs of the economy as well as the entities which operate within it.

\(^2\) See: www.gpw.pl/dobre-praktyki2021 [date of access: 20.08.2021].
Good practice codes must be amended since there is a need to continually adjust formal institutions to the evolving informal institutions. As corporate governance rules aspire to provide an ethical and cultural paradigm, they strive to respond to the problems encountered by the participants of the capital market. In order to rise to this challenge, the contents of good practice codes are consulted with issuers, investors, as well as institutions interested in enhancing the quality of corporate order in listed companies and with the representatives of scientific communities, who indicate new areas of activity. This is why their authors endeavour to design rules and recommendations which will cater for the needs of companies and their stakeholders. For instance, after consultations with capital market participants and following their suggestions, the code of good practices published in 2021 takes into consideration issues associated with ESG, including those relating to climate protection, sustainable development, diversity in the composition of company boards, and equal pay. It also mentions the previously indicated weaknesses of the Polish capital market, e.g. the problem of equal treatment of shareholders, the methods of profit sharing, issue of shares with the exclusion of subscription rights, or buyback of own shares. Attention was drawn to the need for adequate substantive and organisational quality of the general meeting, which would involve setting deadlines for submitting draft resolutions by shareholders, procedures for submission of candidates for supervisory boards, and the processes of their appointment in accordance with diversity policies [GPW, 2021: 3].

The rules of corporate governance developed in the form of good practice codes are based on the ‘comply or explain’ principle. Companies are obliged to implement guidelines or explain the reasons for failing to comply with them. Practice has shown that the recommendations sometimes eventually find a reflection in legislative provisions. If this happens, they are removed from good practice codes since these are supposed to be in line with the binding legislation but not to duplicate legal regulations.

Amended good practice codes follow the trends and solutions accepted in the field of corporate governance in other countries. They are also an answer to the demands of market participants interested in higher quality of corporate governance in listed companies. However, it must be admitted that merely changing the provisions will not in itself improve the quality of the capital market [Oplustil, 2010: 54]. They must also be actively implemented and enforced. It is also prerequisite that companies are monitored and held accountable for compliance with the recommendations.
5. Conclusions

A systemic approach to the issue of corporate governance reveals that it is a collection of both formal and informal institutions. Through mutual interaction, corporate governance rules lead to the emergence of a relatively stable and predictable environment in which enterprises and their stakeholders can operate. Among the effects of corporate governance systems are good practice codes, containing recommendations which respond to the expectations of market actors interested in higher standards of corporate order. In view of the dynamically changing realities, good practice codes are periodically reviewed and consulted so as to meet the current needs as adequately as possible. Informal institutions in the form of principles of conduct, social norms, conventions and behavioural patterns are thereby transformed into formal institutions. As is inherent in the concept of corporate governance, by creating behaviour patterns, the proposed rules convince people of their validity through economic arguments, e.g. proving that certain objectives can be achieved thanks to policies implemented with their help. To make this possible, it is necessary to maintain institutional coherence, as intended by the authors of the codes.

Analysis of good practice codes in Poland reveals that the process of their adjustment to the current social and cultural norms as well as the expectations of the market can be positively evaluated, as evidenced by the fact that their new editions continue to be published. The provisions which appear in good practice codes year by year adequately reflect the needs and expectations of the market. Some of them are modified, others discarded, while still others become part of economic law.

References

Borkowska B., Klimczak M., Klimczak B., 2019, Ekonomia instytucjonalna, Wrocław.


Żak M., 2019, *Corporate governance w XXI wieku – w stronę instytucjonalizacji nowego paradygmatu prawa handlowego?*, “Przegląd Prawa Handlowego”, No. 5.

www.pfcg.org.pl.