

CORPORATE GOVERNANCE—THE ROLE AND APPLICATION OF THE PRINCIPLE OF TRANSPARENCY

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The aim of the current research is to clarify the concept of ‘corporate governance’ as we believe it is a relatively new concept at national level. At the same time, our analysis focused on the manner in which the principle of transparency has been incorporated into the recommendations and regulations/provisions of the Bucharest Stock Exchange (Romanian: BVB) and how this principle has been applied by the companies listed with the BVB. In order to accomplish the objectives of our research, we adopted a deductive approach, from general to specific, by means of which we were able to combine qualitative with quantitative studies. Therefore, our approach started from the definition found within the principles of OECD according to which ‘corporate governance’ is the system by which companies are run and controlled. In Romania, the concept of ‘corporate governance’ was first advanced in 1999 by the Strategic Alliance of the Business Associations (Romanian: ASAA), which drew up a “Voluntary code of corporate governance” in association with the Confederation of Private Entrepreneurs in Timiş county and the Chamber of Commerce and Industry of Romania and Bucharest. Another facet of our research is the principle of transparency and the manner in which entities should put it to practice in order to ensure efficient corporate governance. To this effect, since the beginning of 2009 the entities listed with the BVB have been under obligation to report which recommendations of the new Corporate Governance Code have actually been implemented by the company in the current financial year by disclosing to BVB the “Comply or Explain” Statement. The findings of our research show that the concept of ‘corporate governance’ has lately been a matter for intense debate due to the famous financial failures in recent years. In 2009, Transelectrica was the only company in tier I of the BVB which filled in and submitted the “Comply or Explain” Statement. Therefore, we believe that Transelectrica should serve as a fine example for the entities listed with the BVB as regards the filling in and submitting of the said Statement.

Keywords: corporate governance, transparency, efficiency, recommendations, regulations M42, M48

1. Introduction

As framework for the operation of the external audit, corporate governance has been conceptually analyzed starting from the universally acknowledged definition found in the principles of OECD, then in terms of its attributes by taking into account its underlying principles. Therefore, we believe that efficiency may be a defining attribute for corporate governance on condition that all recommendations and principles of OECD issued in this regard are strictly followed. Our purpose has been to deal at great length with the principle of transparency, as it is closely related to the topic being researched. To this effect, we studied the manner in which the principle of transparency has been incorporated into the recommendations and regulations of the BVB. In order to conclude our theoretical study we analyzed the manner in which this principle is applied by the Romanian societies/companies listed with BVB in tier I, and then we made a detailed presentation of an example of good practice and conducted a case study focused on Transelectrica society.

In the final part of our scientific endeavour we present the main conclusions which highlight the findings of the research conducted.

2. Research methodology

In order to accomplish the objectives of our research, our scientific endeavour adopted a deductive approach, from general to specific, which combines qualitative with quantitative studies. The starting point of our research is based on the current level of knowledge of the key concept „corporate governance”.

The concept of governance has been approached in terms of the Principles of Corporate Governance issued by OECD as well as the degree to which these principles have been incorporated at national level and the role they play in developing efficient corporate governance. Going from synthesis to analysis, we continued by stressing the importance of observing the principle of transparency and conducted a case study about the observance of the said principle by the Romanian entities.

In conducting our case study on the practices of efficient corporate governance adopted by the societies listed with the Bucharest Stock Exchange, we made use of the non-participant observation method which, according to Krüger (1988), gives a series of advantages because the information can be obtained easily and at little expense when the respondents are not willing to impart it. Thus, we were able to obtain in-depth, direct information which has not been processed or interpreted.

3. Defining the concept of corporate governance

The concept of corporate governance was first introduced in 1999 by the Organization for Economic Co-operation and Development (OECD). OECD defines ‘corporate governance’ as the system by which companies are run and controlled as well as the manner in which liabilities and rights are shared by the main actors (shareholders) of an entity. Of these, OECD mentions the Board of Directors, who has a substantial decision-making role to play in a company, followed by managers, shareholders and other stakeholders. In order to support entities to apply the principles of corporate governance, OECD published a guide to corporate governance describing the principles underlying an efficient corporate governance.

The OECD principles describe the manner in which decisions should be taken within an entity, starting from the definition of the strategic objectives, the proper means to achieve them and the monitoring of the financial performance. Managers occupy the leading role in bringing more efficiency to the corporate governance. Therefore, a good corporate governance must provide managers with adequate incentives in order to motivate them to run the entity properly and pursue the accomplishment of the entity’s and shareholders’ objectives (OECD, 2004).

The concept of corporate governance could be well summarized as being a set of processes, customs, policies, laws and institutions affecting the way an entity is administered and controlled, with a view to increasing its performance and value. It actually refers to enhancing the efficiency of the management systems, with special emphasis on the role of the Board of Directors, the responsibility and remuneration of its members, the credibility of the financial situation/standing and the efficiency of the risk management systems.

In Romania, the concept of corporate governance was first advanced in 1999 by the Strategic Alliance of the Business Associations (Romanian: ASAA), which drew up a “Voluntary code of corporate governance” in association with the Confederation of Private Entrepreneurs in Timiș county and the Chamber of Commerce and Industry of Romania and Bucharest. The Code’s purpose is to draw the attention of the business environments, the Boards of Directors and CEOs of the incorporated enterprises to the experience of the OECD countries and the principles they adopted in the field of corporate governance.

On the other hand, the Bucharest Stock Exchange is actively engaged in promoting the principles of corporate governance issued by the OECD. One of the first steps in this regard was the establishment in 2001 of a Corporate Governance Code which the entities trading on the market of the BVB should apply in whole or in part. In 2008, the Code was amended in order to be harmonized with the principles of corporate governance issued by OECD. The Code, taking effect from the beginning of 2009, contains certain recommendations on the transparency of the obligation toward the BVB and investors to submit the Annual Report. The Code contains 11 articles structured by the principles of OECD. One or more of the 19 principles are explained in each article and for each principle the Code elaborates recommendations for its application so that the Code comprises a total of 41 recommendations. In order to help the issuers apply the recommendations of the Code, in March 2010 the Bucharest Stock Exchange published 'Implementation Guidelines for the Corporate Governance Code' which provides details on the implementation of certain recommendations.

4. Efficient corporate governance

It is necessary to strictly observe each and every principle so that corporate governance may properly be termed "efficient".

a) The role of observing the principle of transparency in developing efficient corporate governance.

Below we shall deal exclusively with the principle of transparency and the manner in which the entities must put it to practice to ensure efficient corporate governance, as the said principle is directly related to the purpose of our research.

An important role within corporate governance is occupied by the transparent information of shareholders and other stakeholder categories. In order to build up their trust in the financial and non-financial information provided by the entity, the information must be audited. As the financial auditor is an independent professional whose activity is carried out in the public interest, his opinion expressed in the audit report contributes to the increase of all stakeholders' trust in the accuracy of information provided by the entity.

The range of reports made up of balance sheet, profit and loss account, cash flow, capital inflow and outflow along with guidance notes and accounting policies are the main financial information provided to stakeholders.

The data contained in the range of financial reports are the product of accounting at organizational level and of the external reporting systems, which provide data on the entities' financial standing and performance.

In order to observe the principle of transparent information/informing of all stakeholders, equal importance must be attached to financial and non-financial information. This requirement is also emphasized in the study conducted by the McKinsey (2001) consultancy firm regarding the opinion of institutional investors from emergent countries (Asia, Southeastern Europe and Latin America) about corporate governance. The study shows that, when taking investment decisions, investors attach equal, if not more, importance to non-financial information on corporate governance as they do to financial information (Robu et al., 2004).

Providing transparent information may contribute to efficient corporate governance through the improvement of the quality of information. The demand for information on the part of investors, financiers and financial analysts has increased considerably over the last years, as did the competition. This aspect, in corroboration with the international financial scandals, required that entities pay increased attention to the quality of information provided, especially in the case of listed companies, as well as the active involvement of security regulators and international accounting bodies.

As shown in the studies conducted by DeZoort et.al., (2002) and Porter (2009), at entity level an important role in observing the principle of transparency for the information provided is occupied by the triad internal audit—audit committee—external audit.

Taking these aspects into consideration, the Corporate Governance Code issued by the BVB deals with transparency, financial reporting, internal control and risk management within the same article, that is, Article 7.

b) Incorporation of the principle of transparency in the BVB's recommendations and regulations

Starting with 2009, the entities trading on the BVB market are under obligation to report which recommendations of the new Corporate Governance Code have been concretely implemented during the current financial year by submitting the “Comply or Explain” Statement.

In the “Comply or Explain” Statement, a set of questions were framed for each principle, concerning which recommendations should be adopted. Of the total number of recommendations published in the Code, the Statement only took 28 of them, framed as questions which can be answered by YES, NO and IF NOT, PLEASE EXPLAIN. The recommendations taken in the Statement focus on the following aspects: definite transparency structures, recommendations on the respect for and active and effective communication with stakeholders, choosing, structure and efficiency of the Board of Directors, establishment of the nomination committee, remuneration of the Board of Directors and various committees and governance structures, the protection of the entity's interests and not somebody's personal interests.

The recommendations which were not directly taken into the “Comply or Explain” Statement complete and provide details about those explicitly found in the Statement. In order to give an overall picture, below we specify those recommendations that were not taken in the Statement: participation of shareholders to the Shareholders General Meetings as well as using the best efforts to facilitate their participation, recommendation on the privilege-based transaction, responsibility and the balanced social structure of the Board of Directors, forwarding the list with the candidates to the office of administrator/director, coordination, appointing and evaluation of the members of the Board of Directors by the Nomination Council/Committee, if any, submitting to the Board of Directors the proposals on remuneration drafted by the Remuneration Council, if any, and last but not least, the modifications regarding the new management system (adopting the dualist system) and the application of the governance codes.

5. Transelectrica case study on the application of the principle of transparency by the Romanian societies

After we analyzed the annual reports of the 21 entities listed with the BVB in tier I, we found out, to our great disappointment, that only one of the 21 entities submitted the “Comply or Explain” Statement for 2009. Transelectrica is the only entity which disclosed to BVB the “Comply or Explain” Statement for 2009 in the Annual Report of Directors.

From the statement made by Transelectrica “Although the ‘Comply or Explain’ Statement is not compulsory for the current Annual Report, the company has decided to submit it as a token of respect for shareholders and investors” we can notice their keen interest in the corporate governance as well as in the participants to the capital market. The analysis of the statement filled in by the entity reveals a small number of negative answers (9) out of the 28 recommendations. Some negative answers were given for Principle XI “*The company will secure the services of good quality directors and executive managers by means of a suitable remuneration policy that is compatible with the long-term interests of the company*”. Of the negative answers, we would like to present the one given to the question “*Does the Board of Directors analyze at least once a year the need to register a remuneration Committee/policy for the directors and members of the executive management?*”. According to the negative answer provided, the company complies with the requirements of the Statement and offers a plausible explanation “*Not applicable. The*

Remuneration Committee was set up as of 2007”, which proves the entity’s interest in adopting the principles of corporate governance. The answer to the recommendation on the company’s remuneration policy is also negative, the explanation being “*Applicable legal provisions and decision of the majority shareholder are enforced*”. This explanation is offered for most of the negative answers.

Although one third of the answers provided by Transelectrica are negative, we would like to also pinpoint the great number of positive answers. Thus, the entity provides positive answers to two thirds of the questions framed according to the recommendations of the BVB’s Corporate Governance Code. Mention must be made of the fact that explanations are also provided in the case of some recommendations for which the entity gives positive answers, thus giving further details about that particular answer. The first explanation given for one of the positive answers was indeed enjoyable to read “*Are the corporate governance structures, positions, competences and liabilities of the Administration Board and of executive management defined in the Corporate governance best practices/regulation? These are defined in the Transelectrica Corporate Governance Regulation as well as in the supporting documents published*” because we could see the entity’s interest in obtaining information and in elaborating corporate governance regulations. Another positive answer whose explanation was worthy to notice is the one related to the audit committees “*Is there an Audit Committee within the company? The Audit Committee was set up as of 2007. Update of appointment currently in progress*” thus proving that the audit committees were set up on the initiative of the company and not under any legal constraints.

6. Conclusions

Our research focused on corporate governance, a topic of intense debate over the last years due to the failure of some famous international companies. One can develop efficient corporate governance only if all OECD principles in this regard are observed. Our research focused mainly on the manner in which the principle of transparency must be put to practice in order to ensure efficient corporate governance. To this effect, we studied the manner in which the principle of transparency has been incorporated into the recommendations and regulations of the BVB. In order to conclude our theoretical study we analyzed the manner in which this principle is applied by the Romanian societies/companies listed with BVB in tier I, and then we made a detailed presentation of an example of good practice and conducted a case study focused on Transelectrica society. By filling in and submitting the “Comply or Explain” Statement, we believe that Transelectrica should serve as a fine example for the entities listed with the Bucharest Stock Exchange. This Statement is a good means to provide the shareholders and potential investors with information on the structure and organization of the entity.

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