

A REVIEW OF STUDIES ON CORPORATE GOVERNANCE IN ROMANIA

Elena Chițimuș, PhD Candidate, "Al. Ioan Cuza" University of Iași

Abstract: The attention given to corporate governance (CG) both internationally and locally has increased following the scandals that received a lot of media coverage, like Enron, WorldCom, Arthur Andersen, Lehman Brothers, whose domino effect triggered the economic crisis from which we're still struggling to get out. Provisions related to CG became subject of dispute, as well as for those that are in charge of their issuance, as for those that will have to comply with the norms. Various authors involved in academic environment, and not only, have studied different aspects related to CG and found results that match or are contradictory to what foreign authors obtained. The current paper shows a brief part of the Romanian author's findings.

Keywords: corporate governance; survey; ownership; management; overall firm performance.

JEL Classifications: G30, G32, G38, M41

Introduction

In a society passionate on continuous development and sustainable brand, companies invest time and money for improving and promoting to stakeholders the system of corporate governance. CG studies the separation of power at the entity level and division of responsibilities between shareholders, management and board of directors. Viewed as a mechanism, the CG system supports aligning management objectives with those of shareholders in order to have a profitable company whose success would benefit all. CG plays an important role in the segregation of power, in order to avoid as much as possible the possibility of fraud and incorrect financial reporting.

A walk through current limitations and points of interest

The separation of power in an entity follows some well established rules. Shareholders elect the members of the Board of Directors to represent their interest in the company. The board or governing body ensures that the entity is being run well and in the right direction. Management is in charge with running the company.

According to the authors Ionașcu and Olimid (2012) company's executive management cannot be in charge with the following:

- decisions on the future development strategy;
- establish accounting policies, preference for the organization of the financial control system;
- investment and dismissal of directors, as well as their level of remuneration;
- review over the activities performed by directors;
- prepare the Annual Report or the General Meeting of Shareholders and the implementation of its decisions;
- to request the opening of the insolvency proceedings.

Feleagă et al. (2011) believe that the implementation of the CG in Romania is characterized by some fundamental inconsistencies:

- relations between owners and managers were not examined in detail;
- the process that ends with important decisions for the company doesn't receive significant attention from all stakeholders;

- the absence of a theoretical framework for an efficient market together with its social and collective implications;
- in the promotion and development of CG the involvement of auditors is often questionable;
- failure of reforms built for implementing an accounting system in line with international developments;
- the weakness of control mechanisms for obtaining financial information distinguished as sincere, relevant, reliable, understandable, comparable and significant.

The separation amongst ownership (shareholders) and management (directors) brings conflicts between the two parties involved. Although the ultimate goal is the same for both sides – a strong and profitable company – managers are more focused on short-term goals, acting under the impulse of the moment, wishing to maximize profits at the expense of shareholders. On the other hand shareholders set long-term targets, joining their efforts on surrendering a lucrative business to the next generation (Guni, 2011).

CG regulations come to ensure a transparent environment, reinforce accountability within the company, limit the abuse of power by managers, or better said for insiders who have access to first-hand info, that can impact the future development strategy, as well as the distribution of society's resources in various activities and infrastructure projects. Worldwide, in 2004, there were 180 codes of good practice, characterized by a high degree of convergence in terms of the content (Aguilera, Cuervo-Cazurra, 2004, in Feleagă et al, 2011).

Developed countries focused on the evolution and transformation of CG codes by investing time and money; through market mechanisms that work and react in a short period of time to the new policies, these codes of good practice brought visible improvements in the degree of compliance and transparency; but in emerging countries is not enough to follow a model in order to obtain positive results, it is necessary at first to build a solid institutional structure that should verify the implementation of these codes. In emerging countries many companies are controlled by a group or by an economic conglomerate, the latter being at the forefront of decision-making taking in consideration the number of owned shares, which in most of the cases is significant.

Various authors have analyzed if affiliation to a group impacts in a positive or negative way the development of a company. Feleagă et al. (2011) refer to two studies for Chile issued several years apart. Kahanna and Palepu in 1999 concluded that group membership increased the economic performance, positively influenced by the degree of diversity of conglomerates, but only after a certain level was exceeded. Lefort and Walker in 2003 end by saying that group membership leads to lower firm value, with the possibility of restricting the effect by separating cash flow and control rights.

Related to the relation between governance and performance, Credit Lyonnais Securities Asia (CLSA) calculated in 2001 an index of CG for 495 companies in 25 emerging countries and 18 fields, reporting that companies with higher governance index recorded higher operating performance and higher stock returns. Based on the ranking made by CLSA, Klapper and Love (2002) made their own analysis on the connections between governance and performance. They consider well established, at country level, that firm value is influenced by the degree of protection of shareholders' rights as well as the efficiency of the legal system. Their work emphasizes the differences associated to CG mechanisms at company level, the relation with the legal environment at country level, and correlations between governance and performance.

The results obtained can be summed up as follows:

- companies in countries with overall weak legal system, occupy, on average, places on the bottom of the ranking;

- companies that are also traded on U.S. market have a higher degree of governance provisions, especially in countries with weak legal system;
- good corporate governance is associated with a better market value and increased operational performance.

The improvement CG is in their opinion an achievable goal that requires the support of the political class, because the process besides being long-lasting will also be difficult and demanding. Before legal and judicial reform, companies can achieve reduction of the cost of capital by establishing credible investor protection provisions. The authors conclude that until the renewal of the legal system companies can improve CG through changes to their regulations, in order to protect investors, positively affecting both performance and value of the company.

Research made by Feleagă et al. (2011) aims to examine the importance given to corporate governance principles in our country. The analysis was based on official published data by companies listed on BSE, more specifically at the end of 2010 there were 101 companies (25 in category I, 49 in category II, one company in category III, 26 companies unlisted). For having consistent and unitary data authors removed from these to finally end with a number of 15 companies to review. Indicators used during the research were closely related to Board characteristics: size, structure, number of meetings, degree of independence, separation of the position of CEO from position of Chairman of the Board, disclosure of information and the existence of a code of ethics. Regarding the size of the BoD, for the sample studied, the authors obtained an average of six members, which is in line with the Company Law which requires a minimum of three, maximum 11, and always odd. We're below European average, of 12,5 members, justified by authors through company size and shareholder's structure. Referring to the BoD structure with an emphasis on internationalization, age and diversity of participants, the numbers showed a percentage of 16% for foreign members. Value is identical to the European average, except that in the chosen sample only 3 of 15 companies had foreign members. The second part shows that the average age is 51 years, below the European average of 55 years. And the percentage is 16% for the female category, as against European average of 7%. The findings for the number of times that members meet: 6 for the companies in the sample, compared to the European average of 6,7 meetings for the two-tier BoD and 9,3 for the unitary council. Results are rather controversial as referred to the independence, due to the need of ensuring objectivity in decision making; 20% of the companies analyzed did not provide data on independence and for the remaining, 27% met the principle of independence, while 53% did not. Another worrying percentage is that for 67% of companies, the managing director also occupies the position of Chairman of Board. Transparency is of opaque nature, if I'm allowed to use this expression, when it comes to remuneration of board members and of management, because none of the companies submitted payment information for these services. Authors decide on providing, related to this subject, the value for the European average that is 7.301 euro per meeting in 2005.

Focusing on the existence of a code of ethics, it is showed that in Europe 73% of companies have meaningful codes of ethics and in our country only 47% of companies provided information on the matter. As a general conclusion results show that most of the companies analyzed do not meet the recommendations of the governance code regarding the independence of directors and audit committee members. The degree of transparency remains at a much lower level as compared to European values which is an indicator of the remaining work to be done in order to improve this segment.

Răileanu and Dobroțeanu (2011) believe that literature in Romania and abroad do not provide a sufficient number of studies that might indicate the level of development and implementation of corporate governance provisions. Much of the research tries to discover

whether corporate governance is part of the daily business life of companies because it is required by law or because administrators understand the benefits of good governance. Objectives of the research conducted by Răileanu and Dobroțeanu (2011) were to identify deficiencies causing an unsatisfactory level of transparency and governance for companies in Romania, and detect criteria for measuring the level of corporate management. The analysis was based on information published on the official websites of the companies listed on BSE. After going through the information provided the main conclusion is that companies in our country are not yet aware of the importance of presenting the degree of compliance with corporate governance. According to the authors mentioned above, in charge with achieving good governance are the shareholders, through the BoD that they assign. Also they believe that educational and awareness actions often prove to be more useful than the legislative or regulatory activities.

Companies characterized by fragile corporate governance find excuses in high cost of improving this area and fear of disclosing strategic information for the company. Hence there is weak hope to obtain notable results until administrators will not be convinced that the benefits of good governance outweigh the costs, that they will get more value and increased performance. To avoid further scandals with financial loss, mistrust, bankruptcy, desolation among people involved, companies and the society must come up with viable solutions. A part of the solution is in the corporate governance codes proposing rules leading to board effectiveness, objectivity and avoiding pursue of self-interest. No one can say that a code is better than the other, especially since each country or company present their own peculiarities that require specific solutions.

According to Răileanu and Dobroțeanu (2011) the best known system for assessing corporate governance is the one proposed by the rating agency Standard & Poor's. The analysis is based on two components: macro, the score given to the country, and micro, the score given to a company. The macro section is important if you look at things from the perspective of investors, which will focus their financial availabilities to countries with a better score. The score of the country focuses on the state support in developing and tracking compliance with the principles of governance. The emphasis is on the law-making framework, the country's rules related to capital market, on the degree of compliance with generally accepted accounting principles, and on the way in which is fulfilled the financial reporting. All this taken together creates an image of the society where companies will have to operate, having in the first phase a minimum of understanding on the degree of bureaucracy and the extent of initial efforts. The other part of the problem, the company's score, refers to the effectiveness of actions taken by stakeholders, shareholders and management. The scrutinized areas to obtain the score of the enterprise are:

- ownership structure and how it affects the company;
- the interaction between parties;
- financial transparency through the content (qualitative and quantitative) of information available to the interested public, the independence of financial auditors;
- management structure and process (leadership role and composition, independence, remuneration, assessment methods and succession)

The score for each component is from 1 to 10, for obtaining a final score also situated between 1 and 10. Romania was occupying place 7th out of 10th in 2000, in a study made by S.G. Emerging Funds Equity Research on the level of corporate governance (Răileanu and Dobroțeanu, 2011).

Another study conducted in Romania, this time by Ionașcu and Olimid (2012) seeks to determine the extent to which corporate governance policies affect financial analysts' forecasts. The sample was composed of 19 companies listed on BSE, which were under scrutiny of financial analysts, using for the analysis monthly forecasts for the period 2008-

2010. An aggregate index was calculated – IndGov – having as starting point the studies of Garcia Lara et al. (2007) and Olimid et al. (2009), using three indicators: Board size, percentage of non-executive directors on the board, if general manager occupies also the position of Chairman of the Board. Through the use of a regression model it was concluded that for the companies with better corporate governance practices there were smaller forecasting errors, the indicator of corporate governance being negative correlated with the forecast errors of financial analysts.

Ștefănescu (2011) makes a review of the literature focused on CG and believes that although it is generally accepted that a Board of Directors consisting of up to 7 or 8 people can help improve performance (Jensen, 1993; Lipton and Lorsch, 1992), many controversies exist related to its degree of independence; some part of authors see as valuable the presence of non-executive directors (Fama and Jensen, 1983), while others pinpoint a weak link or no connection between the level of board independence and performance (Pi and Timme, 1993; Klein, 1998; Weir, Laing and McKnight, 2002; Adams and Mehran, 2004). Many authors converge on the same idea that a large number of board members leads to inefficiency and constructive coordination failure. Due to various studies and all the controversy created by their results, Ștefănescu (2011) concludes that the size, the structure, can be good or bad according to the components authors analyzed, and that there is an optimal structure of corporate governance that vary over time and from firm to firm.

Albu et. Al (2013) started their own study about the level of corporate governance among professionals in Romania. The questionnaire prepared by them was filled in by a number of 76 people, considered as having a thorough theoretical background, but also practical experience. The practice of the persons that answered the questions had the following split (56,58% - under 2 years; 25% between 2 and 5; 14,82% over 5 years); the percentage of experienced persons under 2 years is explained by authors, through other studies, that showed that experienced accountants with more or less seniority have different views when relatively new themes and concepts are discussed. Their field of work presents following distribution: 48,68% work in the financial & accounting field, 11,84% are engaged in banking and insurance, 6,58% in auditing, 5,26% in consultancy, 27,63% are involved in other work areas or are not employed. The 12 questions composed by authors focus on data related to the persons interviewed and the way corporate governance is perceived, to financial reporting, to the beneficiaries of good corporate governance, agency problem solutions, mandatory corporate governance rules and their future in Romania. As to understanding the benefits of good governance, people surveyed, that had more practical experience, present an orientation towards the stakeholder model. Related to the normalization of governance, opinions are divided as follows: 72% see necessary as professionals to be involved in issuing norms and 50% consider that the representatives of capital markets and of the audit firms should assume this responsibility. Regarding academic environment 37% of respondents consider its involvement a necessity. The lowest percentage was recorded by the version that each company should issue its own governance code. The persons interviewed believe that effective governance improves financial reporting, reducing fraud; 47% of respondents believe that governance rules should not be mandatory and that is better to adopt a system type like „comply or explain”. Related to agency problems the persons with experience under two years see the solution in: management training, an effective internal and external control and a continuous monitoring of performance. The persons having a work experience higher than two years believe that results will be seen through management training and effective control policies. The general conclusion of the study and the opinion of most respondents, respectively 81,58%, is that the importance of corporate governance will increase.

Conclusion

The business environment is the place where titans collide. High stakes determined policies and procedures to be put in place. How a company is managed and how the strategy of the company evolves on short and long term is the thin line between success and collapse. The regulatory framework has changed constantly trying to keep up with the challenges of a tumultuous business cycle. Companies must stay updated with the law in the jurisdiction they are located and also in all the places they do business. CG concerns all parties involved, either they are issuers of regulations or the ones that have to comply. Both sides have to work for a common goal and that should be prosperity.

Bibliography:

Albu, N., Durica, A., Grigore, N., Grigoras, D., Mateescu, R., Ichim, A., (2013) *Guvernanța corporativă în România. Percepții și perspective*, Contabilitatea, expertiza și auditul afacerilor, iunie 2013

Cremers, M., Ferrell, A., (2009) Thirty years of Corporate Governance: Firm valuation & stock returns, downloaded from <http://ssrn.com/abstract=1413133> on January 2014

Feleagă, N., Feleagă, L., Dragomir, V.D., Bigioi, A.D., (2011) *Guvernanța corporativă în economiile emergente: cazul României*, Economie teoretică și aplicată, Volumul XVIII, No. 9(562), pag. 3-15.

Ghiță, M., Iațco, C., Brezuleanu C., Vorniceanu, M. (2009) *Guvernanța corporativă și auditul intern*, Editura Tipo Moldova, Iași

Guni, C.N., (2011) *Financial assumptions in addressing the concept of corporate governance*, Sibiu Alma Mater University Journals. Series A. Economic Sciences – Volume 4, no. 1, March/ 2011

Ionașcu, M., Olimid, L., (2012) *Impactul practicilor de guvernanță corporativă asupra previziunilor analiștilor financiari: cazul României*, Audit Financiar, Nr. 4/2012, pag. 31-36

Ionașcu, I., Ionașcu, M., Olimid, L., Calu, D.A., (2007), *An empirical evaluation of the costs of harmonising Romanian accounting with international regulations (EU Directives and IAS/IFRS)*, Accounting in Europe, Volume 4, Issue 2, 169-206.

Ionașcu, I., Olimid, L., Ionașcu, M., Calu, D.A., (2011) *Efectul politicilor de guvernanță corporativă asupra reducerii costului capitalului pentru companiile românești cotate*, Audit Financiar, Nr. 2/2011, pag. 12-17.

Klapper, L.F., Love, I. (2002) *Corporate Governance, Investor Protection, and Performance in Emerging Markets*, accessed on December 2013 at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=303979

Larcker, D., Tayan, B. (2013) *Trust: The unwritten Contract in CG*, Stanford closer look series, Topics, Issues, and Controversies in CG and Leadership, July 31, 2013

Company Law no. 31 from 1990 downloaded from Legis in March 2013

Răileanu, A.S., Dobroțeanu, C.L., Dobroțeanu, L., (2011) *Probleme de actualitate cu privire la măsurarea nivelului de guvernanță corporativă în România*, Audit Financiar, Nr. 1/2011, pag. 11-15

Shleifer, A., Vishny, R., (1997) *A survey of Corporate Governance*, The Journal of Finance, volume LII, No.2, June 1997

Ștefănescu, C.A. (2011) *Do corporate governance “actors” features affect banks’ value? – Evidence from Romania*, Procedia Social and Behavioral Sciences 24 (2011) 1311-1321

Corporate Governance Code of BSE accessed on December 2013 at http://www.bvb.ro/info/Rapoarte/Diverse/Cod%20Guvernanta%20Corporativa_prelucrat.pdf

OECD Principles accessed on August 2013 at
<http://www.oecd.org/daf/ca/corporategovernanceprinciples/40823806.pdf>
<http://www.capital.ro/detalii-articole/stiri/cele-mai-mari-falimente-ale-americii-157455.html>, viewed in September 2013
<http://www.zf.ro/business-international/ce-se-intampla-dupa-cinci-ani-de-criza-efectele-falimentului-lehman-brothers-se-simt-si-azi-11373720>, viewed in September 2013