

DO ROMANIAN COMPANIES AND THEIR STAKEHOLDERS BENEFIT FROM THE ADVANTAGES OF A GOOD CORPORATE GOVERNANCE? EMPIRICAL RESEARCH ON THE LEVEL OF COMPLIANCE

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Abstract: *Corporate governance is a topical subject interrelated with many other concepts such as financial performance and earnings management and also a topic of real interest especially to shareholders and potential investors, but also to other stakeholders. The advantages attributed to corporate governance (maximizing global and long-term financial performance, increasing transparency and investor confidence) are the impetus for carrying out the present paper by asking a question related to approaching the concept in our country and, more importantly, the extent to which the principles of corporate governance are applied practically. The specialized literature in Romania has been dealing intensely with the subject in recent years, both through theoretical and empirical studies. The present empirical research is carried out among the companies listed on the regulated market of the Bucharest Stock Exchange in 2017 for which we analyzed the Statement on compliance with the provisions of the Corporate Governance Code issued by the Bucharest Stock Exchange. The results show that 40% of the analyzed companies apply more than 75% of the principles of the Code regarding the responsibilities of the board of directors, the risk management system and the internal control, to the just reward and motivation and last but not least, to the relationship with investors, to transparency. Moreover, 66% of the analyzed companies apply over 50% of the principles. Comparing the results obtained with the results of other studies from the past, we appreciate a positive evolution of the corporate governance in Romania, obtaining for 2017 an average compliance score of 58% with growth prospects, considering the mentions regarding the implementation process of certain criteria stated by some companies. However, at EU level, Romania occupies the last positions in some aspects regarding corporate governance according to indicators published by the World Economic Forum.*

Keywords: *corporate governance; protection of shareholders' interests; transparency; financial reporting quality; performance.*

JEL Classification: *G34; O16; M41; M49.*

1. Introduction

At the international level, corporate governance has been marked by several benchmark moments. In 1992, in the United Kingdom, the Cadbury Report was issued which defined corporate governance as “the system by which companies are run and controlled”. The report established the principles on which good corporate governance is built: integrity, transparency and accountability.

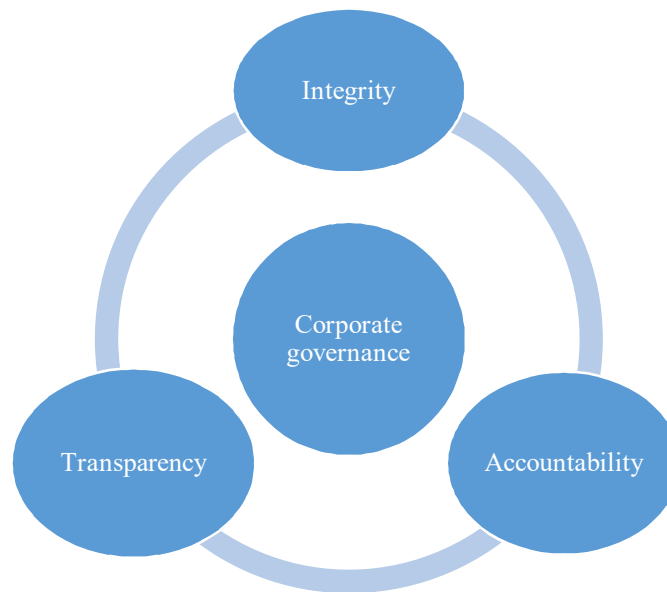


Figure 1. Principles of corporate governance according to the Cadbury Report
Source: Author's projection

In 1999, the Organization for Economic Cooperation and Development issued “the only set of principles unanimously accepted worldwide” (Ghiță, 2008) regarding corporate governance. The OECD (1999) defines corporate governance through the following elements:

- a set of relationships between a company's management, its Board of directors, its shareholders and other stakeholders
- the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined
- the system of incentives for the Board and management to pursue objectives that are in the interest of the company and shareholders and should facilitate effective monitoring, thereby encouraging firms to use resources more efficiently

The Sarbanes-Oxley law adopted in the US in 2002 has emerged in response to major financial scandals that have rocked reputable companies such as Enron (2001), Qwest Communications, Global Crossing, WorldCom, Adelphia or Tyco (2002) and have led to the loss of public confidence in practices and figures reported by companies. Therefore, the Sarbanes-Oxley Law sets more stringent standards on the accounting, auditing and responsibilities of boards of directors. Romanian companies that are part of the groups listed on the New York Stock Exchange, including Romtelecom, Vodafone, Orange, Coca-Cola, ArcelorMittal, Bunge Romania, Autoliv Romania, Fiat, Delphi-Packard, Avon Cosmetics had to implement SOX regulations. (Mihăileanu, 2008)

Romania has adopted the OECD principles in the corporate governance code issued in 2008, which replaced the first code issued in 2001, and in 2015 a new code adapted to European and national requirements, as well as to the interests of different stakeholders in corporate governance, would be issued. The Corporate Governance Code of the Bucharest Stock Exchange, applicable from January 1, 2016 and currently valid, includes a set of principles and recommendations for companies whose shares are admitted to trading on the regulated market. The principles are based on efficient and transparent communication with shareholders, potential investors and other stakeholders, with the aim of increasing transparency and investor confidence.

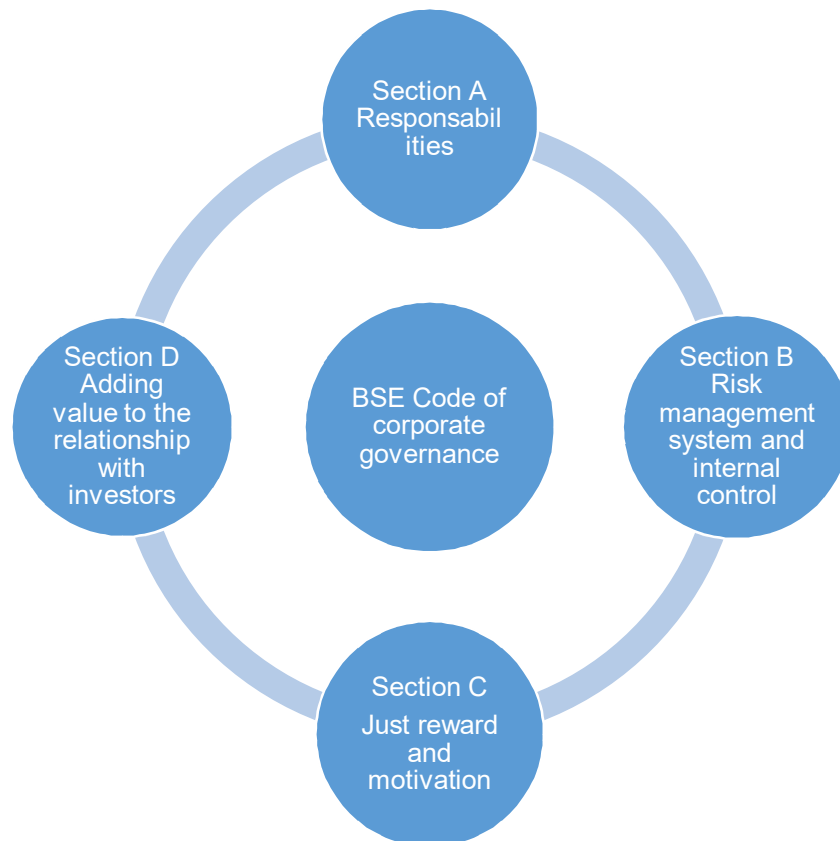


Figure 2. Organization of the BSE code of corporate governance
Source: Author's projection

Companies whose shares are admitted to trading on the regulated market of the Bucharest Stock Exchange can voluntarily adopt the BSE Code of Corporate Governance, in which case it will have to publish annually the so-called Apply or explain statement. That statement contains 40 questions, organized into four

sections, to which companies have to answer with YES, NO and if NO, then explain why.

Section A contains 11 questions regarding the composition and responsibilities of the Board of Directors or of the Supervisory Board / Directorate, as the case may be, as well as information regarding the independence of the Board members.

Section B contains 12 questions regarding the risk management system and the internal control, as well as the organization of the internal audit activity.

Section C contains a single question regarding the remuneration policy of the members of the Council and of the Director General, as well as of the members of the Directorate in the dualist system.

Section D contains 16 questions regarding investor relations.

2. Literature review

A functional capital market is based on “strong investor protection” (Kieff & Paredes, 2010). A functional capital market is based on “strong investor protection” Corporate governance limits the abuse of power of the internal ones on the company's resources and provides the means to monitor the behavior of the managers, to ensure the protection of investors and other external stakeholders (Feleagă et. al., 2011).

Various studies (Dechow et al, 1996, Davidson et al, 2005), Dhu & Hbp, 2019) demonstrate the association between earnings management and the absence of strong corporate governance. A strong corporate governance structure is less prone to fraud, income manipulation and other creative accounting practices (Dechow et al, 1996, Beasley, 1996). Corporate governance has the role of reducing the information asymmetry that is considered the point of genesis for the emergence of creative accounting (Vladu & Mătiș, 2010). Karamanou & Vafeas (2005) have shown that effective corporate governance is associated with quality of financial reporting.

The effect of adopting and meeting the principles of corporate governance noted by Murwaningsari (2010) is to maximize the financial performance of the companies, and Apostol (2015) extends the positive effects on the global performances. Brown and Caylor (2009), Erickson and others (2005) also advocate a positive association between corporate governance and performance. There are also studies (Core and others, 2006, Aman and Nguyen, 2007) that question this connection, but even in its absence we cannot neglect the main purpose, that of protecting the stakeholders' interests.

Given these benefits, we raise the question to what extent the Romanian companies and the stakeholders benefit from the advantages of adopting and observing the principles of corporate governance. This interest led to the present research.

In Romania, specialized literature in the field of corporate governance has developed especially since 2011. The topic was touched by authors such as Răileanu et al. (2011), Feleagă et al. (2011), Manolescu (2011), Ionașcu & Olimid (2012), Achim & Borlea (2013), Albu et al. (2013), Mihalcea & Burja (2018) that exploited some particular aspects related to corporate governance (related to the attributes of the board of directors: size, structure, frequency of meetings, independence of the board of directors, disclosure of information on the remuneration of Board members and

directors, some aspects regarding transparency), the evolution of corporate governance at the legislative level, and tested some hypotheses related to the correlation between corporate governance and performance among a sample of Romanian companies.

3. Research methodology

As methods, we used descriptive methods, comparison, analysis and synthesis. For the purpose of data collection we have accessed the Annual Reports for the year 2017 for listed companies on the regulated market of the Bucharest Stock Exchange. Based on the statement regarding compliance with the provisions of the Corporate Governance Code issued by the Bucharest Stock Exchange, we calculated a corporate governance score in the following way: 1 scored with 1 each affirmative answer, 0.5 with partial compliance and 0 with each negative answer within the Apply or explain statement. For each company, this score will be able to record values between 0 and 40. By averaging them, we will obtain an average score of corporate governance at the level of the Romanian companies for 2017. We will then compare this score with similar ones calculated, highlighting thus the evolution of the corporate governance system in Romania in recent years.

For the evaluation of the corporate governance at macroeconomic level and the comparison with other countries, the efficiency index of the board of directors (Efficacy of corporate board) by Achim & Borlea (2019) can be used, but also other indices such as Protection of minority shareholders' interests. These indices are calculated and reported annually by the World Economic Forum in The Global competitiveness report and can take values between 1 and 7.

4. Findings

13 out of 86 listed companies (15%) did not include the statement in the annual report for 2017. If we eliminate them we get an average corporate governance score of 69%. We do not eliminate them, however, because, as this statement is prepared by the companies that have voluntarily adopted the Corporate Governance Code of the BSE, we conclude that the 13 companies did not adopt the recommendations of the code and do not apply the principles of corporate governance. They will be taken into account with a score of 0 corporate governance. Otherwise, we get an average corporate governance score of 58%. Compared with the results obtained for 2009 by Răileanu et al. (2011), which showed a very low, insignificant compliance with the principles of corporate governance, the percentage obtained in the present research is an optimistic one, but lower than the one calculated in 2012 by Achim&Borlea (60%) according to a similar methodology. The evolution in time is not a permanently ascending one, as it would be ideal, but the mentions regarding the process of implementation of certain criteria declared by some companies have growth prospects. This small setback can also be explained by the introduction of the new corporate governance code in 2015, which brings new recommendations that companies have not implemented immediately.

In a more detailed analysis, the extreme positive represented by the observance of all the principles is gathered by 7% of the total of the companies listed on the regulated market of BSE. 66% of companies respect more than 50% of the principles.

On a scale from 0 to 40, the median, which divides the series into two equal parts, is represented by the value 25.5, which means that half of the analyzed companies respect the principles in proportion of over 63%. The quartile of ordinal 3 is represented by the value 35,375, so a quarter respects the principles in a proportion of over 88%.

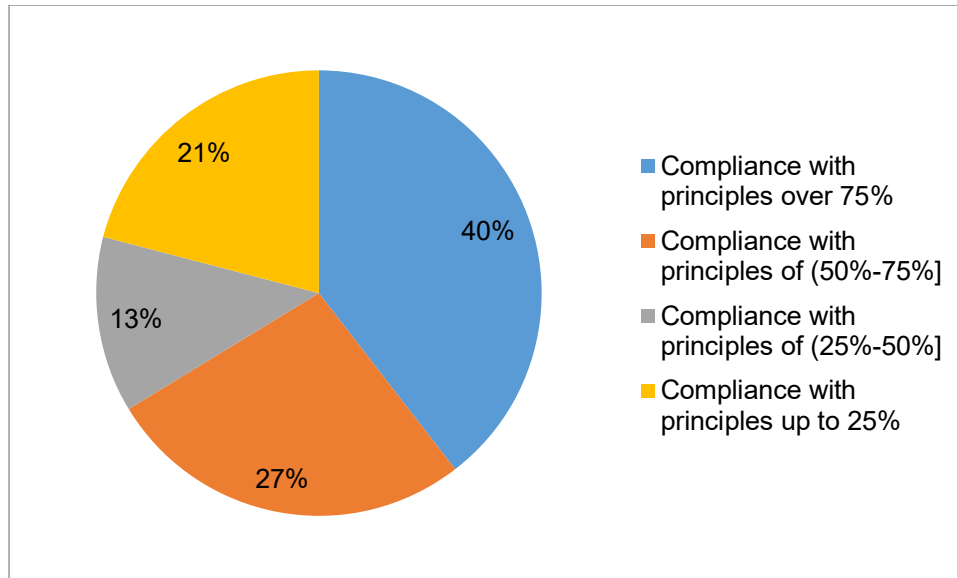


Figure 3. Dividing listed companies by their degree of compliance with the Corporate Governance Code

Source: Author's projection

According to the Efficacy of corporate board, Romania ranked in the penultimate place at the EU level in 2017-2018, and Protection of minority shareholders' interests ranks our country in 5th place from the bottom, according to the graphs below.

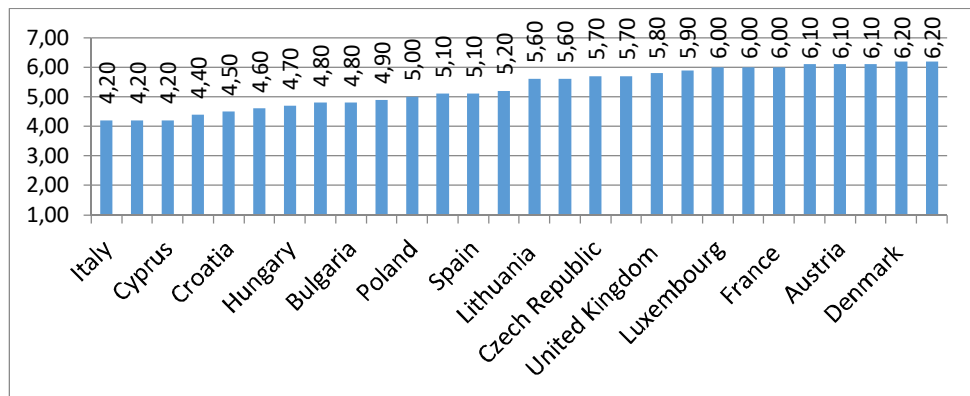


Figure 4. Efficacy of corporate board
Source: Author's projection

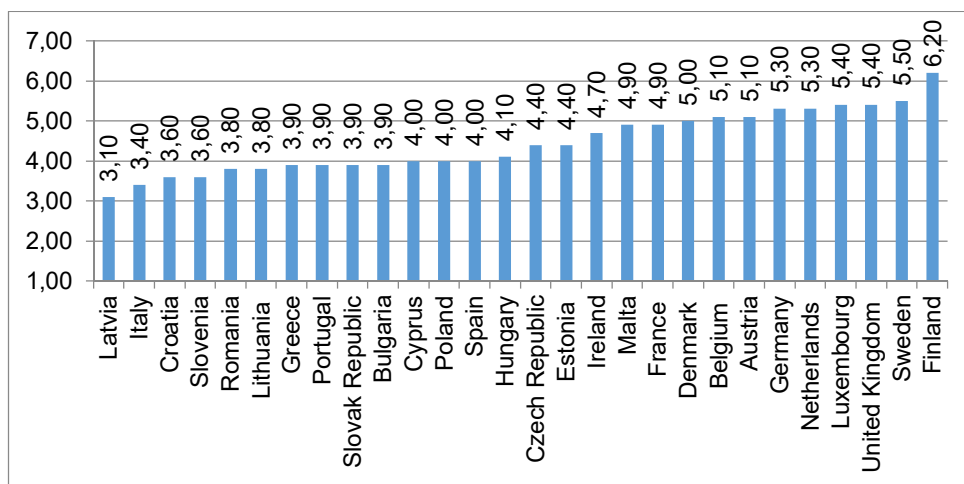


Figure 5. Protection of minority shareholders' interests
Source: Author's projection

5. Conclusions

The benefits of corporate governance affect the quality of financial reporting, financial and global performance. Effective corporate governance leads to the well-being of all stakeholders.

In Romania, we have, theoretically, laid the foundations for corporate governance. The corporate governance code of the BSE contains a set of principles and recommendations based on effective and transparent communication, aimed at increasing investor and other stakeholder confidence. Practically, however, the degree of compliance of listed companies on the regulated market of BSE is an average one, of only 58%, but it is nevertheless to be appreciated that in the last

years progress has been made, and the mentions regarding the process being implemented by some principles stated by some companies show growth prospects. At the macroeconomic level, the indicators taken into account by the World Economic Forum - the efficiency index of the board of directors (Efficacy of corporate board), Protection of minority shareholders' interests places our country on top of the EU level, which makes us focus more on this topic.

6. Research Perspectives

The results obtained will be used further to test a correlation between corporate governance score, earnings quality and risk of manipulation.

7. Acknowledgement

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