

Corporate Reputation and Shareholder Engagement Impact on Companies' Success in Croatia

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Abstract — In a business community shareholder activists are often perceived as a group with hidden agenda, whether it is social, economical, environmental, value based or any other, that could have impact on companies' reputation. On the other hand this type of activism is becoming an increasingly sophisticated strategy of engagement, which exploits shareholders rights to engage companies on particular issues that are important to them. Although activism can take many forms, shareholders in transitional economies such as Croatia are still showing high level of passivity and inertia. On parallel basis corporate responsibility as an integrative model directly reflecting corporate reputation is gaining exponential attraction since it is more widely perceived as a new strategic source of competitive advantage. In that sense this paper explores reputational interaction between corporations and one of their most powerful stakeholders, its shareholders. The research within this paper is focused on Croatian companies and is covering several aspects of shareholder activism. In this paper authors are trying to describe reasons behind passive investors' community and why they should act as a more vibrant corrective factor for possibly poor corporate governance.

Keywords — corporate reputation, corporate social responsibility, shareholder activism, stakeholder management

I. INTRODUCTION

MOST of today's companies are riding through the greatest storm of change and disorder since the beginning of the industrial revolution. Businesses everywhere are facing new realities of operating in a world in which they no longer have the control over markets that they once had. Fromm mentions how the modern society has become materialistic and prefers "having" than "being" [1]. Companies are participants in economic ecosystems in which all constituents are interrelated, interconnected and interdependent. The so called "having societies" are steeped in self-centeredness, egoism, selfishness, greed and have a great focus on materialism. Contrary to the aforementioned, the "being societies" are deeply vested in high ground moral values where each and every element of society is treated equally. Ever since companies are increasingly being held accountable for their economic, environmental and social performance, the ethical conduct has become central to many

businesses. Hawken, Lovins and Lovins believe that the world stands on the threshold of basic changes in the conditions of business and its relation towards society [2].

Free flow of information, social media, activist movements, democratization of media and even governmental actions initiated inevitable change regarding problems that companies did not consider as their own business responsibility initiated. Through further social pressures, invoking of ethics and morality, the importance of socially responsible business rises, and many companies are already reporting on corporate social responsibility and sustainability issues, along with their regular annual reports [3]. This basically means that proacting (anticipating, planning and initiating) is more practical and less costly than simply reacting to social problems once they have surfaced [4].

On parallel basis, except perhaps among day traders and other short-term profiteers, more and more shareholders do enjoy feeling good about companies in which they invest [5]. Since they want good returns but they also want to invest in companies they truly admire, better reputation management is another important argument for the integration of CSR especially in the context of improving company's image, building innovation capacities and strengthening its brand position. Although some studies that have examined the relation between social reputation and consumer preferences or share performance did not provide unambiguous conclusions, there is evidence suggesting that companies operating in accordance with the principles of social responsibility are achieving better results [6].

Croatia is on the doorstep of becoming the 28th member state of the European Union, and that fact creates many opportunities along with new challenges and threats for Croatian companies to consider. When setting goals for EU within so called Lisbon Agenda strategic framework, European policy makers made special appeal on CSR, seeking from business in meeting such goals. Through CSR model they want to promote society's interests and a route to sustainable and inclusive recovery [7]. In that sense Croatian companies must not only comply with EU regulations and standards, they must reinvent their own competitiveness and strive for corporate governance excellence.

Companies with CSR integrated in the corporate strategy and regular operations will be more responsible towards their

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shareholders and their activism and rights as well – and better relationships with shareholders should have a positive effect on company performance (performance on the stock exchange). Hereby we define shareholder activism as a proactive strategy through which the shareholders can assert their power as company owners in order to influence the corporate behavior and fulfill specific interest.

II. CORPORATE REPUTATION, SHAREHOLDER ACTIVISM AND CORPORATE SOCIAL RESPONSIBILITY

The awareness of mutual business-society-environment interests is rising, along with the need for a symbiotic approach to global sustainability and the good of future generations. Reputation is perception of past actions and future behavior viewed in the context of other actors' activities. As companies have many stakeholders with different interests, their reputation is perceived differently relative to the stakeholder position. Growing expectations of corporate responsibility is among widely recognized trends in reputation [8].

Reputation is critical to gain and sustain stakeholders' confidence, the same way damage to the reputation and loss of trust reduces the company's share value and financial results. Reputation does not occur by chance – it relates to leadership, management and organizational operations, the quality of products and services, as well as relationships with stakeholders. Organizations increasingly recognize the importance of corporate reputation to achieve business goals and stay competitive [9]. Reputation is a 'collective representation' of images and perceptions, and involves relationships with all stakeholders, gained, maintained and enhanced over a period of time with a track record of delivering on promises is evident to everyone [10].

Company's ethical behavior through CSR initiatives, may both ameliorate and exacerbate market reactions. CSR initiatives may buffer a firm against general wrong-doing but even expose it to greater scrutiny and sanction for related wrong-doing. Companies with enhanced overall reputations for CSR are partially buffered from scandal revelations. However, when a company possesses an enhanced reputation for CSR associated with corporate governance, violations pertaining specifically to the governance are viewed as hypocritical and more harshly sanctioned [11].

The role of active shareholders in improving corporate performance has been extensively discussed over the last two decades [12]. Although large shareholders (including pension and other funds, and other investors) hold a substantial and increasing fraction of shares in listed companies in Croatia, most large shareholders play a limited role in overt forms of shareholder activism. Shareholder activism is placed on a continuum of responses that dissatisfied investors can give to corporate governance concerns [13]. Shareholder activism encompasses a variety of tactics such as Wall Street Walk ("voting with your feet", exit strategy when shareholders sell their shares outright when they are unhappy with management rather than becoming

active and attempting to impact decisions from within the firm.), strategic voting, shareholders' proposals, private discussion and/or public communication with corporate boards and management, press campaigns, blogging, etc. Responsible investors use a variety of tactics primarily to raise sustainability, economic justice and corporate governance issues [14].

The acceptance of CSR principles among the Croatian companies is on the rise, as continuous growth of companies involved in research of the Croatian CSR Index proves. Shareholder activists, by definition, are committed to using their leverage as shareholders to seek corporate change. Companies are defining themselves as social institutions, charged with a vital economic role [15]. The awareness of the CSR concept and responsibility as a universal value changes relationships between the company and its shareholders. This transition is not going to be easy since many financial analysts are still uncomfortable with anything other than conventional business models. Their understanding is limited by images of corporate reality taken almost exclusively from sightings through the lens of numbers [16].

Drucker wrote that profit is not the explanation, cause or rationale for business behavior and business decisions, but rather the test of their validity [17]. Furthermore, the European Commission in 2011 did put forward broad conceptualization that goes beyond traditional perception of the role of business in society, i.e. it defines CSR as the responsibility of enterprises for their impacts on society, and it suggests that enterprises should, in close collaboration with their stakeholders, have a process for integrating social, environmental, ethical, human rights and consumer concerns into their business operations and core strategy.

Studies on influence of shareholder activism announcements and their enforcement on corporate performance (stock performance) also did not find conclusive evidence of direct impact. However, some studies have shown a positive and some negative impact of shareholder activism on the performance on stock markets [18].

III. RESEARCH ON CSR AND SHAREHOLDER ACTIVISM PRACTICE AMONG COMPANIES IN CROATIA

In order to explore correlations of CSR, shareholder activism and company's performance, a research was conducted on a sample of companies listed on the Zagreb Stock Exchange (ZSE). The referent list of the companies was taken from the trading report of ZSE for the period of the first six months of 2012 [19]. Relevant contact list contained individuals/departments in charge of shareholder relationships, CSR and sustainability, legal and finance departments, as well as chairmen and members of management boards. The survey contained questions focused on CSR and shareholders relationships practice.

A. Research methodology and sample characteristics

The research instrument was a highly structured survey sent

in October 2012 to e-mail addresses of relevant individuals/departments in 133 companies whose stocks were traded on the ZSE in the first six months of 2012. Questions covered CSR and shareholder relationships practice, company's stock performance and general demographic questions.

The data collected was processed using statistical software for quantitative and qualitative data processing of social researches SPSS 11.01 in order to test the hypothesis and correlations. The table for data input had 25 nominal, ordinal and interval variables.

Statistical data processing included descriptive statistics, calculation of average values and standard deviations, absolute and relative frequencies and cumulative, as well as inferential statistics for determination of statistical significance using Spearman rank correlation coefficient.

B. Review and interpretation of research results

The research results show that companies are mostly big sized, privately owned. Dominating types of companies are the ones doing business in finance and insurance, IT and communications.

Individuals, the survey respondents, are mostly men older than 36 years, with university higher degree belonging to the middle and top management.

C. Correlation between CSR and shareholders relationships practice

Practices of CSR and shareholder relationships level were investigated along with statistical correlation analysis in order to test the hypothesis below.

H1: Companies with CSR integrated have better shareholder relationships.

The CSR practice was investigated through the set of questions with possible answers Likert-type scaled in four levels, where level one means the worse practice and level four associates with the best practice of CSR.

The results of CSR practice inquiry are presented in the following tables.

TABLE I
ARE THE PRINCIPLES AND STANDARDS OF CSR IMPLEMENTED IN THE CORPORATE PRACTICE?

	Freq.	%	Cumulative
CSR is not within the business scope because it is not a legal obligation, therefore it is not applied	0	0,0%	0,0%
CSR issues are covered without formal framework, depending on possibilities and available resources	9	60,0%	60,0%
CSR is applied because of global trends, public relationships and perception of the company through media	1	6,7%	66,7%
CSR is significantly contributing to the company's competitive advantage	5	33,3%	100,0%
TOTAL	15	100,0%	-

Source: Authors' research

TABLE II
HOW IS CSR INTEGRATED IN THE CORPORATE PRACTICE?

	Freq.	%	Cumulative
It is not in the scope of the business	2	13,3%	13,3%
Donations, charity and voluntary activities are being realized occasionally, according to possibilities without specific plan	5	33,3%	46,7%
CSR issues and philanthropic charity activities are being covered through reports published by our PR and/or corporate communications department	0	0,0%	46,7%
The principles of CSR are integrated in the business strategy, organization and management structures, and are implemented in company's daily operations	8	53,3%	100,0%
TOTAL	15	100,0%	-

Source: Authors' research

TABLE III
WHO IS RESPONSIBLE FOR CSR IN THE COMPANY?

	Freq.	%	Cumulative
No one is currently responsible for CSR	4	26,7%	26,7%
General / common affairs department	3	20,0%	46,7%
PR, corporate communications or marketing department	7	46,7%	93,3%
Dedicated CSR department / specialist	1	6,7%	100,0%
TOTAL	15	100,0%	-

Source: Authors' research

TABLE IV
WHAT IS CSR REPORTING PRACTICE OF THE COMPANY?

	Freq.	%	Cumulative
It is not legal obligation, and it is not done	8	53,3%	53,3%
Information is published on our Internet site after each charity	2	13,3%	66,7%
Dedicated CSR report is issued annually	1	6,7%	73,3%
CSR report is integrated within company's annual report	4	26,7%	100,0%
TOTAL	15	100,0%	-

Source: Authors' research

TABLE V
HOW DOES CSR IMPACT THE PERFORMANCE AND BUSINESS SUCCESS?

	Freq.	%	Cumulative
No specific impact	4	26,7%	26,7%
Free resources, if available, are sometimes used for charity or donations improving company's image and public perception	5	33,3%	60,0%
CSR is generating additional expenses because it requires engagement of internal resources, but it is necessary because of social trends, image and public perception	1	6,7%	67,7%
CSR is the source of competitive advantage, enabling entrance to new markets and market share growth	5	33,3%	100,0%
TOTAL	15	100,0%	-

Source: Authors' research

TABLE VI
DID THE COMPANY PARTICIPATE IN CROATIAN CSR INDEX?

	Freq.	%	Cumulative
The company is not aware of such activity	7	46,7%	46,7%
The company did not participate in Croatian CSR Index	6	40,0%	86,7%
The company did participate in CSR Index	0	0,0%	86,7%
The company participated and was awarded within its category	2	13,3%	100,0%
TOTAL	15	100,0%	-

Source: Authors' research

TABLE VII
DESCRIPTIVE ANALYSIS OF CSR INDICATORS WITHIN THE SAMPLE

ELEMENTS	n	Arithmetic mean (1 – 4)	Standard deviation	Rank
Application of CSR principles in business practice	1 5	2,73	0,96	2.
CSR integration within the company	1 5	2,93	1,22	1.
Responsibility for CSR within the organization	1 5	2,33	0,98	4.
CSR reporting practice	1 5	2,07	1,33	5.
CSR impact on company's performance	1 5	2,47	1,25	3.
Participation in Croatian CSR Index	1 5	1,80	1,01	6.
CSR PRACTICE TOTAL	1 5	2,39	0,90	-

Source: Authors' research

The best ranked CSR indicator is the integration of CSR within the company (2,93 on 1-4 scale), and the worst ranked is Croatian CSR Index participation – where almost half of subjects within the sample answered that they are not aware of Croatian CSR Index.

The level of shareholders relationships is measured through concrete practice indicators, with possible answers forming Likert-type scale in five levels, where level one means the worst practice, and level five the best practice in shareholder relationships.

The results of shareholder relationships practice inquiry with descriptive analysis are presented in the following tables.

TABLE VIII
WHO IS RESPONSIBLE FOR COMMUNICATION AND RELATIONSHIPS WITH SHAREHOLDERS IN THE COMPANY?

	Freq.	%	Cumulative
Management board administration	5	33,3%	33,3%
General / common affairs department	3	20,0%	53,3%
Legal department	2	13,3%	66,7%
Corporate communications department	1	6,7%	73,3%
Dedicated department / specialist for shareholders relationships	4	26,7%	100,0%
TOTAL	15	100,0%	-

Source: Authors' research

TABLE IX
IN WHICH PERIOD ARE INQUIRIES AND DEMANDS OF SHAREHOLDERS PROCESSED, WITH RELEVANT FEEDBACK?

	Freq.	%	Cumulative
Not specified, but within three months	0	0,0%	0,0%
Over a month	0	0,0%	0,0%
Between one week and a month	0	0,0%	0,0%
Within 7 days	2	13,3%	13,3%
Immediately upon receipt	13	86,7%	100,0%
TOTAL	15	100,0%	-

Source: Authors' research

TABLE X
HOW IS THE SHAREHOLDER SIZE RELEVANT TO PRIORITY AND ACCEPTANCE OF DEMAND / QUESTIONS PROCESSING AND COMMUNICATION?

	Freq.	%	Cumulative
There is no formal process of receiving and processing shareholders' questions beside annual general meeting	2	13,3%	13,3%
It is done only for big shareholders and institutional investors	0	0,0%	13,3%
For owners of at least 20% of company's shares	1	6,7%	20,0%
For owners of at least 5% of company's shares	1	6,7%	26,7%
Equally for all shareholders	11	73,3%	100,0%
TOTAL	15	100,0%	-

Source: Authors' research

TABLE XI
DOES THE COMPANY PROVIDE PARTICIPATION ON THE ANNUAL GENERAL MEETING FOR SHAREHOLDERS NOT ABLE TO ATTEND PERSONALLY OR BY PROXY VOTE?

	Freq.	%	Cumulative
There are no other technical possibilities	8	53,3%	53,3%
It depends on concrete case, if a shareholder asks for alternative possibility within reasonable	4	26,7%	80,0%
Yes, by conference call	0	0,0%	80,0%
Yes, by video conference call	0	0,0%	80,0%
All modern communication technologies are available for shareholders – telephone, video, Internet...	3	20,0%	100,0%
TOTAL	15	100,0%	-

Source: Authors' research

TABLE XII
DID THE COMPANY HOLD EXTRAORDINARY GENERAL MEETING OF SHAREHOLDERS DUE TO SHAREHOLDERS' REQUEST WITHIN THE PAST YEAR?

	Freq.	%	Cumulative
Extraordinary general shareholders' meeting is never held on shareholders' request	1	6,7%	6,7%
Never, we did not have such requests	13	86,7%	93,3%
Yes, only if it is requested by a shareholder or shareholders' group owning at least 20% of the company	0	0,0%	93,3%
Yes, only if it is requested by a shareholder or shareholders' group owning at least 5% of the company	1	6,7%	100,0%
It would be held on request of any shareholder	0	0,0%	100,0%
TOTAL	15	100,0%	-

Source: Authors' research

TABLE XIII
WHAT IS THE OWNERSHIP PERCENTAGE OF THE LARGEST
SHAREHOLDER OF THE COMPANY?

	Freq.	%	Cumulative
Less than 5% of company's shares	0	0,0%	0,0%
Between 5% and 20% of company's shares	5	33,3%	33,3%
Between 20% and 25% of company's shares	2	13,3%	46,7%
Between 25% and 50% of company's shares	1	6,7%	53,3%
Over 50% of company's shares	7	46,7%	100,0%
TOTAL	15	100,0%	-

Source: Authors' research

An interesting thing to analyze is the answer to the question about the promptness of processing and answering shareholder requests and questions – 86,7% answered that it is done immediately, and the rest within a week. It is hard to believe that companies are so much more progressive in this segment when compared with the legally required minimum. This is a far shorter period than given within legislative regulations and, in combination with some issues pointed in the paragraph above, the question of professional competence of people in charge of shareholders relationship arises – are they really not fulfilling even minimal legal requirements in their practice?

Another protruding indicator is the fact that 86,7% of the respondents never received request for extraordinary general meeting. It indicates the sole deficiency of shareholder activism practice itself.

Correlation analysis was done to examine possible correlations between CSR and the level of shareholder relationships practice within the sample, and results show statistically significant presence of correlation.

The practice of CSR is statistically significantly correlated with shareholders relationship practices at the 5% significance level. The same level of statistical significance is shown in correlation of CSR reporting and CSR impact on performance with ownership concentration and total shareholder relationship practice.

Statistical significance of 1% is shown in correlation of application of CSR principles in business practice with ownership concentration and total shareholder relationship practice.

Based on the conducted analysis hypothesis H1 is confirmed, according to which companies with implemented CSR principles have better shareholder relationships.

D. Correlation between shareholders relationships and economic performance

The data on shareholder relationships practice (Tables VIII-XIII) was taken and analyzed along with the company performance indicators in order to confirm the H2 hypothesis.

H2: Developed relationships with shareholders have a positive impact on economic performance

Since the focus of the research is on the relationships with shareholders and shareholder activism, the performance of a company's share on the stock market was taken as a measure

of company performance, with additional comparative performance indicator within an industry.

A correlation test was done to establish possible correlations between shareholder relationships practices and company's performance indicators. Statistically significant correlation is established only between two elements of shareholders relationship practices with subjective perception of company performance within the industry. However, even these two correlations have opposite signs. The correlation of shareholder relationship practices with objective indicators of company stock performance is not statistically significant.

Based on the analysis done and interpretation of results the conclusion is that the hypothesis H2 cannot be accepted, due to the fact that a positive correlation between shareholders relationship practice and company's economic performance was not established.

E. Development of shareholder activism in Croatia

Shareholders activism is analyzed from different perspectives to determine the development level of shareholders activism and thus test the H3 hypothesis:

- Company perspective: how the company responds to shareholder requests and questions – the perspective was evaluated through descriptive analysis of survey questions already processed for the needs of the H1 hypothesis;

- Shareholders perspective: are shareholders aware of their own rights and are their rights directed towards their interests – evaluated through descriptive analysis of survey questions and analyze of shareholders' practice;

- Legal perspective: analyzing shareholders rights defined within legal regulations, forming a framework and possibilities for shareholder activism; it is used as the key reference point in judging the company practice regarding this issue

H3: Mechanisms and tools of shareholder activism in Croatia are not developed enough.

From the company's perspective, the research indicated significant issues related to shareholder relationships in Croatia. Results show that the practices of companies regarding shareholder relationships, respecting their rights and principles of equality, are under the legal minimum requirements as shown within the analysis of the H1 hypothesis. Answers to clearly legally regulated questions showed elementary law-breaking, instead of receiving relatively uniform answers.

Management board administration, legal department, or especially assigned departments are responsible for shareholder relationships in 73,3% (Table VIII) of the cases. The fact that this responsibility lies on dedicated qualified professionals that are legally bound to cover this issue, and that most of them have university-level education emphasizes the importance of the problem.

The ignorance is additionally emphasized through the answer regarding promptness of processing and answering on shareholder requests, a question that showed immediate and extremely over-the-legal-minimum answers within the whole

sample. It is hard to believe that companies are so highly performing on this specific issue, and it actually doubts in the honesty of the answers and perhaps suggests a lack of professional competence.

Shareholders perspective that is above the Wall Street Walk principle and that indicates the level of shareholder proactivity in corporate governance is partly, yet significantly, discovered through the question about holding extraordinary general meetings – 86,7% of the companies never received such a request (Table XII) by a shareholder.

A shareholder would rather take the exit strategy, sell company's shares, then try to influence the management and involve personally in processes and mechanisms available toward corporate governance excellence for company's performance in his own interest. Besides law-breaking in the matters of shareholder rights, this research also indicated that shareholders are even not trying to pursue rights assured by legal regulations.

Could it be that shareholder ignorance caused such a behavior? Cases of manipulation with illiquid shares that are suddenly being intensively traded causing high price growth, and leaving victims of the fraud with virtually worthless illiquid shares strongly overpaid, actually confirm a significant level of ignorance among shareholders as well.

Ignorance does not grant amnesty from responsibility, especially for managers and responsible professionals within the company. It is also hard to believe such ignorance among the shareholders; because that means that the shareholders are investing on hearsay principle, without proper analysis, without spending time and effort to gain knowledge. It could be that shareholders are optimizing their own efforts and costs by simply deciding not to get involved in corporate governance and to do the Wall Street Walk. Whatever the reason for such shareholder passivity, the fact is that shareholder activism in Croatia is almost nonexistent. Therefore, based on the analysis the above hypothesis H3, which states that mechanisms and tools of shareholder activism in Croatia are not developed, can be accepted.

IV. CONCLUSION

In the modern understanding of society-business relationship, interests of all stakeholder groups are permeated in a symbiotic co-existence. In the process, a new model of responsible ownership is being forged, based on the ideals of responsibility as a universal obligation for global sustainability and democratic shareholder decision-making powers.

As a relatively young democratic country Croatia went through a turbulent period of transition from a state to a market driven economy. Despite the proven increase in CSR issues and practices there is no clear evidence that Croatian companies are giving enough attention to shareholder activism. Croatian business culture in that sense still lags behind despite numerous measures undertaken to increase the survey response.

Given the circumstances of economic crisis and business

difficulties, the low response rate might be understandable. Another reason for the low response is the fact that the legal system does not impose any sort of pressure on companies regarding those issues, and the fact that active shareholders only realize a relatively small fraction of the benefits from their monitoring while bearing the full cost, which can be substantial. There is also an evident lack of guidance in a majority of listed companies regarding issuing any sort of social or/and environmental report. The academic community should also provide insights on this dynamic field based on research and analysis through conferences, networks, seminars, roundtables, published reports and articles.

This paper has reviewed a broad understanding of shareholder activism and its role within CSR paradigm shift, and has dealt with questions how and why business people in Croatia might undertake proactive behavior – whether as a company management member or as an investor and a shareholder. Although there is no clear recommendation, it is quite obvious that companies are focusing more on the concept of CSR and the society is paying even more attention to the actions of the companies. Yet these responsibilities are not clearly reflected in the corporate accountability to shareholders although there is no conflict between doing good and doing well.

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