Corporate Governance Codes in Romania and European Union Countries

Mihail BUSU[1]

Abstract

In recent years, European conglomerate-type companies have used to define their operating strategies according to the principles established by means of corporate governance programs. In Romania, the corporate governance programs are best illustrated by listed companies which are coordinated by such rules. Mostly, these rules involve company's objectives, the relationship with shareholders and investors, the reports made by them, the structure of the board, the role of companies' presidents and even managers' remunerations. The specific rules of corporate governance programs follow the OECD general principles stated in 1999 as well as the package of European Union Directives. This article provides an assessment of the corporate governance policy framework and enforcement and compliance practices in Romania and comparisons between Romania and other UE member states.

Keywords: *corporate governance, shareholders, operating strategies, competition rule, country development*

JEL classification: G34, G38, O16.

1. Introduction

Reducing the state's intervention in the economy is one of the results achieved because of market competitive functioning. Increasing the awareness of managers to comply with competition rules besides the corporate governance ones, does represent a continuous process, initiated in Romania in recent years. The economic environment tries to assimilate corporate governance with competition rules.

Romania's corporate governance framework is based on commercial law, the securities legislation being in line with the commercial framework. Corporate governance is not defined as such under Romanian legislation, but there are several guidelines which our country must follow in order to have an adequate corporate governance.

After becoming a member of the European Union on 1 January 2007, Romania has amplified the process of harmonizing its laws with the communitarian acquis. As a result, the country has made significant amendments to its commercial legislation and has substantially reformed the legal framework applicable to

[1] **Mihail BUSU**, The Bucharest University of Economic Studies, Romania. E-mail: mihail.busu@man.ase.ro

investments. Consequently, the business climate has improved, leading to an investor friendly environment. Nevertheless, several vital issues remain to be addressed in order to help Romania reach its full market potential. In particular, despite government's efforts the problem of corruption remains visible and the laws need to be better enforced.

A Corporate Governance Code was issued in 2008 and companies are free to apply principles and recommendations set forth in the Code if they so decide. The latest European Bank for Reconstruction and Development (EBRD) assessment of the corporate governance legislation showed Romania being in "high compliance" with the OECD Principles of Corporate Governance and evidenced no major shortcomings in the relevant framework. Similar favorable results were found by the 2009 EBRD Insolvency Law Assessment and the latest EBRD Assessment of Securities Markets legislation.

Firms with low shareholder rights and excess cash have lower profitability and valuations (Blair, 1996). However, Harford et. al. (2012) and Busu and Cimpan (2014) consider that there is only limited evidence that the presence of excess cash alters the overall relation between governance and profitability.

The Corporate Governance is very important for any economy, but even in countries with advanced market economy there are disagreements regarding the existing mechanisms of corporate governance. For instance, while Denis and McConnell (2003), Becht et. al (2003) and Romano (2004) make an optimistic assessment of the EU corporate governance system, Cernat (2004), Branson (2001) and Busu (2014) believe that there are still big gaps of corporate governance codes between the Western and Eastern UE member states.

2. Corporate Governance in EU Countries

The 2007 EBRD assessment on corporate governance showed Romania being in "High Compliance" with the OECD Principles of Corporate Governance (Figure 1). The various categories represent the level of compliance of a country's legislation (the "laws on the books") with international standards as set out in the OECD Principles of Corporate Governance.

This graph shows us the fact that Romania has a high compliance with the legislation of the EU countries, while other EU countries such as: Poland, Bulgaria, Latvia and Estonia have a medium -low quality of corporate governance legislation with the EU Countries.

Besides Romania, other Est European EU countries have a high convergence with EU legislation, such as Hungary, Slovakia and Czech Republic.

It is also interesting to observe that, from the non-UE countries, Russian federation has a high convergence with EU legislation, while countries like Belarus and Ukraine have a very low compliance with the legislation in EU.

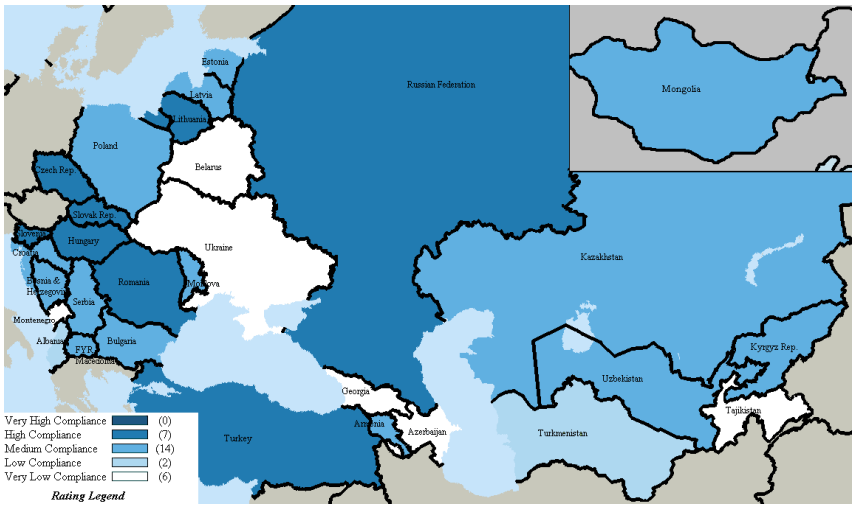

Figure 1. Quality of corporate governance legislation in the EU Countries
(Source*:* EBRD Corporate Governance Sector Assessment

Now, as can be observed in Figure 2, the assessment has found that the majority of areas assessed are in compliance with international standards, with the exception of responsibilities of the board. In this particular area the assessment has found some shortcomings, such as the fact that monitoring and managing potential conflicts of interest are not included in the responsibilities of the board.

The extremity of each axis represents an ideal score, i.e., corresponding to OECD Principles of Corporate Governance. The fuller the 'web', the more closely the corporate governance laws of the country approximate these principles.

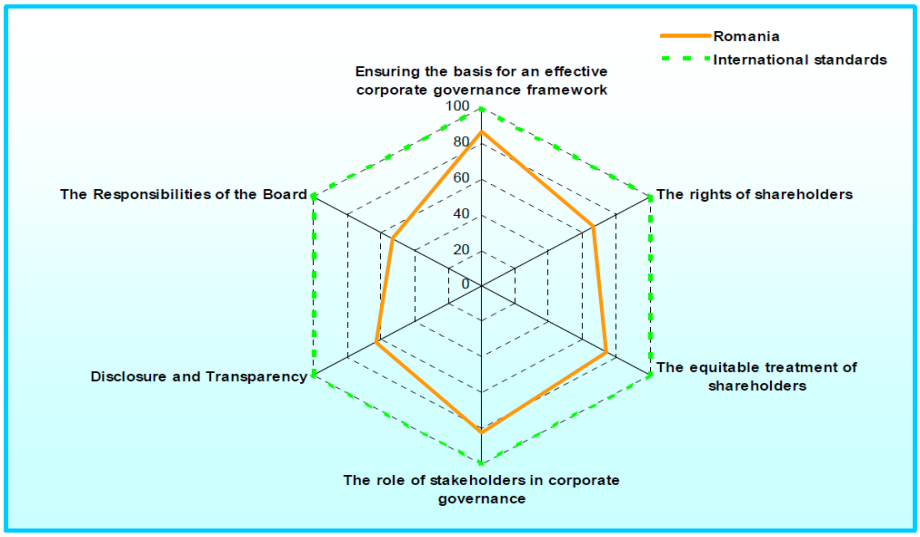

Figure 2. Quality of corporate governance legislation in Romania
Source*:* EBRD Corporate Governance Sector Assessment

The above graph shows the quality of corporate governance legislation in Romania. We could conclude that Romania is close to international standards on "ensuring the basis for an effective corporate governance framework", and far from these standards on "the responsibilities of the board.

The preparation and disclosure by listed companies of corporate governance compliance statements in line with the requirements of the Corporate Governance Code have been very poor so far. The practice should improve from 2012 as the Bucharest Stock Exchange has committed for a better implementation of the Code. IFRS is still not required for credit institutions however from 1 January 2012 all credit institutions were required to prepare their accounts in accordance with IFRS.

The rules on external auditor independence should require more transparency on the provision of non-audit services so as to strengthen external auditors' independence.

With specific reference to corporate governance of banks and due to the fact the major banks in the country are subsidiaries of foreign groups, the National Bank of Romania should require the adoption of a governance policy for the group that clearly maps out the relationship between group and subsidiary boards, as well as the relationship between group and subsidiary functions and businesses. Moreover, in close co-operation with home supervisors, Romanian host supervisors should further develop their supervision toolkit, allowing them to access the adequacy of the group risk function, especially when the latter is fully consolidated within the group function.

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3. The Romanian Capital Markets Law

The general framework for Romanian corporate governance is provided by the following legal acts**:** the Law No. 31/1990 on commercial companies, the Law No. 297/2004 on capital markets and The Bucharest Stock Exchange Corporate Governance Code.

The Company Law sets the framework for all company forms and contains provisions regarding the management of companies, the appointment and dismissal of directors, the composition and functioning of the members of management bodies, their remuneration, responsibility and liability towards the company.

The Law No. 441/2004 amending the Company law created two alternative corporate management systems: the one-tier system, where the company is managed by a sole director or a Board of Directors (BoD), and the two-tier system, where the company is managed by the Directorate and the Supervisory Board.

The main amendments in 2006 and 2007 in the Company Law to enhance corporate governance rules in Romania refer to the following:

i. One or more members of the Board of Directors (BoD) should be independent;
ii. Company managers are requested to inform the BoD of their actions on a regular basis;
iii. The new regulation made a clear separation between executive positions (executive directors) and non-executive positions (non-executive directors);
iv. Any director may ask the company managers for information on the daily management of the company;
v. At least one member of such committees should be a non-executive independent director;
vi. BoD members should act in good faith, prudently and with the diligence of a good director;
vii. The BoD may create consultative audit, nomination and remuneration committees;
viii. The duty of loyalty for both directors and managers.

These new corporate governance rules governing the functioning of joint-stock companies are drafted in accordance with the OECD corporate governance principles.

The National Securities Commission has made efforts to adapt the Romanian regulation to the community acquis of the European Union and its standards. The Bucharest Stock Exchange is the starting point for the implementation of the corporate governance rules. The main provisions of Law No. 297/2004 on Capital Markets (hereinafter – the Capital Markets Law) refer to the

fact that the listed issuers should ensure equal treatment for all shareholders holding the same position.

The directors of the listed issuers are obliged to report, as soon as possible, the execution of any legal documents between the company and its directors, employees and controlling shareholders, as well as with anyone related to them, when the accumulated value of such transactions accounts for at least the RON equivalent of EUR 50,000.

The reports on related party transactions should include the documents concluded and / or their amendments and should refer to the following details: the parties which concluded the legal agreement, the date and nature of the agreement, the total value of the agreement, mutual claims, guarantees, payment terms and conditions.

The reports should include all other relevant information to determine the effects of such contracts on the issuer's financial position. Members of the BoD in a listed company may be appointed by cumulative voting. The appointment is compulsory when requested by a significant shareholder (10% of the share capital or voting rights).

4. An overview of the Bucharest Stock Exchange

Romania's accession to the European Union in 2007 resulted in several changes in Romanian capital markets legislation which had to be introduced in accordance with the new requirements of the European market. In light of these changes, the Bucharest Stock Exchange drafted a new Corporate Governance Code - 2008 version which was harmonized with the Romanian and European legislation applicable to listed companies.

The Corporate Governance Code - 2008 version creates a flexible corporate governance framework, essential for each category of investor for the construction of an integrated European capital market and for the maximization of the benefits resulting from accession. It currently contains rules which are in line with the EU recommendations as well as the OECD Principles of Corporate Governance and increase the transparency, credibility and trust for all stakeholders.

As mentioned above, the BSE Code contains 8 articles that regulate the following aspects:

i. The corporate governance framework;
ii. The financial instruments holders' rights;
iii. The composition of the Board of Directors;
iv. The role and duties of the Board of Directors;
v. The conflicts of interests and related parties transactions;
vi. The regime of corporate information;
vii. The transparency, financial reports, internal control and risk management;
viii. The corporate social responsibility;

The BSE Code principles and recommendations are not mandatory for listed companies, being applied on a voluntary basis. The main principle of the BSE Code is that issuers should adopt a clear and transparent corporate governance framework, which is adequately disclosed to the general public. The corporate governance framework should set out the functions of the BoD and management, as well as their powers and responsibilities. The main aspects of the BSE Code refer to the points described below.

3.1. The Bucharest Stock Exchange

The Bucharest Stock Exchange was formally set up on 21 April 1995, based on the National Securities Commission ("the NSC") Decision no. 20, being Romania's primary stock exchange. It started trading on 20 November 1995 with six companies and one trading session per week. The Bucharest Stock Exchange adopted the first Corporate Governance Code in August 2001.

When the first Corporate Governance Code was adopted in 2001, the Plus Category (the "transparency plus") was set up. The Plus Category contained the companies that in their Articles of Association had undertaken to adhere to the provisions of the Corporate Governance Code only as a whole. The Plus Category was designed for companies that wished to introduce corporate governance principles to increase the transparency standards of the Romanian stock exchange. The promotion to the Plus Category did not reflect the economic / financial performance of a company, but rather the communication and transparency standards that a company was prepared to adopt and implement.

The Plus Category was not a success for the Bucharest Stock Exchange, as only one company, namely *"Electroaparataj Bucharest*", requested registration in the Plus Category. Corporate Governance Institute - Bucharest Stock Exchange. In 2003, as a result of the Report on corporate governance in Romania issued in December 2001 by the OECD, the Bucharest Stock Exchange founded the Corporate Governance Institute, whose aim is to raise Romania's managerial culture to EU standards and to encourage companies to comply with the corporate governance principles. Both the Bucharest Stock Exchange and the Corporate Governance Institute were engaged in the promotion of adequate corporate governance standards to Romanian listed companies.

3.2. Voluntary compliance to the "comply or explain" approach

Companies that decide to adopt, wholly or partially, the provisions of the BSE Code have to transmit to the BSE, on yearly basis, a corporate governance compliance statement specifying which of the recommendations of the Code were actually implemented and in what manner (the "Statement").

If the principles and recommendations of the Code contain provisions related to the companies, directors, auditors, shareholders or other corporate bodies, each company has to provide accurate, correct, precise and easy to

understand information on the manner in which these recommendations were practically implemented during the period to which the Statement refers.

Should the companies fail to implement, totally or partially, one or more of the Code recommendations, they have to provide adequate information regarding the grounds for the partial compliance or the non-compliance with these recommendations. However, the BSC Code gives principles and recommendations but does not provide for sanctions in the case of companies' non-compliance.

From 2009, companies are required to include the Corporate Governance Compliance Statement (the "comply or explain" statement) in their Annual Report.

The Annual Report prepared by listed companies that decided to adopt the BSE Code has to include a chapter on Corporate Governance describing all the relevant information in relation to corporate governance that was registered in the previous financial year.

3.3. Legal evolution

The Company Law has been amended several times since 1990. Law No. 441/2006 amending the Company law brought a number of important changes that were enforced from December 2006.

The most important changes for joint-stock companies relate to corporate governance, especially regarding the ordinary and extraordinary general shareholders meetings and the board system. Moreover, Law No. 441/2006 brought significant changes to the rights, duties, attributions and powers granted to the members of corporate management bodies.

Furthermore, over the past ten years, the governing law on the Romanian capital market has undergone numerous changes, which resulted in a new, consolidated capital market law that was enacted on 28 June 2004 and came into force one month later.

The new Capital Markets Law aims to bring the Romanian capital market law in line with European standards. While the new law outlines only the general principles, additional secondary legislation was developed by the regulatory body, the NSC.

The new Bucharest Stock Exchange Corporate Governance Code was adopted in 2008 and replaced the BSE Corporate Governance Code adopted in 2001.

4. Conclusion

The corporate governance norms were adopted in the context of the increasingly competitive environment in Romania. Corporate governance is also a means to stimulate and improve companies' social responsibility. As corporate governance is a new and challenging concept for our country, a learning process was initiated and fostered by various players. The development of corporate governance rules has not been organized according to a defined process or tangible rule. Nevertheless, the steps

initiated by the Bucharest Stock Exchange and the amendments of the Romanian laws contributed to the positive development of companies' corporate governance practices.

The convergence between the EU and Romanian legislation is closer than it is with other member states. The Capital Markets Law brought the Romanian capital market law in line with European standards, while the Bucharest Stock Exchange Code improved the Corporate Governance framework.

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