Corporate Governance and ESG in Romania, Concept Awareness

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Abstract

This study examines corporate governance and ESG (Environmental, Social, and Governance) in Romania, focusing on current awareness and implementation while suggesting improvements. Using a qualitative approach, it reviews relevant laws, reports, and regulations.

Global economic development varies, and corporate governance provides rules to ensure investor transparency and security. Non-financial reporting is crucial, with companies increasingly evaluated on social and financial metrics, leading to more sustainability reports in line with GRI standards.

Romania's corporate governance began in the early 2000s, with governance codes adopted in 2001, updated in 2008, and a new code by the Bucharest Stock Exchange in 2015, supported by the EBRD. The EU Directive 2014/56, integrated into Romanian Law 162/2017, requires accounting professionals on audit committees to enhance transparency, though implementation is ongoing. This study aims to clarify the current state and suggest improvements for corporate governance and ESG in Romania.

Key words: corporate governance, ESG (Environmental, Social, Governance), CSRD, GRI
J.E.L. classification: M4, M14, F23

1. Introduction

Despite the trend towards globalization, the world's economies are not uniform; some are highly advanced, while others are just beginning to develop. Corporate governance fundamentally involves establishing rules that companies should follow to offer investors transparency and greater security in their investment decisions. Transparency is not only about the publication of information but also the quality and professionalism of those responsible for the information disclosed. Non-financial reporting has also become a crucial concern for managers, with companies being evaluated not only financially but also socially. Consequently, there is a growing trend of companies publishing annual sustainability reports in accordance with GRI standards.

The governance of corporations pertains to the structure through which companies are managed and supervised. (OECD 1999).

Originating in the UK private sector, shareholders sought better control over management to maximize financial results. The Organization for Economic Co-operation and Development (OECD) later promoted this concept globally by publishing universally applicable principles. The initial set of principles was established in 1999, with an improved version released in 2004. The national level guidelines for implementing these principles have also been issued by the OECD. These guidelines encompass shareholders' rights, the fair treatment of all shareholders, the responsibilities of different parties engaged in corporate management and control, transparency, and the disclosure of information.

As stated by (IFAC 2009) corporate governance involves the interrelationships among a business's executive leadership, board of directors, shareholders, and other stakeholders. It establishes the structure for defining the company's goals, accomplishing those goals, and overseeing performance. Successful corporate governance encourages companies to pursue objectives in the company's and shareholders' best interests, fostering efficient use of resources and strong performance oversight. IFAC defines corporate governance as a conceptual framework with two primary aspects: adherence and performance. Adherence encompasses the responsibilities, framework, and compensation of management, while performance focuses on strategy and generating value. This aspect assists management in making strategic choices, identifying risks, enhancing performance, and identifying critical decision-making moments. Therefore, it is important to develop best practices and approaches customized for various economic entities. Consequently, developing best practices and techniques tailored to different economic entities is essential.

Several scientific studies have integrated these principles and have shown that the implementation of corporate governance benefits shareholders and maximizes their profits. Even in the face of recent global financial challenges, there is a continuous discussion on whether improved corporate governance can lead to increased economic and financial stability. The primary aim of the corporate governance system is to protect investors' interests. Financial scandals involving multinational companies have led to significant shareholder losses, prompting some shareholders to develop mechanisms to safeguard their interests.

Modern corporate governance is heavily influenced by the adoption of best practices in corporate governance and corporate social responsibility, as these are the only ways to ensure a company's sustainability and long-term value addition. In evaluating a company's overall performance, it is important to consider the concerns of international rating agencies that assess ESG scores. These scores are used alongside financial scores to enhance the accuracy of evaluating a company's performance and risks. (Achim and Bordea, 2015).

2. Theoretical background

2.1. Overview of the Corporate Governance ecosystem

Economic globalization complicates business management by dispersing capital and resources, making it difficult to locate stakeholders and diversifying their interests. Multinational companies adapt business practices to local standards, while international companies impose uniform standards wherever they operate. Transnational companies combine local standards with those of the parent company. Globalization brings complex competition between international markets, where products are manufactured in areas with cheap labor and sold in more profitable markets, leading to an inequitable distribution of profit and loss between markets and countries. These factors are among the main ones influencing corporate governance, determining how companies set and implement their operating rules and standards to ensure transparency and security of investments. (Telembeci, 2014)

The term "governance" in Romanian is interchangeable with "administration" or "leadership," encompassing all management activities within an organization. Hence, if "governance" equals "leadership," then "corporate governance" signifies the overall leadership of the entire organization, given that "corporate" originates from "corp," indicating the notion of a whole, a unit. Corporate governance spans various fields, spanning from economics and reaching into information theory, law, accounting, finance, management, psychology, sociology, and politics. This concept encompasses all the influences affecting institutional processes, including the appointment of regulators or control authorities involved in organizing the production and sale of goods and services (Turnbull, 1997).

The management of an organization and its structures is closely connected to corporate governance, the specialized literature (Bunget et al., 2009) recognizes that this concept includes significant issues related to social responsibility and business ethics. Corporate governance has a broad connotation, encompassing elements such as transparency in internal and external audits, strict deadlines for financial reporting, managers' responsibility for the accuracy of information in financial

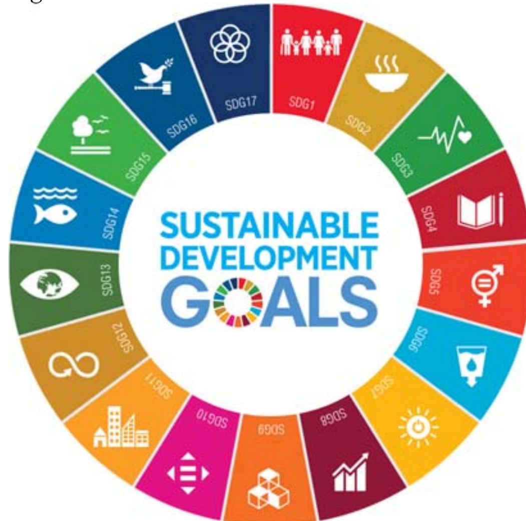
reports, and total transparency in financial results. In common language, the concepts of "corporate management" or "corporate leadership" emerged in the United States during the Watergate scandal in the 1970s, when American companies were found to be involved in political financing. Corporate governance developed after a string of impressive mishaps in the business world, leading to a loss of investor confidence in managers' ability to lead large corporations or public institutions. In 1992, Sir Adrian Cadbury in the UK produced the extensive Cadbury Report, identifying significant issues in internal control systems as the main cause of major corporate failures. (Cadbury, 1992) This indicated that the management of these entities not only failed to prevent bankruptcies but also caused them. The World Bank also commented on corporate governance, stating that its scope is to align the interests of society, corporations and individuals. Over the past two decades, various definitions of corporate governance have emerged in the literature, without a universally accepted definition. The Cadbury Report defines corporate governance as the system by which companies are directed and controlled. In April of 1999, the Organization for Economic Co-operation and Development (OECD) expressed that corporate governance delineates the allocation of rights and responsibilities among various participants within the organization, including the board, directors, shareholders, and other stakeholders. It sets forth the regulations and processes for making decisions regarding corporate matters. The OECD views corporate governance as encompassing a series of connections among the company's management, board, shareholders, and other stakeholders, and the framework through which the company's goals are defined and pursued, with incentives provided to the board and management in order to achieve these objectives in the best interest of shareholders and society. (OECD, 2004).

2.2. Sustainability Reporting Frameworks and Regulations

In the last three decades, there has been a significant global push towards sustainable development, evident through initiatives such as the Paris Agreement and the United Nations Sustainable Development Goals (SDGs). Alongside these international efforts, various frameworks and regulations have emerged to guide businesses and organizations in reporting their sustainability practices.

- Paris Agreement (2015): The Paris Agreement outlines a comprehensive action plan to mitigate global warming and reduce greenhouse gas emissions to limit the increase in global temperature to well below 2 degrees Celsius above pre-industrial levels. It emphasizes efforts to achieve net-zero emissions by 2050, with major economies like China, the United States, and the European Union committing to significant emission reductions. The EU, for instance, has pledged to reduce emissions by 55% by 2023 compared to 1990 levels. (Paris Agreement, 2015)
- United Nations Sustainable Development Goals (SDGs): In 2015, all UN member states adopted 17 goals known as the SDGs, which are designed to tackle a wide range of global social, economic, and environmental challenges. It is crucial for entities to align their sustainability objectives with these SDGs to ensure comprehensive and coordinated efforts towards sustainable development. (United Nations, 2023)

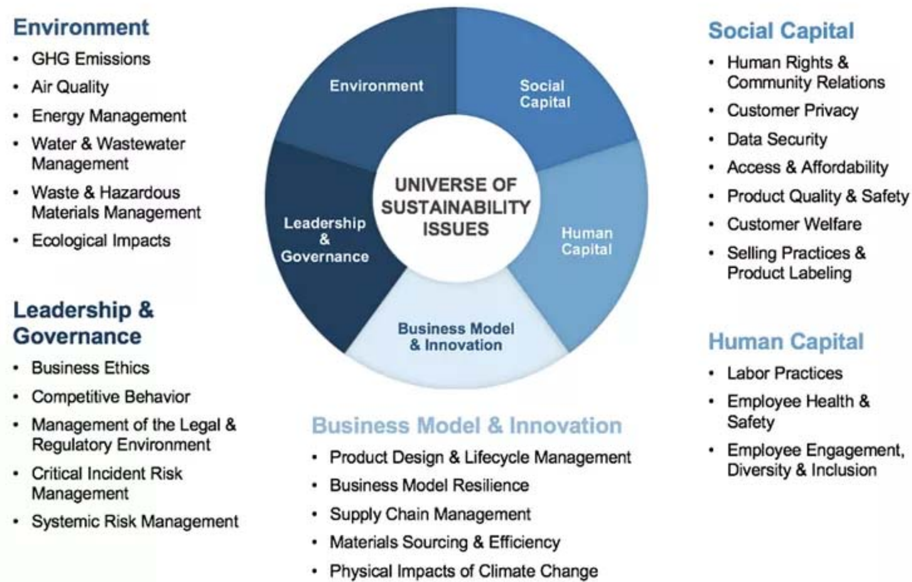
Figure no. 1. The 17 SDG Goals



Source: safricom.co.ke

- Romanian Government's Sustainable Development Objectives: Romania has developed its national strategy for sustainable development, focusing on achieving sustainable development goals by 2030. This includes the establishment of a National Department for Sustainable Development and the implementation of a national action plan. These efforts align with the broader international agenda for sustainable development. (Vladineanu and Celac, 2018)
- Reporting Frameworks and Regulations: Several reporting frameworks and regulations have been introduced to guide organizations in disclosing their sustainability performance. The ESG framework in Romania showcases a company's commitment to being sustainable and ethical. The push for mandatory ESG reporting in Romania is driven by legal requirements and the expectations of the community, highlighting the significance of openness and ethical behavior in different business sectors. At the moment, this is a requirement for bigger companies and certain sectors in specific areas, in line with the global trend towards corporate accountability. Although mandatory ESG reporting is not a requirement for all companies yet, choosing to voluntarily disclose can bring several benefits. Mainly, it shows a forward-thinking commitment to sustainable and ethical business operations. (ACACE)
- Global Reporting Initiative (GRI): Established in 1997, GRI provides voluntary standards for reporting on environmental, social, and economic impacts, offering specific guidance on presentation formats. It is widely utilized, with 73% of the largest companies adopting its standards. GRI Guidelines were formally sent off in October 2016. The new guidelines are planned to achieve more straightforwardness organizations' effects on the economy, climate and society and work with better decision-production at hierarchical level. The items in Principles contain particular between related norms, considering updates of any autonomous guidelines or expansion of new ones without modifying the entire set. The design involves three widespread norms that apply to all associations: GRI 101 – Foundation; GRI 102 - General Disclosures; GRI 103 - Management Approach. These are followed by three series of topic-specific standards: GRI 200 – Economic; GRI 300 – Environmental; GRI 400 – Social (Rao, 2016)
- Sustainability Accounting Standards Board (SASB): Founded in 2011 in the US, SASB develops sustainability accounting standards for 77 industries, facilitating industry-specific reporting on sustainability performance. Every set of standards divides topics according to five issue categories: Environment; Social capital; Human capital; Business model and innovation; Leadership and governance.

Figure no. 2. Sustainability Accounting Standards Board



Source: https://www.investopedia.com/sustainability-accounting-standards-board-7484327

- European Union Regulations: The EU has implemented various regulations to promote sustainable finance and reporting. These include the Non-Financial Reporting Directive (2014/95), which requires large companies to disclose non-financial information, and the EU Taxonomy Regulation (2020/852), establishing criteria for determining sustainable economic activities. (UNPRI, 2022)
- Corporate Sustainability Reporting Directive (CSRD): The directive (EU) 2022/2464 has been legally added to the Romanian laws by the Ministry of Finance on January 26th, 2025. This year signifies the debut of company reporting for entities in Romania. It is part of the net zero project and aims to extend ESG reporting to several categories of companies by 2050, which will have an impact on business models

3. Research methodology

This research methodology involves a comprehensive analysis and comparison of various studies on corporate governance and ESG (Environmental, Social, and Governance) about Romanian market and global market, from the 1900s till present.

The methodology includes a systematic review of existing literature, legislative documents, and policy regulations related to corporate governance. Therefore, we analyzed it from 2 points of view, first from a global perspective and then we tried apply the global perspective to Romania, in order to have a perspective at country level.

Studies were selected based on their relevance, credibility, and the comprehensiveness of their findings. A chronological approach was adopted to trace the evolution of corporate governance and ESG practices over the years.

Comparative analysis techniques were employed to identify trends, patterns, and significant changes in legislation and policy regulations. This approach ensures a robust understanding of how corporate governance and ESG frameworks have developed and their impact on corporate sustainability and performance in Romania.

4. Findings

The demand for sustainability assurance statements and responsible investment strategies is growing among both private and institutional investors. (Bauckloh et.al, 2023)

Investors are increasingly interested in companies committed to ESG criteria and sustainable practices. Examining ESG criteria across business sectors can attract investment and improve stakeholder reputation. Good ESG performance positively impacts economic measures, reducing financial risk, corporate opacity, and debt agency costs while lowering bond credit spreads (Chen and Xie, 2022; Lian et al., 2023). This effect is amplified by media coverage, particularly in developing nations, which boosts analyst attention and reduces agency costs (He, Guo and Yue, 2024). Integrating ESG factors is vital for sustainable development and addressing environmental and social challenges (Lokuwaduge and Heenetigala, 2017; Raman, Bang and Nourbakhsh, 2020).

Recent research has highlighted the shortcomings of ESG ratings, focusing particularly on the lack of transparency in the criteria used to rate companies. For instance, Busch and Hoffmann (2009) discovered that major ESG rating agencies employ different criteria, weighting schemes, and rating scales, leading to significant discrepancies in ESG ratings across agencies. Similarly, Khan, Serafeim and Yoon (2016) criticized these ratings for their opaque and inconsistent methodologies, advocating for greater standardization and transparency in the assessment process. Consequently, further studies on appropriate ESG criteria for evaluating companies' environmental activities, social responsibility, and governance policies—considering different countries, time periods, industries, and cultural conditions—would be highly beneficial for various stakeholders (Chatterji, Levine and Toffel, 2009a; Huang et al., 2024).

Over the past three decades, globally, corporations have been involved in various financial-accounting practices, some fraudulent, leading to bankruptcies and notable scandals. This trend highlights the persistent risk of accounting fraud in developed capitalist countries, despite ongoing regulatory improvements. Common factors behind these scandals include managerial incompetence, non-compliance with internal regulations, inadequate risk management, flawed role allocation, disregard for internal audit recommendations, and ineffective external audits. (CFI)

5. Conclusions

The results of the methodology applied in this study, offers us a perspective about the evolution of corporate governance and ESG over time. The literature analysis was conducted starting with the 1900s and up to the present, something that made us able to expose in an objective way the evolution of the 2 indicators over time and gave us a clear perspective on the actual regulations and policies as well as on the future directions.

Introduced in 2022, the CSRD expands reporting requirements to more companies, mandates detailed reporting formats, and introduces mandatory assurance of sustainability information.

Reporting on ESG encompasses the strategy and action plan detailing how organizations aim to achieve their ESG objectives and targets. This involves both qualitative and quantitative information, provided retrospectively and prospectively within the annual report. Auditors play a crucial role in ensuring the integrity of sustainability reporting, transitioning from limited assurance for non-financial statements to reasonable assurance for sustainability reports by 2028. Auditor qualifications are essential, requiring deep theoretical knowledge of relevant ESG domains and at least eight months of practical training, with additional responsibilities assigned to audit committees. Internationally, ESG scores are assessed by various agencies using diverse scales and evaluation methods. However, there are growing concerns regarding the complexity of ESG reporting, challenges in data acquisition and measurement, significant additional costs, limited access to funding sources, and the prevalence of greenwashing. These issues underscore the need for standardized reporting frameworks, robust auditing practices, and greater transparency to address the multifaceted challenges associated with ESG reporting and performance evaluation.

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