CORPORATE GOVERNANCE REGULATION IN EMERGING COUNTRIES. CASE OF ROMANIA

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Abstract:
Most of the literature on corporate governance emphasizes that firms should be run in the interests of shareholders. This is a suitable objective function when markets are perfect and complete. In many emerging economies this is not the case: markets are imperfect and incomplete. Corporate governance issues are especially important in emerging countries, since these countries do not have the long-established financial institution infrastructure to deal with corporate governance issues. This paper discusses how emerging countries are dealing with corporate governance issues and the extra obstacles they have to overcome due to a lack of regulations. Romanian case study is examined.

Keywords: corporate governance principles, corporate governance key actors, emerging country

Introduction

Harmonization of practices in the governance of an organization with existing global standards at a given time is an essential element of organizational success. Good governance is an essential vector for any organization in order to maximize profit in an increasingly turbulent and competitive global market.

The notion of "corporate governance" is not very old, both in public and in academic circles. However, some issues related to this concept were addressed at the beginning of the 20th century (Berle and Means, 1932), and even much earlier (Smith, 1776). Since the 8th decade of the 21st century the main aspects of the concept of corporate governance issues have become a hot topic not only in economic literature but also in debates in the public space. Over time corporate governance has been identified to confusion on various topics that were of interest at different times: hostile takeovers of companies, financial crises which led restructuring of companies, and rules that manage the activities of institutional investors. In a very broad sense concept of governance is not limited to organizations, it may be used for a transaction or a department and, in general, for any form of organization. In a very limited sense, corporate governance refers to the economic management of an organization called the corporation.

Garvey and Swan believes that the organization is a set of contracts (economic, social, cultural, etc.), governance being the theory which describes the ways that the general management of the company manages these contracts (Garvey and Swan, 1994).

Other authors, Shleifer and Vishny define corporate governance as relationships through those who provide capital corporations ensure that their ROI is good and there is not the risk of loss (Shleifer and Vishny, 1997). Caramanolis-Cotelli considers corporate governance aims at managing the balance between companies' insiders and outsiders (Caramanolis-Cotelli, 1995).

According to John and Senbet governance ensure the functionality of mechanisms through stakeholders trying to exercise supervision over the management corporation, so that their requirements are met (John and Senbet, 1998). They widen the scope outsiders, to all stakeholders, not just shareholders. In the stakeholders are included suppliers, creditors, employees, customers, governments, local communities, etc. Hart agrees with such a vision showing that the governance is required when appear conflicts between stakeholders of a corporation, and these conflicts cannot be solved by existing contracts (Hart, 1995).

In turn Zingales says that corporate governance is a set of constraints through that corporation manage relationships with the people who had influence and interests in the corporation (Zingales, 1997).

An OECD study which stated the principles of corporate governance considers that it is the system by which corporations are directed and controlled (1999). Corporate governance establishes mechanisms that allocates rights and obligations between stakeholder, approaches to decision making, organizational goals and actions that fulfill these objectives, the methods by which the overall organizational performance monitoring.

In Roe's view, corporate governance defines the relationships established between actors dealing with corporate leadership - the board of directors, superior level managers and shareholders (2004). Through corporate governance authority is distributed between the three actors, ensuring balance and control of decisions. There are two separate issues dealing with corporate governance: one concerning vertical governance (managing relationships between majority shareholders and managers), one concerning horizontal governance (management of relations between majority shareholders and minority shareholders).

A number of studies have investigated how it is treated corporate governance in emerging markets. Prestigious researchers analyzed the implications of corporate governance in emerging markets and concludes that the main issue refers to overwhelming control of majority shareholders which restrict the rights of minority shareholders (Claessens, Djankov and Lang, 1999; La Porta, Lopez-de-Silanes and Shleifer, 1999; Lins, 2000).

Key actors of corporate governance

In order that corporate governance to be effective it is necessary to clearly delineated roles of key actors in the process of governance: board, various board committees, various stakeholders. Relations between the leadership of the corporation and shareholders should be transparent, relations between the leadership of the corporation and employees must be correct, relations between management corporation and local communities should be based on principles of social responsibility and relations between the management corporation and public administrations should be governed by the laws and rules both at international and domestic level as well.

Key actors of corporate governance mechanisms are: Board of Directors, which runs effectively through a series of committees (audit committee, governance committee, the compensation committee) and senior management at the helm of which is Chief Executive Officer.

Board of directors. Corporate leadership is ensure by the board which is in charge of recruitment, selection and appointment of Chief Executive Officer.

Based on the mandate given by the Board, Chief Executive Officer is the one who makes the decisions at operational and tactical level of corporation. The Board receives its mandate from shareholders at the General Meeting of Shareholders. The main responsibilities of the Board shall be (The Business Roundtable, 2002, pp. 4-6):

• planning and implementation of recruitment, selection and appointment of management corporation;

• establishing and reviewing strategies;

• establishing and revising general budget;

• advising management regarding important tactical decisions;

• endorsement transparency and fairness of financial and non-financial reporting;

• choice of accounting rules and techniques used;

• supervision of the entire company.

Audit committee. To ensure compliance with financial standards, corporations must have audit committees composed of minimum 3, maximum 5 members consisting of independent persons from the corporation. This committee must follow corporate governance rules established at national and international level. The main responsibilities of the audit committee are (The Business Roundtable, 2002, pp. 12-66):

• carry out audits and risk management;

• oversees corporate procedures;

• supervised the internal control;

• supervises the conduct of audits by external auditors;

• ensure communication between the Board and the external auditor;

• oversees and supports the financial and non financial reporting.

Compensation committee. Compensation Commission has the main role of general supervision on the compensation plans within the corporation and establish salaries of Chief Executive Officer and for top management. Management remuneration structure must be directly related with the corporate objectives that are set by long-term interests of shareholders.

CEO (Chief Executive Officer). Chief Executive Officer is the one that manages corporation and provides operational and tactical decisions and their implementation. In exercising his authority Chief Executive Officer has the following responsibilities (The Business Roundtable, 2002, pp. 7-8):

• operational management of corporate activities;

• implementation of strategic decisions;

• construct and implement operational plans;

• delimitation of optimal organizational structure;

• identification, risk analysis and treatment;

• ensuring fairness reporting system.

Principles of corporate governance in emerging countries

Corporate governance is only one variable in the economic environment and business corporations which operate alongside other variables such as macroeconomic policies and competitiveness in markets for products and services. In addition to economic factors corporate governance are influenced by legal, regulatory and institutional framework. In addition, factors such as business ethics and social responsibility can influence corporate reputation and development.

Although corporate governance has a number of advantages both for companies and for the countries, the pace of globalization has led to a faster implementation of the rules generated by it. To cope with the effects of globalization firms and national governments should carry out a number of essential changes in the mode of governance. Regarding corporations they must change their behavior and rules of organization and functioning, while national governments are designed to build and establish and maintain optimal institutional and legislative framework.

Efforts to improve corporate governance through regulatory action started in the early 90s and once the crisis outbreak gained ground.

Principles of corporate governance regulation provides assistance to governments in building an effective corporate governance framework. These principles represent a useful benchmark for emerging markets and economies in transition. Effective corporate governance principles provide a framework for analysis and implementation of best practices in developing countries, taking into account country specific factors, such as legal and cultural traditions.

In order that the principles of corporate governance to influence the economies it is necessary to implement a series of democratic institutions and mechanisms related to free market economy, including a legal system that protects property rights and enforce contracts. But in most emerging economies, democratic and market institutions have big problems. Based on these considerations, implementation of corporate governance within emerging countries and markets requires not only benchmarking of successful models of corporate governance from developed countries but it is necessary to pay special attention to building political and economic institutions, adapted to the specific needs of emerging country.

Table 1 lists the main countries that have built corporate governance codes, principles of corporate governance and implement corporate governance reforms. CGRI (corporate governance regulation index) is an index that we propose, being the product of the number of years since the country developed corporate governance acts and the number of acts developed.

Table 1

Corporate governance regulation index

Countries	Development period	Number of acts	CGRI
Developed countries			
Australia	1995-2008	9	117
Austria	2002-2008	4	24
Canada	1994-2008	7	98
Denmark	2000-2008	4	32
Finland	2003-2008	2	10
France	1995-2008	6	78
Germany	1998-2008	11	110
Iceland	2004-2008	2	8
Ireland	1999-2008	1	9
Italy	1998-2008	5	50
Japan	1997-2008	5	55
New Zealand	2003-2008	5	25
Norway	2004-2008	4	16
Portugal	1999-2008	6	54
Sweden	2001-2008	5	35
Switzerland	2002-2008	3	18
Netherlands	1997-2008	6	66
United Kingdom	1992-2008	21	357
USA	1997-2008	12	132
Emerging countries			

Bangladesh	2004-2008	1	4
Brasil	1999-2008	3	27
Bulgaria	2008	1	1
China	2001-2008	2	14
Cyprus	2002-2008	3	18
Czech Republic	2001-2008	2	14
Estonia	2006-2008	1	2
Greece	1999-2008	2	18
Hungary	2002-2008	2	12
India	1998-2008	3	30
Indonesia	2000-2008	3	24
Jamaica	2005-2008	3	9
Latvia	2005-2008	1	3
Lithuania	2003-2008	1	5
Mexico	1999-2008	1	9
Peru	2001-2008	2	14
Poland	2002-2008	4	24
Romania	2000-2008	2	16
Russia	2002-2008	1	6
Turkey	2003-2008	1	5
Ukraine	2003-2008	1	5

Source: European Corporate Governance Institute, "Index of all codes", http://www.ecgi.org

Each region or country is in a different stage of establishing a democratic and competitive framework, based on market economy rules and a system of corporate governance effectively and transparently. Therefore, each nation has its own set of challenges.

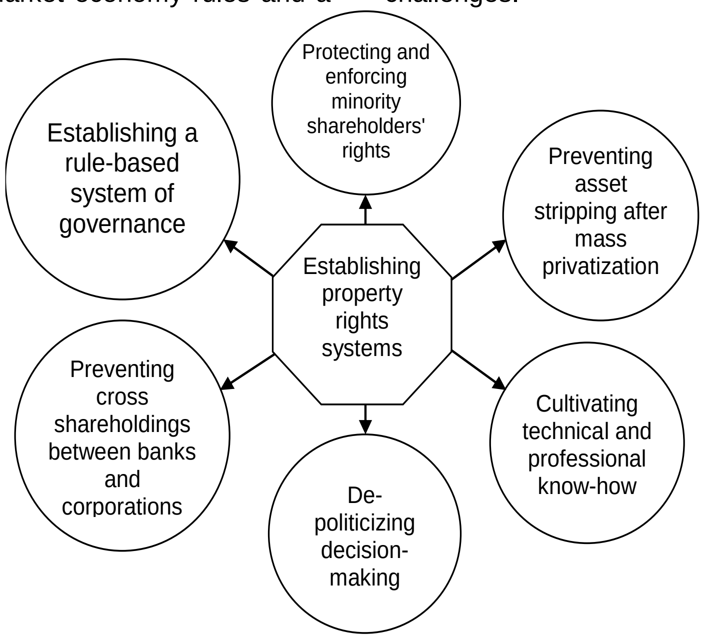

Figure 1. Challenges on corporate governance for developing, emerging and transitional economies include
Source: CIPE, 2002

It can be seen lately improved corporate governance framework in several emerging countries such as Brasil, Poland, India etc. Most emerging countries are developing a framework for corporate governance.

Corporate governance principles and practice in Romania

Corporate governance framework in Romania must take into account a number of recommendations and guidelines on the following areas: legal framework, framework institutional and private voluntary initiatives.

The legal framework. Regarding the legal framework the highlight is on application of laws, rules and existing rules. Privatizations should be transparent and insider transactions should be made public. In addition to these considerations it can be made a number of recommendations regarding the legal framework (figure 2).

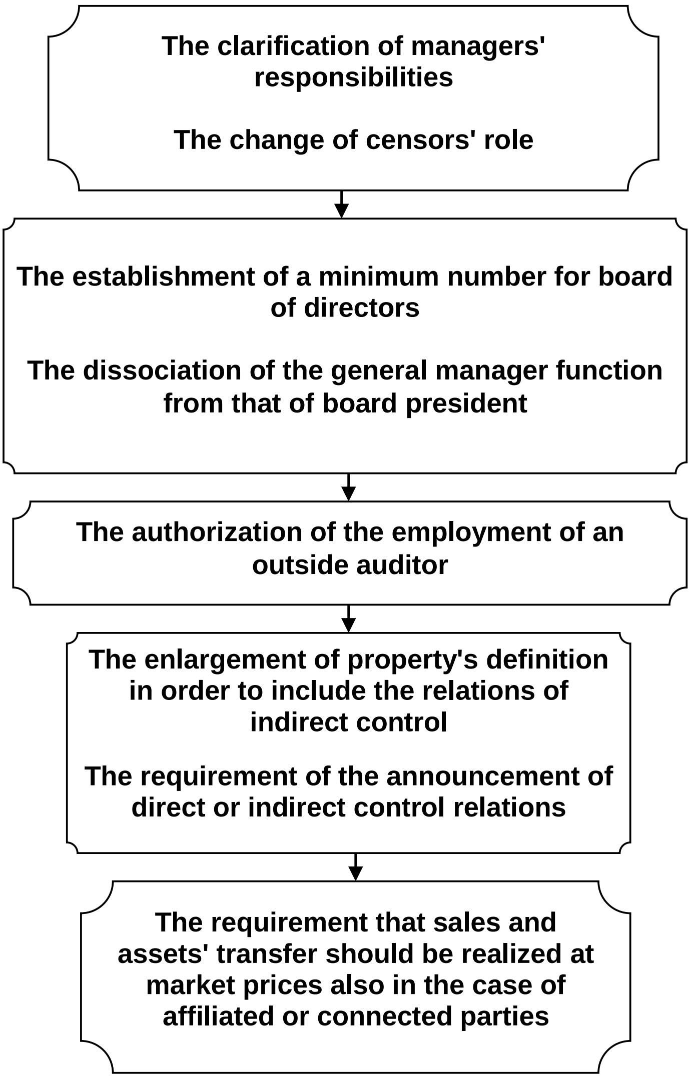

Figure 2. The main recommendations regarding the legal framework

The institutional framework. CNVM (Stocks and Shares National Commission) is the regulatory and supervisory body of the capital market in Romania ensuring transparency requirements and compliance to the international reference framework. Is important that CNVM to apply the same rules to all categories of companies from Bucharest Stock Exchange and encourage voluntary compliance to these rules and unlisted companies.

Voluntary/private initiatives. The main type of voluntary initiative is to establish a corporate governance code or code of conduct that conforms to international norms and rules and national laws. Bucharest Stock Exchange initiated the Corporate Governance Institute (2003) which aims to create a generic corporate governance code to be proposed to all companies that want to list. But this process is lengthy and application of corporate governance principles in Romania will be gradual, extending over several years.

Conclusions

The action to establish an effective corporate governance framework does not end when the mechanisms, political and economic institutions, voluntary initiatives are operational. One problem with existing regulations is the fact that these rules do not apply equally to all economic entities. Unlisted companies are obliged to adhere only to legal regulations, not to governance codes and other guidelines. To be effective, these codes must be supplemented by other instruments to treat issues not covered by these codes.

In Romania, a strategy was developed to establish a corporate governance code. Some parts of the code were adopted by the Bucharest Stock Exchange, which has set up an Institute of Corporate Governance for developing its own corporate governance code.

The conclusions of this research show that the scale of legal reform in corporate governance has been impressive. It can be seen that many emerging countries have higher levels of protection of shareholder rights and stakeholder than some of the developed economies. However, the legal and institutional development has not been followed so far by the development of financial markets. Improving the legal framework is a partial solution, but important is commitment to respect all rules of corporate governance.

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