

Corporate Governance in Romania - Current Trends

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Abstract

The failures of large corporations like Enron, Parmalat, Arthur Andersen, or Marconi have demonstrated that inappropriate corporate governance can seriously affect both shareholders and other interest groups (creditors, investors, the state, employees, suppliers, customers), even in a developed market economy. These problems would have produced less negative effects if there were more effective ways of controlling and monitoring company management and transparency of their business. The aim of this article is to offer a better understanding of the current state of affairs in terms of corporate governance principles and their implementation in Romania, showcased comparatively via two established companies. On the base of these examples, we conclude by outlining a few priorities that could be taken into account for a better and faster implementation of such principles within the Romanian business field.

Key words: corporate governance, stakeholders, shareholders rights, listed companies, unlisted companies

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1. Introduction

A good corporate governance makes companies to use their resources more efficiently and have a better relationship with employees, creditors and other stakeholders. For developing countries such as Romania, it is very important that corporate governance takes steps to increase the trust of domestic and foreign investors, which in turn leads to attracting investment, especially in the long run.

A very current issue is related to implementing the principles of corporate governance in developing countries from Central and South-Eastern Europe and in the former Soviet Union countries. The 1997-2000 financial crisis in Asia, Russia and Latin America have proven once again the need to introduce a system of standards and guidelines on corporate governance for developing countries.

Corporate governance has become increasingly important in the nineties due to the growth of private sector around the world. This is also the case for Romania, a country that did not have large private enterprises at the beginning of the nineties, but which currently has an important sector of such companies.

2. Theoretical background. Corporate governance - a few definitions

As defined by the British almost three decades ago, corporate governance is the system by which a company is run and controlled (Cadbury Code - UK, 1992).

This being said, the Organization for Economic Cooperation and Development (OECD) considers that corporate governance is:

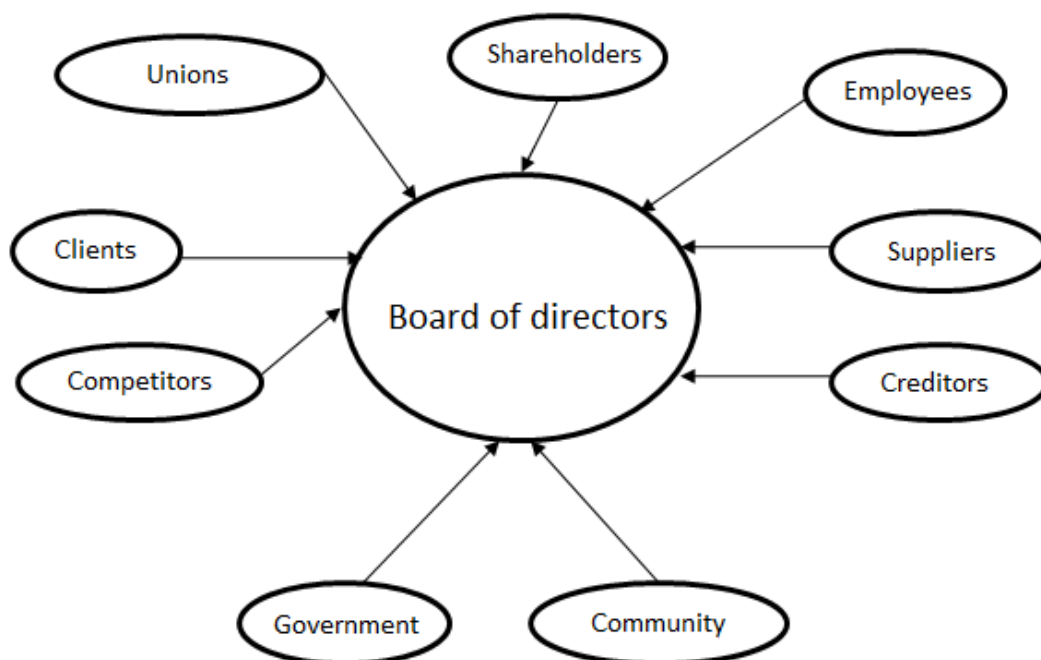
- a set of relationships between different bodies : the management of the company on one side, the Board of Directors on the other side, the company's shareholders and other interest groups in society;
- the structure helping to set out objectives for society, as well as the means for achieving these objectives;
- the system of incentives that the Board of Directors and the management representatives are given in order to pursue objectives that are in the interest of society and that of shareholders, and to facilitate monitoring, thereby encouraging companies to use their resources more effectively (according to the OECD Principles).

In our view, "corporate governance" is a complex system of relationships and interactions between different stakeholder groups within and outside a company in order to maximize their own expectations (Sergiu Sarchizian, Doctoral Thesis, 2011).

The term „stakeholders" was taken from the Anglo-Saxon literature and embraces all agents interacting with the company in one way or another or who have an interest in the company. This category includes: shareholders, managers, employees, creditors, suppliers, competitors, central and local tax authorities, trade unions, the broader community that includes: civil society and opinion leaders.

Schematically, stakeholder relationships can be represented as follows:

Figure no. 1. Relationships between stakeholders – authors' own representation



Source: Authors' contribution

3. Corporate governance structures as they appear in the Romanian economy

A new regime was born in Romania in 1990. The need for a quick transfer of ownership felt back then, as well as the requirements of providing means of co-existence during the property transfer period required a new law, which was Law 115/1990 for reorganizing the state-owned enterprises, the basis of enterprise reform. Thus, two forms of economic units were created:

a) **Autonomous Regias**, independently managed state companies designed after the French model for the strategic sectors of the national economy (defense, energy, mining, rail transport) and owned by the Romanian Government;

b) **Trade companies**, most of which were corporations, with the state as sole shareholder. Institutional design was somehow forced and intended to limit state ownership/control, as a sole shareholder, which applied exclusively to strategic sectors.

In practice, many activities in the economy were organized as autonomous regias.

Law 31/1990 for trade companies has created a certain normality, establishing the framework for creating, organizing, functioning, modification and liquidation of various types of trade companies.

Thus, business structures could take the following forms:

- **General Partnerships** : business arrangements in which two or more partners decide to share in all assets, profits and financial and legal liabilities of a jointly-owned business structure. Within such an arrangement, the involved partners agree to unlimited liability. This means that either of their personal assets may be liable to the partnership's obligations. In fact, any partner may be sued for the entire amount of the business partnership's debts;
- **Limited partnerships** : business arrangements where joint venture partners respond only up to the limit of their input and commanders respond unlimitedly and jointly to social obligations;
- **Partnerships limited by shares** : business arrangements where the company's capital and ownership is divided between shareholders with limited liability on one side, and one or more partners with full liability for the company's debts, on the other side. The partner(s) will usually be the one(s) managing the company's operations, while the shareholders are passive investors.
- **Joint-stock companies** : at the origins of what we now call a modern corporation lays the joint-stock company. This is a business owned by several investors, each of them holding a part of the company based on the amount of stock they purchased;
- **Limited Liability Companies** : in this type of business structure, the owners are not personally liable for the company's debts or liabilities. These companies can be labeled as hybrid entities combining the characteristics of a corporation and those of a partnership or sole proprietorship.

The main privatization methods used in Romania were as follows:

1. Mass privatization, a way of distributing coupon-based assets, which proved to be a cumbersome and inefficient method, because it did not bring capital flows into the companies privatized in this way. There were corporate governance issues as a result of control diffusion within privatized companies, coupon trade has been encouraged (partly on the black market) and implicitly an uncontrolled capital market appeared.

2. The MEBO method (Management Employee Buyouts) was the first serious privatization effort deployed at national level. Originally designed for small companies only, the MEBO method, which essentially represented the sale of shares to management and employees, enjoyed tremendous success, becoming the main method of privatization. The success of this method was determined by a special law (Law 77/1994), which provided substantial facilities to managers and employees who purchase shares of the companies in which they carried out their activity. The MEBO method had the great disadvantage that it did not favor the penetration of significant capital flows.

3. The foreign direct investments in the following years, especially in 1997 and 1998, were correlated with the foreign currency requirements that Romania faced during the period. In parallel with the external loans, the authorities changed their approach to privatization, which was changed from a social justice instrument into a source of government income designed to cover the budget deficit.

4. Privatization using the capital market

As a sign of reduced privatization prospects via the Bucharest Stock Exchange, there have been cases in which typical portfolio investors acquired the majority of shares in a quoted company, with the primary goal of protecting their initial investment, either against faulty company management, in absence of privatization, or by a foreign investor who would not have approved of a strong minority shareholder.

Regardless of the type of privatization used, numerous cases of non-observance of minority shareholders' rights have been reported, such as:

1. Dilution of capital held by minority shareholders due to:
 - a) Capital increase without a prior proper re-valuation of the existing capital;
 - b) Increase of capital through contribution in kind by majority shareholders.
2. Transferring profits outside the company.
3. Transferring the company assets somewhere else ("*naked shell*" tactics)
4. Abusive profit allocation.
5. Delays in payment of dividends.
6. Limited access to information for minority shareholders.

The solutions to minority shareholders' issues can be grouped as follows:

- a) improving shareholder participation in General Assemblies and their decisions;
- b) developing the voting system through "*specific power of attorney*", as well as "*cumulative vote*";
- c) prompt payment of dividends;
- d) no contribution in kind (in principle);
- e) real rights, universal rights and regulated selective empowering;
- f) transparent approval of transactions with stakeholders or their co-relatives by the Board of Directors;
 - g) discussion of major transactions in the Board of Directors meeting;
 - h) building a real capital market, correlated with increasing liquidity;
 - i) open-listed companies on the Stock Exchange should be consolidated;
 - j) improving corporate governance by offering a fair, lawfully and loyally option for maneuver and exit for minority investors;
 - k) the existence of effective corporate governance control mechanisms, including the mandate of guarantees granted according to certain criteria;
 - l) adopting a process of exerting pressure;
 - m) increasing liquidity and improving corporate governance by privatizing state owned companies, while ensuring their management through:
 - improving the education and training capabilities of decision-makers;
 - the creation of "committees" (working groups) focused on opening, decentralization and deregulation;
 - construction of professional mechanisms.

4. Corporate governance in Romania: the current state of principles' implementation

The Corporate Governance Code had a very important role in the implementation of the OECD Corporate Governance Principles in Romania. This was developed by the Bucharest Stock Exchange in 2001. After being revised in 2008, the initial Corporate Governance Code was replaced with a new one in 2015.

The Corporate Governance Code of the Bucharest Stock Exchange contains a set of principles and guidelines for companies whose shares are traded on the Stock Market. The aim of the Code is to create an attractive Romanian capital market on international level, based on best practices, transparency and trust. The code encourages companies to build a strong relationship with shareholders and other stakeholders, to communicate efficiently and transparently and to be open and transparent with all potential investors.

The objective of the Code is to increase the level of trust in the listed companies. It does that mainly by promoting new and improved standards of corporate governance amongst these companies. A good corporate governance is a powerful tool to strengthen the competitiveness on the market.

The Bucharest Stock Exchange is maintaining a mechanism based on the "apply or explain" principle, through which clear, exact and updated information is relayed on the market, about observing the corporate governance rules by the listed companies.

The core elements of this Code are access to investor information and shareholders rights protection. The Code, however, tries not to impose to the listed companies excessive rules that could exceed the benefits, but the listed companies should try to follow the Code. Good corporate governance is meant to facilitate a good, efficient entrepreneurial leadership that can sustain the long-term success of society.

The companies on the Stock Exchange have to include a corporate governance statement in their annual reports. This is normally included in a section that contains a self-assessment regarding how "provisions to be respected" were fulfilled, as well as the steps taken towards those provisions that were not met.

Every instance of non-compliance by a listed company of any of the sections titled "Provisions to be respected" will be publicly reported by using a current report, respecting the dispositions of the Bucharest Stock Exchange Code.

This code has a major disadvantage in the fact that it is addressed to the listed, or "open" companies, which actually is a small number of the total Romanian companies, while for the unlisted, or "closed" ones, there is no obligativity to respect the principles of corporate governance. Thus, the Corporate Governance Code of the Bucharest Stock Exchange has an extremely low impact, as only about 390 companies are currently listed on the stock exchange.

Implementing the OECD principles of corporate governance in Romania is supported by the Government Emergency Ordinance 109/30.11.2011 on corporate governance for public companies.

GEO 109/2011 is addressed to:

- public as well as private companies;
- Financial Investment Services Firms, Financial Institutions and Investment Management Companies stated by Government Emergency Ordinance 99/2006 for credit and capital adequacy institutions, approved and updated by Law 227/2007;
- companies whose activity is not regulated by Law 32/2000 regarding the activity and supervision of the insurance companies and intermediaries.

The objectives of GEO 109/2011 are:

- the need to increase the public enterprises contribution to the improvement of the Romanian economic parameters and government budget balancing;
- understanding that the efficiency of an economic operator depends, in a decisive manner, on how well its management performs and on the correct implementation and functioning of good corporate governance mechanisms;
- improving the legal framework regarding the autonomous regias administration, which negatively affects the competitiveness of this sector, as well as its economic performance;
- the need to develop new mechanisms of corporate covernance in order to improve the efficiency of state owned companies;
- the need to develop means to ensure the transparency of processes such as naming the management representatives and the members of the management bodies, to guarantee professionalism and responsibility in the management decision making process, the development of additional mechanisms to protect minority shareholders' rights and increased transparency towards the public of both the activities of the state entities and of the state owned companies policy in accordance with the principles of corporate governance of state companies, developed by the Organization for Economic Cooperation and Development (OECD).

The impact of GEO no. 109/2011 is not very large either, according to Statistical Yearbook of Romania, in 2017, out of a total of 525,660 active enterprises, only 1,335 were with majority state capital, ie 0,25% .

5. Comparative study of two models of corporate governance, an open company (ARGUS S.A.) vs. a closed company (DOBROGEA GRUP S.A.)

In order to give an example, we conducted a comparative study between two corporate governance structures in Romania, an "open" company (ARGUS S.A.) and a "closed" company (DOBROGEA GRUP S.A.). Both of them are in the food industry and are representative at national level, both having their headquarters in Constanta.

Table no. 1. Similarities and differences between ARGUS S.A. and DOBROGEA GRUP S.A.

Similarities and differences	ARGUS S.A.	DOBROGEA GRUP S.A.
Industry they belong to	Food industry	Food industry
Main activity	Manufacture of oils and fats	Manufacture of milling, bakery, pastry and frozen products
Social capital	Private	Private
Privatization method	MEBO	MEBO
Shareholders	Slightly dispersed	Very dispersed
The Chairman of the Board of Directors is also General Manager	No	No
The existence of a voluntary code of corporate governance	No, but following the principles of corporate governance described in the Corporate Governance Code of the Bucharest Stock Exchange	No
Applying OECD Corporate Governance Principles	Yes	Yes
Transparency in the presentation of financial statements	Published on company website and on the Stock Exchange website	Limited to shareholders
Transparency in communicating GMS decisions	Publishing on company website and on the Stock Exchange website	Limited to shareholders
Respect for the rights of smallholders	Yes	Yes
Vote through power of attorney	Yes	Yes
Share trading	Through B.S.E.	Only among the shareholders, with the approval of the Board of Directors
Pricing method	Stock exchange mechanisms	Free negotiation between seller and buyer
Involvement in the social life of the community	Yes	Yes

Source: (Sergiu Sarchizian, Thesis, 2011)

The comparative study of the two models of corporate governance, an open company (ARGUS S.A.) vs a closed company (DOBROGEA GRUP S.A.), compares several advantages and disadvantages of each model and allows some interesting conclusions.

A first conclusion is that in an "open" (listed on a regulated financial market) company, the way of communication of internal information is very transparent, they are published both on the company website and on the stock exchange where it is quoted. Moreover, the shareholders have a dedicated e-mail address available to communicate with the company.

Another important aspect in terms of differences is underlines by the two ways in which the shares are traded, as well as the way the price is formed. While in an open company any trading of shares is made through regulated financial markets (B.S.E), any person or company can purchase its shares, and the price is determined by transparent stock exchange mechanisms, in a closed company transactions are made only between shareholders. The approval of the Board of Directors is nevertheless required. Although the price at which the shares are traded is fixed by direct negotiation between the seller and the buyer, depending on the demand and supply in terms of shares existing at one point, it can not be determined if the way in which a certain trading value is reached is perfectly transparent, as it is not being fixed in a regulated financial market.

Another aspect would be that a listed firm is required to have its own code of corporate governance. At the very least, a listed company should comply with the principles of the Corporate Governance Code of the Bucharest Stock Exchange.

It should also be noted that a "quoted" firm has much easier access to financial resources and a higher credit rating than an "unlisted" firm.

6. Conclusions

Corporate governance is needed anywhere in the world, even in developed countries (bankruptcies of some prestigious companies such as Enron, WorldCom, Arthur Andersen, Global Crossing, Tyco, Parmalat demonstrate it clearly).

Moreover, a better corporate governance is needed in developing countries in Central and South-Eastern Europe, where the corporate governance model is still inefficient, most companies in these countries being "*closed companies*", mostly as a result of the power being concentrated in the hands of managers and employees, and lack of control from the outside or inside of other important stakeholders such as banks, institutional investors, or through the capital market. We can say that in practice we are dealing with a "*coexistence*" between different models of corporate governance, which in fact shows differences in tradition and culture.

The Romanian companies that came to be by privatization of former state-owned enterprises face the same types of problems: dilution of minority shareholders' capital, transfer of profits outside the company, transfer of company assets to other parties, abusive profits, delays in payment of dividends, limited access to information for minority shareholders.

It can be noted that, in terms of corporate governance, significant progress has been made in Romania in recent years. Recent reforms in the country's legal and regulatory framework are commendable. Still, assuring its effective and sustainable implementation should remain a priority.

We believe that applying the principles of corporate governance should not be limited to public companies or to those listed on a financial market, on the contrary, following the study, we think they can be extended to non-listed companies, which would lead to increasing their transparency.

Based on the analyses and conclusions in the previous paragraphs, we outlined a series of personal assessments and priorities that will lead to accelerating the implementation of corporate governance principles in Romania.

Priority 1: Increase awareness of corporate governance principles

In our sincere opinion, it is of utmost importance to make the principles of corporate governance known among managers and other interested parties through various events - seminars, round tables, symposiums - organized through the Regional Chambers of Commerce and the Bucharest Chamber of Commerce, as well as other key institutions such as the Corporate Governance Institute, the Bucharest Stock Exchange etc., where mass media should be present.

Priority 2: Increasing flexibility of business access conditions to a financial market - Stock Exchange

In this way, it will be able to increase the number of listed companies in Romania, which is currently very small.

Priority 3: Obligativity to adopt, at least by the listed companies, of a Voluntary Corporate Governance Code that complies with OECD principles

In our opinion, simply complying with the principles of corporate governance described by the Bucharest Stock Exchange Code is not enough. What would be truly effective would be for listed companies to have their own Corporate Governance Code.

Priority 4: The systematic organization of interactive training programs for managers, in corporate governance, for a better leadership awareness of its importance.

Priority 5: Establish an interactive IT platform dedicated to corporate governance that business administrators, managers, and stakeholders can access and share ideas and knowledge in an interactive way.

Priority 6: Introducing a new section - "Corporate Governance Award" - as part of the annual business charts made by the Chamber of Commerce of Romania and the Regional/Bucharest Chambers of Commerce, awarded to the most transparent companies.

Priority 7: Emphasizing the role of the Corporate Governance Institute in promoting the principles of corporate governance

At the moment, the existence of this Institute and its object of activity are not very well known.

Priority 8: Introducing the study of corporate governance, as a stand-alone class, in economics faculties in Romania

We strongly believe in the importance to cultivate the fundamental notions of corporate governance from the the undergraduate level for the future managers and administrators of Romanian companies.

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