COMPARATIVE STUDY ON CORPORATE GOVERNANCE

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Corporate governance is a key element of today's economic reality being more and more present in many countries around the world. This paper has two main objectives. The first one is to offer more insight into the concept of corporate governance by a thorough literature review and by presenting and analyzing a framework of corporate governance. The second objective of this paper is to investigate the corporate governance situation in three developing economies (Romania, Bulgaria and Hungary). The World Bank and the European Bank for Reconstruction and Development published a series of reports on corporate governance. The present study uses data from these reports in order to illustrate how these developing economies are dealing with corporate governance. Based on ROSC Reports a corporate governance score was calculated. As this score shows, there is room for improvement for all three developing economies. This study is important because it shows the differences in corporate governance among developing economies and the need to study these nations at the individual country level. Corporate governance has many benefits for developing economies. It helps developing economies to register sustainable growth rates, to increases investors' confidence in the national economy, and to increase the ability of capital markets to mobilize savings.

Keywords: corporate governance, shareholders, stakeholders, investors, corporate governance principles.

JEL Classification: G30, M10

I. Introduction

Corporate governance has become an important topic in practice and academic literature in recent years. To ensure a competitive position, to attract capital, to ensure sustainability, and to combat corruption, companies from developing countries need to put in place good governance institutions.

According to Monks and Minow (2004) the importance of corporate governance has increased dramatically in 2002 when a series of events led to the bankruptcies of large U.S. companies and the loss of thousands of jobs. The way companies are governed determines their fate as well as that of the economy in general. Failure to attract adequate levels of capital threatens the existence of firms which can have serious consequences for the entire economy. Firms that are unable to attract capital may remain outside of international markets entirely, while economies may not benefit from globalization. The investors are interested in those companies with good corporate governance because, according to OECD (1999), Corporate governance specifies the distribution of rights and responsibilities among different participants in the company, such as managers, shareholders and other interested parties, specifying the rules and procedures for making decisions on company's affairs. In this way, it also provides the structure through which company's objectives are set, the means of attaining those objectives and monitoring performance. Thus deficiencies in corporate governance can have as a consequence not only scandals and corporate liquidations but also financial crises and economic instability.

The Center for International Private Enterprise (2002) listed some of the main advantages of a strong corporate governance. These include:

-improved access to capital and financial markets;
-higher accountability and transparency;
-stimulation of performance;
-protection of shareholders and their investment;
-reduces the incidence of corruption;
-enhancement of marketability of goods and services

The list illustrated above gives a general image of the most important benefits of a good corporate governance. For developing countries, the problem of good corporate governance development becomes more complicated because of the underdeveloped institutional infrastructure. For this reason there is a need for a careful approach to governance restructuring.

A weak or absent corporate governance can have the following consequences:

-reduces the opportunities to attract sufficient capital, limits competitiveness and job creation;
-has a negative impact on employees' commitment;
-may lead to bankruptcy due to a lack of solid company strategy and leadership from the board of directors;
-allows company managers and directors to follow their own interests at the expense of shareholders, creditors, and other stakeholders;
-excessive regulation that impacts private sector growth (CIPE, 2002).

II. Review of the literature

The literature on corporate governance is extremely broad. Only in recent years hundreds of articles and dozens of books have been oriented toward corporate governance.

The concept of corporate governance began to take shape more clearly after 1997, in the European Union, when most countries have adopted codes of corporate governance. The impulse of adopting these codes has been the financial scandals related to the failure of British companies quoted on the stock market. On the other hand, the Asian economic crisis of 1978 and the withdrawal of investors from Asia and Russia had created problems for the international business community regarding the consequences of the investors lack of trust in corporate management.

Corporate governance principles developed by the OECD (Organization for Economic Cooperation and Development) provide specific indications, meant to improve the legal regulations. They formulate practical proposals to the attention of stock market authorities, investors and other pillars that have intervened in the governance of the company. Adapting corporate governance principles for the purposes of ensuring transparency, accountability and fair treatment of shareholders has resulted in the development of the OECD Principles of Corporate Governance. The principles underlying corporate governance should ensure the strategic direction of the company.

The concept of corporate governance encountered many definitions. Depending on their perspective, different authors define this concept in different ways. Thus corporate governance definitions can be groups in two categories: narrow and broad definitions. These two categories are illustrated below.

In a narrow sense, corporate governance can be defined as the relationship among various participants in determining the direction and performance of corporations. The primary participants are (1) the shareholders, (2) the management, and (3) the board of directors (Monks and Minow, 2004).

A broader definition was given by Cadbury Committee, 1992. Thus corporate governance was defined as the system by which companies are directed and controlled.

An even broader definition belongs to Zingales (1998). According to this author, corporate governance is the complex set of constraints that shape the ex post bargaining over the quasi rents generated by the firm.
Many researchers consider that the corporate governance mechanisms fall into one of the two groups: those internal and those external to the firm. This aspect is illustrated in figure 1 which depicts the separation of ownership and control.
On the left side, figure one illustrates the internal governance and on the right hand side the external governance. The Board of Directors is charged with advertising and monitoring management and has the responsibility to hire, fire and compensate senior management team (Jensen, 1993).

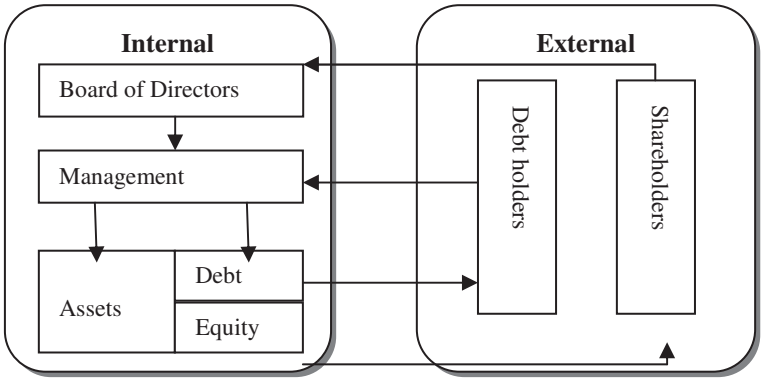


Figure 1. Separation of ownership and control – balance sheet model.
Source: Adapted from Gillan, S. (2006): 382.

In conclusion we can say that there is no exact definition of corporate governance, not even in developed countries. All are based on the theory of interest holders. Interpretations of corporate governance refer to a set of relationships, distribution rights, set of rules, sector of the economy.

III. Corporate governance framework

If we closer analyze Figure 1 we can see that firms are more than board, managers, debt holders and shareholders. A more detailed framework of corporate governance is depicted in Figure 2.
This is an expansion of the previous figure in order to examine a broader set of governance influence. As in Figure 1, the corporate governance framework is divided into two broad classifications: Internal and External Governance.
At the center of this system as an internal force, is the board of directors which is considered by many as the lynchpin of corporate governance (Gillan, 2006). Its overriding responsibility is to ensure the long-term viability of the firm and to provide oversight of management. In many countries the board is responsible for approving the company's major decisions and strategy and for hiring, monitoring and replacing the management (World Bank, 1999).
A large amount of research on corporate boards was concentrated on the relationship between board structure and firm value (Vafeas, 1999). Others were concentrated on the analysis of the structure and activity of board subcommittees (Klein, 2002; Deli and Gillian, 2000).
More recent studies focus on changes of board structure over time. Here we can mention the study conducted by Coles at al. (2005) who focused on board changes over time and on the costs associated with board changes resulting from the new regulations.
Other empirical studies were focused on board characteristics. According to Ferris et al. (2003) busy boards don't have a negative impact on the shareholders' wealth and Larcker et al. (2005) found that "cozy" board relationships limit effective monitoring.

The composition of the board of directors also shows strong contrasts between countries. For example, Japanese companies are known for the large number of board members and therefore their inefficiency. These can consist of more than 50 members with few external ones to monitor the management activity and the strategic direction of the company. Italy and France are considered to have medium-sized boards but still inefficient due to the lack or reduced number of independent non-executive directors. The most active boards are the ones in Great Britain and the United States due in part to the efforts in improving corporate law.
As previously stated the framework includes internal and external forces that face one another and have an impact on the activity of the existing corporations. The external forces are represented by policy, legal, regulatory and market. The role of the external forces is to strengthen the internal mechanisms for corporate governance.

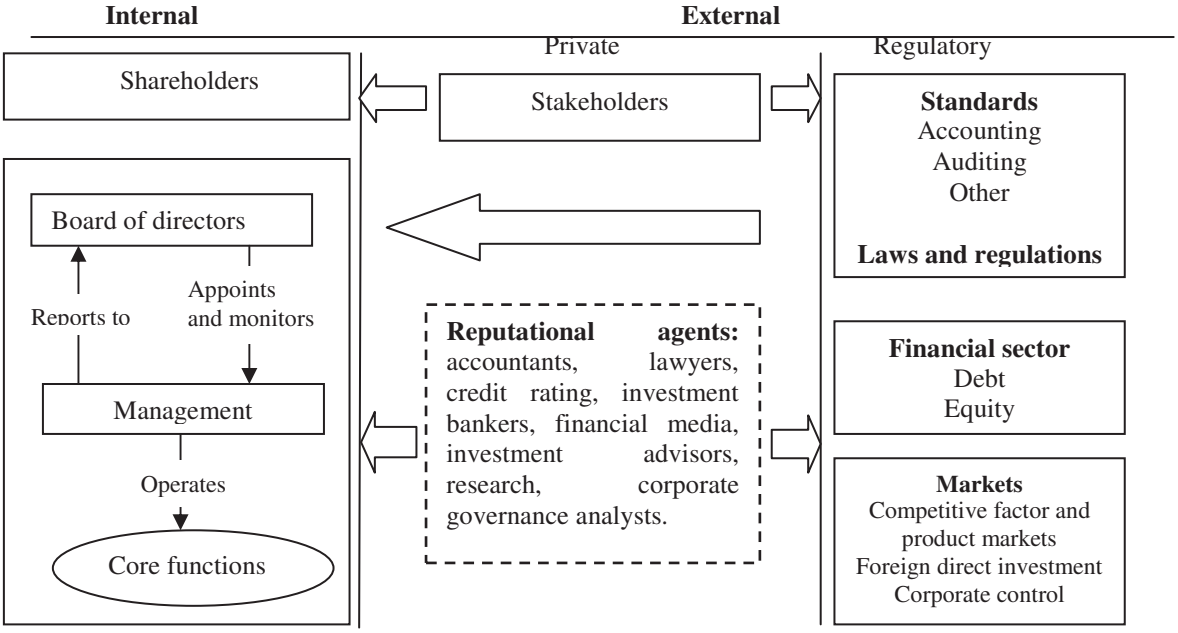


Figure 2. Corporate governance framework.
Source: Adapted from World Bank, Corporate Governance: Framework for Implementation, Overview, 1999: 4.

Many authors and analysts consider that the problem of corporate governance has become increasingly important for developing countries. The challenge for these countries is to adapt systems of corporate governance to their own corporate structures and implementation capacities, in order to create a culture of enforcement and compliance.

IV. Research methodology

The object of this section is to provide some insight on the corporate governance situation in three developing economies: Romania, Hungary and Bulgaria. In order to analyze the development of corporate governance in these counties we used secondary data analysis, more specifically reports or statistics offered by: European Corporate Governance Institute (ECGI), World Bank Reports (ROSC Reports), European Bank for Reconstruction and Development (EBRD) reports.

V. Data analysis – Country comparison

Table 1 illustrates, for all three analyzed countries, the overall ease of doing business rank (out of 183 economies) and the ranking for protecting investors. As we can see Hungary has the highest index of all three countries with an increase in 2011 of 6 points compared to 2010. Romania is the second one followed by Bulgaria. We should mention here that of all three analyzed countries Romania was the only one which went down two places in the overall ranking regarding the ease of doing business.

We chose to illustrate the investor protection index because we consider it to be very relevant to our study. The Investor Protection Index consists of three dimensions of investor protection: transparency of transactions (Disclosure Index), liability for self-dealing (Director Liability Index) and shareholders' ability to sue officers and directors for misconduct (Shareholder Suits Index). Thus, as the above table shows the situation in Romania and Bulgaria (both ranked 44 with an absolute value of 6) is far better compared to the one registered in Hungary (which ranked 120 with an absolute value of 4.3).

Table 1. Ease of doing business ranking

	Romania	Hungary	Bulgaria
Ease of doing business-rank	56(-2)	46(+6)	51(0)
Protecting investors-rank	44	120	44
-disclosure index	9	2	10
-director liability index	5	4	1
-shareholder suits index	4	7	7
-investor protection index	6	4.3	6

Source: own compilation, based on Doing Business Report, 2011

Table 2 illustrates the existence of a national code for corporate governance and the degree of compliance of CG legislation with the OECD principles of corporate governance.

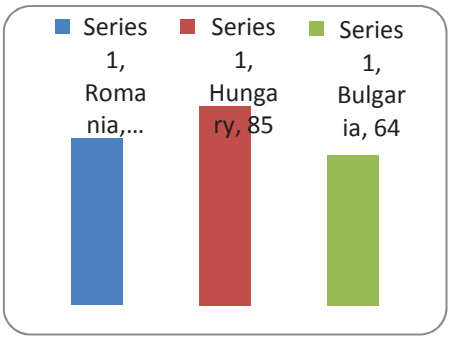
Table 2. Corporate Governance assessment

Country	Corporate governance (CG) code	Compliance of CG legislation with the OECD Principles of Corporate Governance.
Romania	The Bucharest Stock Exchange has issued a voluntary Corporate Governance Code for the companies traded on the regulated market of the Bucharest Stock Exchange, 2008	Low-compliance
Hungary	The Budapest Stock Exchange non-binding guide on corporate governance (Corporate Governance Recommendations), 2008	High-compliance
Bulgaria	Bulgarian National Code For Corporate Governance, voluntary, 2007	Medium-compliance

Source: own compilation based on EBRD Report 2004, 2007; ECGI Index of Codes

All the Codes mentioned in Table 2 are meant to contribute to raising national corporate governance standards and practices by adding voluntary requirements to the national framework's statutory provisions.

Figure 3 shows the score for the observance of various corporate governance practices. The score was calculated from the ROSC reports (2002, 2004) on a 1-5 Likert scale (5-Observed, 4-Largely observed, 3-Partially observed, 2-Materially not observed, 1- Not observed). If a country registered the highest score for all OECD Principles, it's corporate governance score would be 115 (5x25 principles). The lowest score would be 23 (1x23).



As Figure 3 shows none of the three countries had a perfect score. The highest score was registered by Hungary (85) followed by Romania (71). Bulgaria was the last one with a score of 64. As this data shows, for all three countries there is room for improvement.

Figure 3. Corporate governance score.

Source: Own calculations based on World Bank-ROSC reports.

V. Conclusion

This study illustrates the corporate governance situation in three developing nations: Romania, Hungary and Bulgaria. Even if Hungary registered the highest level of compliance of corporate governance legislation with OECD principles and the highest corporate governance score, key deficiencies still remains. For instance Hungary has to solve the problem of protecting investors because a key determinant of a nation wealth is investors' confidence.

Bulgaria ranked last based on the corporate governance score, but regarding the compliance with OECD principles the situation is better than the one reported for Romania, Bulgaria being the only country who has a National Code for Corporate Governance. Also a number of 53 companies reported to have a full comply with the principles of the National Corporate Governance Code (Bulgarian Stock Exchange).

In Romania some progress can be observed in the development of corporate governance in such as in January 2009, when the Bucharest Stock Exchange published an updated Corporate Governance Code, which is required for all listed companies on a "comply or explain" basis. Even so, in Romania there are discrepancies between the written law and the implementation of the law regarding the enforcement of the corporate governance framework. Thus this is a situation that has to be addressed in the future.

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