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Need to implement corporate governance in the Romanian companies

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Abstract. *Under the background of the current economic realities, characterized by uncertainty and mistrust, of increased complexity of the environment in which they operate, the Romanian companies must demonstrate good organization, flexibility, skills, good risk management and be trustworthy economic and social partners. The answer to many of these challenges is provided by a modern management system, which makes proof of more convincing development possibilities, namely corporate governance.*

This article is an attempt to summarize the major theoretical and practical issues related to corporate governance models, as well as a vision of the need to apply this management system in the Romanian companies. At the same time, the paper will briefly present the current state of corporate governance system implementation in the Romanian companies.

Keywords: corporate governance; system management; Romanian enterprises.

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Introduction

The current economic dynamics and the fierce competition on all markets, regardless of their profile, require major changes in the business management system and a new managerial behavior. In this context, the performance management system and corporate governance, as modern and extremely efficient management systems, are more and more often applied (Lenghel, 2005). Due to the steady increase in competitiveness of the national and international business, the managers of today focus their activities primarily on increasing the effectiveness of companies, which implies the existence of a well-defined, modern and efficient management system. In the current context, when the markets become increasingly competitive and demanding, the Romanian companies must be able to quickly adapt to changes in the business environment, to assimilate these changes and to operate with them at the highest effectiveness level. The capacity to absorb information and adapt to the new conditions depends both on the characteristics and structure of companies, as well as on their managerial and leadership skills.

Materials and methods

The materials used for this article were represented by: national and international literature, studies by Romanian and foreign scientists, specialized websites and institutions that have implemented the corporate governance system (Bucharest Stock Exchange, OMV – PETROM company, and so on). The research methods used were based primarily on the bibliographic study and documentation, having in view a thorough knowledge of the basic theoretical aspects of corporate governance, as well as the analysis of the economic practice on the Romanian companies with regard to corporate governance.

Corporate governance – fundamental aspects

Improving the overall economic efficiency on the Romanian companies, and not only, should start from their good governance and management system. Business administration is already widely acknowledged as essential for establishing an attractive investment climate, characterized by the existence of competitive companies and efficient markets.

At present, there are numerous studies and empirical evidence showing that certain fundamental aspects regarding corporate governance plays a key role in improving business performance, primarily by facilitating their access to capital markets, thereby increasing investors' confidence and increasing enterprise competitiveness.

The principles of corporate governance involve a series of measures that ultimately lead to an increase of company transparency, making them more attractive. In addition, the implementation of corporate governance measures is a concern of the managers of listed companies, as well as of the authorities. The corporate governance implementation has an utmost importance in attracting major investors. Recent studies even link company performance to the efficiency of the applied corporate governance model (Briciu, 2012). More recently, the investors have focused on the corporate governance systems implemented in companies and are willing to pay extra for the good results in this area.

The companies are well aware of this reality and give it considerably more weight compared to previous years. The good and bad examples on the international market are relevant in this respect. Thus, on the one hand, there are companies that have put a lot of effort and time to achieve high standards of corporate governance. As a result, these companies are seen as representatives of governance based on added value, being able to maximize their value through systems and processes that enable managers, regardless of their hierarchical level, to assess and monitor the achieved performance. On the other side, there are companies that failed in building a corporate governance system and in having a transparent approach to the various stakeholders. Therefore, the drawbacks of the systems of the respective organizations are revealed and prove to be more than embarrassing, sometimes even leading to disastrous results.

Finally, the test of an enterprise governance model effectiveness is represented by the extent to which this attains its main objective, namely to maximize the company value in terms of shareholders and community. It all depends on how it manages to organize an ideal system: satisfying customers, employees, suppliers, distributors etc., the reward being an increased and sustainable added value, if good results are obtained.

The respect of corporate governance principles is recognized as increasingly important not only in terms of ethics, but also essential in building up a solid and prosperous business. The companies that meet the high standards of corporate governance will gain customers' confidence, the trust of those who provide financial resources, as well as the shareholders' confidence, which will lead to their better performance on the market. The risk assessment exercise is designed to help enterprises to maximize their potential by focusing on long-term strategic objectives and by optimizing the level of risk associated to their operations. In the conditions in which no enterprise operates in a completely risk-free environment, which is a fundamental component of the business environment, the risk assessment exercise should be accurate, complete and based on scientific principles.

Corporate governance emerged and developed while being successively influenced by the economic environment based on family property, banking capital, institutional investors or joint stock companies. Surprisingly, the moments of crisis had beneficial effects on identifying ways to improve corporate governance, so that its application methods and principles should correspond to each stage in the world economy evolution.

Models of corporate governance

The corporate governance principles established by the OECD (Organization for Economic Cooperation and Development) are provided as a standard, but each state should define its own corporate governance code, depending on the specific economic, organizational culture, ownership system, state intervention in the economy, financial and capital market etc.

The main corporate governance models established and implemented throughout the world in time are the Anglo – Saxon and German models.

The Anglo – Saxon or Anglo – American corporate governance model is specific to the firms from the UK, USA, Hong Kong, Canada and Australia. The commercial companies that apply this corporate governance model are characterized by dispersed shareholders, a low financial power concentration, so that power is exercised by managers. It is a system based on the control from external capital markets, which are very active and highly developed influencing, through mergers and acquisitions of listed companies, their control and trading securities (outsider-based system). Under these conditions, the investors' protection, when no major shareholders exist, represent a constant concern of market regulating institutions through corporate governance practices and policies. This shareholders-oriented system is actually based on a stock-exchange model, the evolution of the course of action being considered the synthesis of a listed company performance, thus enabling all the concerned actors, shareholders and managers, in the first place, to optimize their decisions and behaviors.

In order to analyze the Anglo-Saxon corporate governance model, a set of indicators or specific management tools are envisaged, mainly designed in the United States, but which are currently used all over the world, namely (Feleagă, Vasile, 2006):

- A funding indicator – available cash flow (free cash flow);
- A performance indicator – creating stock value or value for shareholder (shareholder value);
- An accounting assessment principle – fair value;
- An incentive tool – awards of options to purchase shares (stocks options);
- A disciplinary mechanism – takeover bids and exchange.

Based on these tools, the corporate governance codes issued after the crisis from the beginning of the century (Sarbanes – Oxley in the USA and New Combined Code – in the UK) had to focus on solving all problems, especially those related to the independence of non-executive directors and auditors from management, empowerment of independent directors, the existence of a single Board of Directors that continuously monitors activity management, risk reduction with transactions with affiliated parties, due to loyalty abuse by managers in their own interest.

Finally, the Anglo-Saxon corporate governance model provides the developed financial markets the last control role in enterprise performance; through purchases of securities it may determine the changes necessary for the recovery of commercial companies.

The German corporate governance model is specific to companies in Germany and continental Europe, as well as to those from Japan; its main characteristic, unlike the Anglo-Saxon model, is the presence of a strong shareholding system, which has an important influence on management, the business owners being banks, financial investment firms and other firms that control the company strategy. In order to strengthen the control of certain shareholders, there is even a limited issue of new shares. Thus, in these countries, the shareholders holding large blocks of shares are actively involved in the management of these companies, by penalizing poor quality management, fostering the economic efficiency and harmonization of the interests of the company social partners, including its own staff. Human capital is considered of utmost importance in the German model.

Property stability ensures long-term development strategies, and the main funding source is represented by credits, and not the capital market as in the case of the Anglo-Saxon model. Although the banks in these countries may not have large holdings of shares in the financed companies, yet they exercise a powerful influence and control over their governance system; hence the main advantage of this model: flexible funding of companies, as well as efficient communication between banks and the companies. The strong involvement of banks in the management of companies provides this system a great stability and priority orientation towards economic development. However, there are also certain disadvantages in this corporate governance system, among which the mostly important ones are the following: its failure to protect minority shareholders, financial power concentration and opportunity for dangerous combinations between the economic and financial power.

The attempts to obtain better performance in corporate governance have been materialized into *a comparison between the two models of corporate governance*. Although they have corporate governance systems built for a long time compared to emergent economies, in the specialized literature the opinions are not fully in agreement with regard to selecting the most functional of them: the Anglo-Saxon or German. From the very beginning it must be mentioned that there is not a clear-cut advantage of one model over the other.

The countries are inclined to criticize the German Anglo-American system for its too mercantile character of the firm – administrator relations. The "Sarbanes – Oxley Act", enacted in 2002, introduces a stricter control of company managers, entailing the consolidation of investors' (shareholders') confidence in the business environment. The law sets new standards for the boards of directors, executives and accounting firms in the US and tougher penalties against those who infringe the law (Șerban, 2007).

Another difference between the two models is the different relation between the three actors, i.e. manager, (reference) shareholder and minority shareholder and their powers. Unlike the European model, which disadvantages the minority shareholder, the Anglo-American system makes no distinction between the minority and the majority shareholder, ensuring greater fluidity to the capital flow and greater stock market efficiency. The majority shareholder role is canceled, in the Anglo-American system, through the voting procedures imposed to administrators (managing director). The latter mitigate the majority shareholders' influence in decision-making, having also a corporative social responsibility, by diminishing appetite for risk. That is why the administration boards of companies that apply the Anglo-Saxon corporate governance model often use personalities outside the business circles, such as university professors.

In conclusion, a leader of an Anglo-Saxon company is engaged on contract terms, while o German one receives a social mandate from the company. In recent times, the trans-Atlantic methodology transfer is produced rather from West to East, so that the European researchers, concerned about future developments, seek to avoid the too sudden transposition of the contract-based method of administrator employment. In these circumstances, the European Commission organized an auction in April 2006, for a study to establish the optimum ratio between shareholders' power and administrators' power in a listed company. Won by three institutions, including the European Corporate Governance Institute (ECGI), this auction will bring the EU executive extremely useful data in decision-making (Șerban, 2007).

The comparative analysis of the *advantages and disadvantages of the two models of corporate governance* in developed countries suggests that the company governance system can be improved as a result of the action of the following factors (Vîtcă, Dănescu, 2006):

- Capital market actually offers official recognition of company performance and of its management implicitly, by the price of the shares of listed companies;

- Acquisitions of companies in developed countries like UK, USA, France, Germany, Japan, are made on a regulated procurement market;
- Institutional investors represent a potential influence power of company governance, especially in the UK and US. At the same time, they represent a danger in terms of the strong control they can have over firms, considering the high percentage of holdings in their capital stock;
- Creditors conclude contracts with the company to protect their rights, and in case of breach, may require initiation of bankruptcy proceedings for their recovery;
- Labor market for managers penalize the managers without notable performance, by replacing them by the Board of Directors, which entails the impossibility of finding a similar job;
- The competitiveness of products and services influences the company corporate governance, but the action of this factor is slow, shareholders can lose huge amounts of money, as a result of product quality degradation, loss of customers and markets.

As it can be noticed, these factors lead to better performance in corporate governance and to the removal of deficiencies, but this does not mean absolute standardization.

As it has been mentioned, there are still sufficient controversies in the economies of the developed countries about the appropriateness or non-appropriateness of different corporate governance mechanisms. For instance, Easterbrook and Fischel (1991) and Romano (1993) made an optimistic assessment of the US corporate governance system, while the studies by Jensen (1993) argue that the system suffers from major deficiencies and significant changes are imposed. The replacement of the Anglo-Saxon governance system by that of Germany and Japan (Gilson, Roe, 1993) is also debated. However, it is estimated that the corporate governance systems in the US, Germany, Japan and UK are among the best in the world, and their differences are not significant compared to the systems of other countries. Although the North American corporate governance model seems to be imposed in many countries and in many businesses, we should not overlook its limitations and criticism.

The corporate governance systems used by companies in Central and Eastern Europe (including Romania)

Unlike the German model based on internal influence (*insider – based model*), the enterprises in Central and Eastern Europe have a common governance model based on internal control, as a result of the privatization and restructuring process. This model, specific to countries from Central and

Eastern Europe, is a form of organization of companies resulting in capturing the control rights by managers or employees from the former state-owned enterprises in the privatization process, holding substantial blocks of shares by *insiders* of the privatization process and exercising their own interests in the decision-making process at the strategic companies level, when the companies still remain into state ownership. Hence problems facing corporate governance in this area appear: managers who have an excessive control of enterprises can act against shareholders, employees and other social partners, thereby jeopardizing the financial health, performance and the whole businesses environment of the company. This raises the need to increase the efficiency of this model by developing capital markets and banking systems as modalities of external or internal influence of the corporate governance systems of firms in transition economies. This is a more difficult approach, as in these countries no appropriate regulatory institutions existed, and therefore, no legal framework on issues that the companies are currently facing, such as bankruptcy, financial and accounting reporting requirements, ownership right, etc.

The corporate governance structures of firms in European countries in transition were significantly influenced by the objectives of the privatization process, i.e. speed, political responsibility, legal regulation and privatization efficiency. Considering the priority of these goals and the political and economic conditions, the privatization process had relatively different forms in the countries from Central and Eastern Europe.

In Russia, for example, the weak corporate governance mechanisms led to the embezzlement of assets from the privatized firms as a result of the managers' actions and to the quasi-absence of external financing for companies in this country (Boycko, Shleifer, Vishny, 1995).

In Romania, the corporate governance system management is applied only on the large state or private companies, due to the lack of information, poor training of some managers, legislative incoherence and economic and financial crisis.

In order to implement and improve corporate governance in the Central and East- European countries, in the Romanian companies inclusively, much more is needed than letting the market mechanisms regulate the company activity. Indeed, under the impetus of market competition, the firms will have to reduce costs, to seek for external financing conditions under most favourable terms, etc.

Thus, in order to accelerate the corporate governance implementation in these countries, the international institutions, governments, regulating institutions, employers' organizations, etc. were involved in the debates at Round Tables that resulted in the Stability Pact for South – Eastern Europe and the White Paper on corporate governance in South Eastern Europe, as the foundation of corporate governance model specific to these countries.

Conclusions

In an economy under continuous change, both at national and world level, business sustainability can be ensured by applying a system including effective management, implementation of modern management methods, proper motivation of employees, performance promotion at individual and organizational level and focusing primarily on results. Given the trends on the international market, we believe that corporate governance will remain a priority for the top management of companies for a long time, because the companies that adopt a transparent organizational culture and an efficient leadership model will have a better performance, while those that refuse to accept this absolutely necessary reality will experience poorer results.

The adopted management style should get adjusted according to the business nature and characteristics, to the structure of the enterprise. At present, the corporate governance is applied as a management system only in the larger firms in Romania. Given the advantages of this leadership model, we expect its expansion to smaller companies as well. The need for corporate governance is primarily due to business growth, both at national and world level.

It goes without saying that market volatility, combined with pressure from shareholders and economic uncertainty, creates the premises for the risk that the company top management acts incorrectly from the ethical point of view. Therefore, the importance of an efficient corporate governance model that controls and evaluates company performance, while satisfying the needs of all stakeholders and thus creates added value will further increase. Under these conditions, corporate governance can be a management tool to help maximize company value.

Corporate governance systems inefficiency is mostly due to the concentration of power in the hands of managerial staff and/or employees, without other market players being able to bring their influence and without active capital markets having an impact upon their evolution. Managers often think that they know everything and that the employees are mere subordinates who must execute orders. This management system can no longer be applied, in the conditions in which long-term performance and company effectiveness are targeted. Thus, a corporate governance system is necessary, which involves all decision-makers and all employees.

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