

ANALYSIS OF THE QUALITY OF CORPORATE GOVERNANCE. CASE FOR ROMANIAN COMPANIES

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Abstract:

Corporate governance, as an important element from the economic environment is a topic of great interest. During the time, researchers tried to find the most efficient corporate governance characteristics, which have a direct impact over the company's well-being. Thus, the present study contains a sample of 66 companies, for the period 2016-2021 listed on the BSE (Bucharest Stock Exchange). For the first step, the corporate governance score was computed, by ranking the responses with 1 if they comply or 0 if they do not follow the best practices of corporate governance, so it can be seen the evolution of the quality of reporting. Then, the evolution of the corporate governance score was analysed through dividing the results into quartiles. Going further, to conduct the research, from the "Comply-Explain" statement five elements which underline the qualitative reporting were selected: EQUIL (Equilibrium of board members), INDEP (Independence of board members), NOM (Selection of the board members), REM (Remuneration policy) and AUDIT (Audit committee). To consolidate our study, we have also analysed the presence of females in boards and the ownership structure, by sector of activity. In the literature, several elements were the key points, which indicated whether a business adopts the best practices of corporate governance, or not. Considering the literature, the above-mentioned elements were selected and analysed. In the case of Romania, particularly taking the corporate governance score it could be seen that there is a positive evolution for the period 2016-2021. In case of the extracted elements which are part of the corporate governance reporting, it can be seen, that they vary from a year to another, but generally presenting a positive trend. This is an encouraging aspect, meaning that businesses start to acknowledge the fact that applying the corporate governance best practices, will assure the long-term benefits for the companies.

Keywords: Corporate Governance, Equilibrium of board members, Selection of the board members, Audit committee, Independence of board members, Remuneration policy

JEL classification: G3

1. Introduction

Each business has its own path to follow, guided by the decision-making process of the management team, the implication of interested parties and the external factors. They function as a well-established mechanism, if proper training and knowledge are found in the leadership positions. Learning from experience, corporate governance has always been placed in a positive light over the business wellbeing. By definition, it is a set of principles through which the long-term prosperity is ensured. The conceptual form of the corporate governance principles, have emerged in Romania around the year 2000. First time, adopting the corporate governance practices, by Romanian companies, has started since 2001. Further, during the financial crises, in 2008, a new code of corporate governance principles was issued and adopted (Feleagă et al, 2011). Since 2015, based on the OECD principles, the latest version of the corporate governance conduit, was issued and is nowadays applied mandatorily by the companies on the Bucharest Stock Exchange, listed on the main market and voluntarily by the rest.

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In case of Romanian companies, the state of corporate governance quality has started to be in the interest of the researchers, since 2011 (Răileanu et al., 2011; Achim&Borlea (2013), Mihalcea, 2021). The interest for researchers has been placed in the frequency of the board meetings, board of directors' meetings, the remuneration policy and so on.

Thus, for the present study, the focus is placed on five elements which are part of the corporate governance reporting: EQUIL (Equilibrium of board members), INDEP (Independence of board members), NOM (Selection of the board members), REM (Remuneration policy) and AUDIT (Audit committee). To conduct the analysis, 66 companies from the main market of Bucharest Stock Exchange, for the period 2016-2021 were extracted. To further continue with the analysis, the Comply-Explain statement was selected, and the elements which reveal the adoption or lack of adoption of the analysed elements were extracted. To have a general overview on the selected sample in terms of quality reporting, the corporate governance score was computed and analysed by using the quartiles. The results indicate us an increasing trend for the corporate governance score, at the level of Romania, for the period 2016-2021. NOM and REM have the weakest evolution during the time. AUDIT has the most encouraging trend, while EQUIL, INDEP fluctuates during the time. To further conduct de analysis, we have extracted the number of females in boards and the ownership structure, by sector of activity. The results indicated us that in every sector of activity that we have in the selected sample, but also at the general level, there is a decreased number of females in boards. On the same note, most of the companies have a private capital.

The paper is structured as it follows: the first chapter approaches the literature review at the Romanian level and at the international level, by using a bibliometric analysis. In the second chapter, data and methodology are detailed. The third chapter will approach the results and discussions, while in the end the conclusions will be presented, followed by the bibliography.

2. Literature review

Corporate governance is seen as a set of “good practices” trough which a company can assess a long-term benefit, by the supervisor of the Board of directors and creating value for the stakeholders. Thus, through a well-defined set of principles, companies must implement and follow the guidelines (OECD, 1999).

Corporate governance is a mechanism which is not self-driven. It is a mechanism which needs the implication of the agents and the mixtures of the possible changes (Kastiel & Nili, 2022).

In the context of the Romania business environment and the adoption of the corporate governance principles, a series of interesting studies were developed. Feleagă et. al (2011), by comparing the state of the emerging countries, have placed Romanian companies as being less transparent in displaying the information, compared to other European countries. Particularly, in the context of board of directors and audit committee, most of the companies published on the Bucharest Stock Exchange, do not comply with these principles.

Another perspective regarding the corporate governance compliance in the case of Romanian companies, was approached by Manolescu et al. (2011). The research was placed in the context of lack of clearness in the legislation, as a cause in the very decreased percent in adopting the corporate governance principles.

On the same note, Tofan & Cigu (2020), conduct an analysis at the level of the change in legislation and the process of implementing them, at the level of corporate governance. The authors have issued a series of proposals for the Romanian legislation in the context of corporate governance.

More recently, Achim et al. (2016) approaches the corporate governance adoption, as a way through which companies can improve their financial performances. In the conducted study, by analysing the relationship between the two elements, the authors have concluded that there is a positive correlation between them. This strongly consolidates the importance of the corporate governance adoption.

Going further, another important corporate governance characteristic is the audit committee. Among the characteristics which compose a qualitative audit reporting, the following elements are contented as good specifications for an auditor: „independence, effort, expertise, size, tenure and the effectiveness”, so that the reporting process would be efficient. (Takhtani et al., 2011).

As it is displayed in figure 1, corporate governance stands as a core element for all the articles in the sample. Studies conducted in correlation with board members, audit committee and remuneration committee are placed also in the general context with corporate governance, due to the fact that they are among the characteristics which influence the qualitative reporting. It can be observed the fact that remuneration committee, board size, board independence, audit committee are found in a strong correlation. This result gives us a general overview on the topics that have been studied during the time, and at the same time, it validated the researched topic for the current study.

The current state of the literature approaches different aspects of the corporate governance best practices. As we have read through the literature, we could see the gap at the current state among the researches. The conducted study contributes to the existing literature, by approaching a qualitative analysis, by focusing our attention on the companies listed on the main market, from different sectors of activity, in Romania. The study offers a systematic analysis among the current degree of adopting the best practices, for the Comply-Explain Statement. Thus, we have proposed the following research hypothesis:

- Hypothesis 1 (H1): Companies start to acknowledge the importance of adopting the corporate governance best practices, from a year to another.
- Hypothesis 2 (H2): EQUIL (Equilibrium of board members) has an increased degree of adoption among the sample.
- Hypothesis 3 (H3): INDEP (Independence of board members) has an increased degree of adoption among the sample.
- Hypothesis 4 (H4): NOM (Selection of the board members) has an increased degree of adoption among the sample.
- Hypothesis 5 (H5): REM (Remuneration policy) has an increased degree of adoption among the sample.
- Hypothesis 6 (H6): AUDIT (Audit committee) has an increased degree of adoption among the sample.
- Hypothesis 7 (H7): There is a decreased number of females in the management positions.
- Hypothesis 8 (H8): Most of the companies are private owned.

By establishing the above-mentioned hypothesis, we have continued in the following with describing the sample and methodology, concluding with the results and final ideas.

3. Data and methodology

For the conducted study, the data consisted of 83 Romanian, non-financial listed on the main market. To provide the corporate governance report, the Bucharest Stock Exchange (BSE) website was used. The time range used for the study starts with 2016 throughout the years until the last report, which was published and available for 2021 financial year. The analysis started from 2016, due to the fact that since then, the new Corporate Governance Code of Bucharest Stock Exchange (2015), started to be applied. The companies which did not have a continuous listing for the selected sample, were eliminated. The remaining companies to be analysed consists of 66.

In order to compute the scores, it was extracted the Comply or Explain statements, which is mandatory for the listed companies to adopt and publish, as a company listed on BSE on the main market. To measure the degree of adopting the principles, the ranking developed by Achim&Borlea (2013) was used.

To gather the information, the hand collection method was approached, due to the fact that it is the only procedure to be applied, in order to compute the corporate governance score. In case of the companies which comply to the corporate governance principle, the element was marked with 1, 0

otherwise. After collecting the information, using the Comply-Explain Statement, a sum between the elements is made. The values of the score can vary from 0 (minimum) to 40 (maximum). The minimum (0) underlines the fact that companies do not comply with the reporting standards. The maximum (40) shows that companies adopt the best practices of corporate governance.

In case of the particular analyses on the elements extracted from the comply-explain statements: EQUIL (Equilibrium of board members), INDEP (Independence of board members), NOM (Selection of the board members), REM (Remuneration policy), AUDIT (Audit committee), the report itself was used. For each year, the analysed section was taken particularly and noted with 1 if they comply, or 0 if they do not. In the end, an average per year was made, for each category.

To have an overview over the presence of females in boards and the ownership structure, we have used the hand collecting methodology, by accessing the available information on their websites and reports.

4. Results and discussions

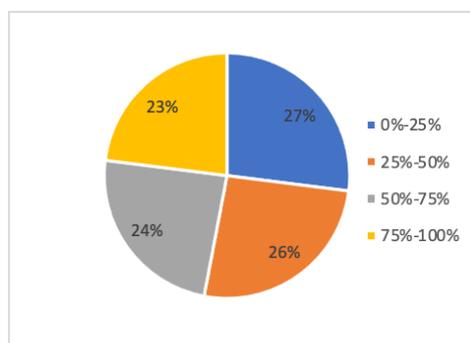
Corporate governance score

In the first part, the average of corporate governance score for the period 2016-2021 was computed. Starting with 2016 the quality of reporting has been increasing from 23, until 2021 to the average score of 27. Since 2019 a relative constant trend of the score was observed. The average of the corporate governance score is constant (27) for the period 2019-2021. This is a positive aspect, in terms of adoption the principles. From a year to another, businesses started to acknowledge the importance and the benefits which arise from adopting a qualitative reporting.

Further, it was used the quartile observation method to divide the elements into four defined categories, considering the corporate governance score, and how it can be compared to the entire dataset. The quartiles are divided in four categories. The first category, from 0-25% contains the companies with the lowest 25% of the corporate governance score. In the second interval, from 25-50%, are found the analysed businesses with the lowest 50% of the score. From 50-75%, is the category in which the companies which adopt the corporate governance principles, over 50%. In the last interval, from 75-100% are found the businesses with the highest score of corporate governance (Mihalcea, 2021). The intervals, for our sample differs from a year to another.

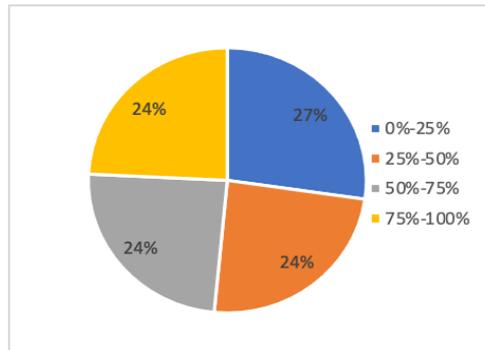
Starting with 2016, it can be seen that in the first quartile, between 0-25%, 27% of the companies from the total sample of 66, have the corporate governance scores between 0 and 14. Going further, in the second quartile (25%-50%), 26% of the companies report the corporate governance score between 15 and 23. Part of the third quartile (50%-75%) are found 24% of the companies from the selected sample, with the score between 24 and 32. In the last group (75%-100%), 23% of the businesses report a qualitative score of corporate governance between 33 and 40.

Figure 2: Quartile of CG score for 2016



Source: Own processing

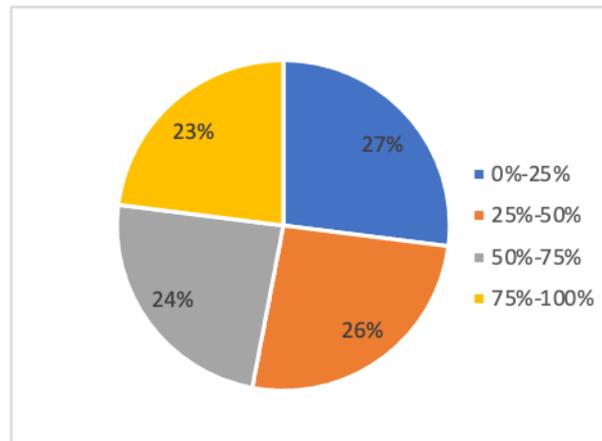
Figure 3: Quartile of CG score for 2017



Source: Own processing

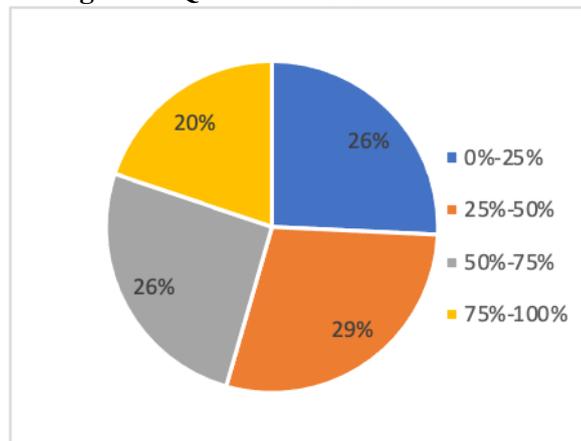
In case of 2017, the first interval of the quartile gathers 27% of the total sample of the companies, reporting the score between 0 and 16. Second quartile, contains 24% of the companies, adopting the score between 17 and 24. In the quartile 50%-75%, 24% of the companies, from the total of 66, report a score between 25 and 34. The qualitative reporting companies, which are part of the last quartile, have the corporate governance scores between 35 and 40.

Figure 4: Quartile of CG score for 2018



Source: Own processing

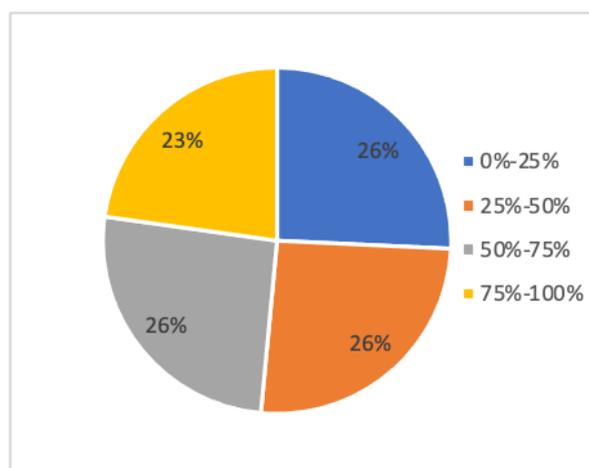
Figure 5: Quartile of CG score for 2019



Source: Own processing

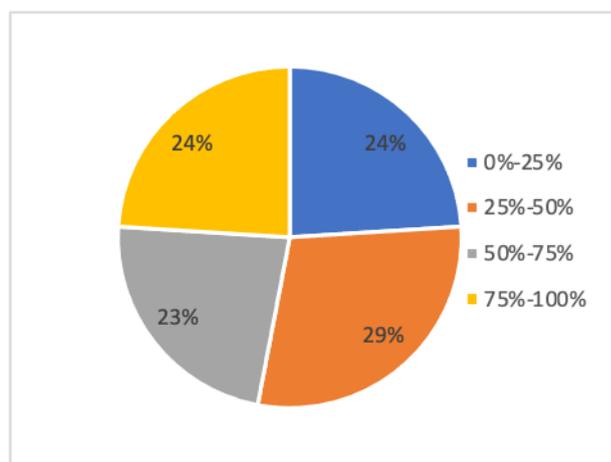
The year 2018, comes with a rather similar division among the quartiles. Thus, in the first range, 27% of the companies have the score between 0 and 17. The second quartile, contains 26% companies, with the score between 18 and 30. Third, 24% companies have the score between 31 and 36. The last, but the most significant, contains 23% of the businesses with the corporate governance score between 37 and 40. In figure 5, the quartiles for the year 2019 are displayed. For the first segment, 26% of the businesses have the corporate governance score between 0 and 18. In the second quartile, 29% of the businesses report a corporate governance score between 19 to 31. In case of the third quartile, 26% of the selected companies, have a score between 32 and 37. In the last segment, 20% have a score between 38 and 40.

Figure 6: Quartile of CG score for 2020



Source: Own processing

Figure 7: Quartile of CG score for 2021



Source: Own processing

For the rather recent years, the quartiles are shown in figures 6 and 7. In case of 2020, the first quartile contains 26% companies, which report the score of corporate governance between 0 and 18. The second quartile, includes 26% of the businesses, with a corporate governance score of 19 to 30. In case of the third category, 26% of the companies are found with a score of corporate governance reporting of 31 to 37. In the last quartile, 23% of the companies from the selected sample, have a score between 38 and 40. The case of the last financial year, 2021, register in case of the first quartile, 24% of the businesses which have the corporate governance score, between 0 and 17. The second one, have the most companies from this year, in proportion of 29%, with the score between 18 and 33. The third

quartile, are found in proportion of 23%, with a corporate governance score of 34 to 37. In the last quartile, 24% of the companies from the selected sample are found with a score between 38 to 40.

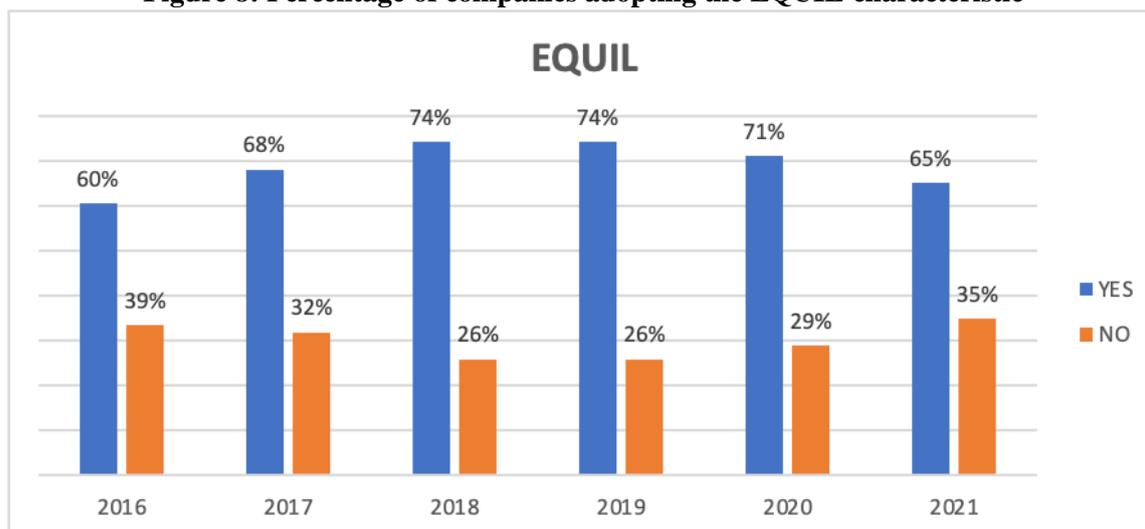
From all the analysed year, in 2017 and 2021 we have the most companies (24%) with the highest score of corporate governance. The weakest qualitative reporting is found in the years 2016, 2017 and 2018. It is interesting to see that in some years, the quartiles are equally divided between reporting scores. Also, at the general level the quartile is quite balanced, we could not see discrepancies between them, or between the analysed year. The positive aspect is that overall, a general increased interest in qualitative reporting is found.

Corporate governance elements

To further conduct the analyse on the elements which are part of the corporate governance scores, the values for each category was extracted, and then compared. Each element that forms the corporate governance conduit, has its own importance, in assuring the well-being of the company. We have extracted a few of them, to see the correlations, interaction and degree of adoption in selected samples: EQUIL (Equilibrium of board members), INDEP (Independence of board members), NOM (Selection of the board members), REM (Remuneration policy), AUDIT (Audit committee). All these variables are more detailed in chapter 3.

A descriptive statistic for each of them was made, so it can be observed the trend during the years, but also the level of adopting them year by year. It is important to mention the fact that each element, if it is applied then it was marked with „1” and „0” otherwise. So, from the total of 66 companies, it is shown in the figures the percentage of applying the conduit, or not. This being said, in Fig.9, for the period of 2016-2021, EQUIL has in the beginning an increased trend until 2019, followed by a decrease in the next years. EQUIL assumed the fact that the majority of the board members must not have an executive function. This means that businesses from the selected sample, started having at least one independent member in the board of directors, followed by a stagnation in 2018-2019, and then decreasing until 2021. The balance in terms of executive directors in the board, has a positive impact over the financial fraud appearance (Marzuki et al.,2019; Romano&Guerini, 2012). The Stewardship Theory has implications over this matter, in the sense that it puts pressure on the executive roles, to act more consciously, so that the stakeholders’ returns are maximized (Abdullah&Valentine, 2009).

Figure 8: Percentage of companies adopting the EQUIL characteristic

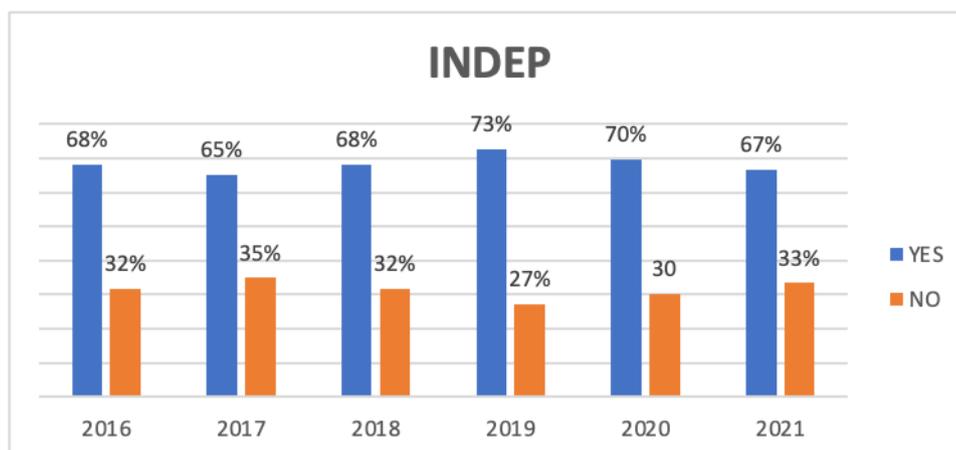


Source: Own processing

Fig. 10 illustrates the trend for INDEP characteristic. The majority of the companies from the sample, revealed in the comply-explain statement the exact number of independent members from the board of directors. It had an unbalanced trend during the analysed period. The most of the companies implemented this characteristic in 2019, but then it is followed by a small decrease until the end of the

chosen period. The Agency Theory consolidate this element from the comply-explain statement, by assuming the fact that the objectives of the managers can be aligned with the owners. By respecting the number of independent directors, studies have confirmed that respecting the number of independent directors in board, have positive impact over fraud occurrence (Rostami&Rezaei, 2022; Khadar&Delen, 2020; Nasir et al., 2019).

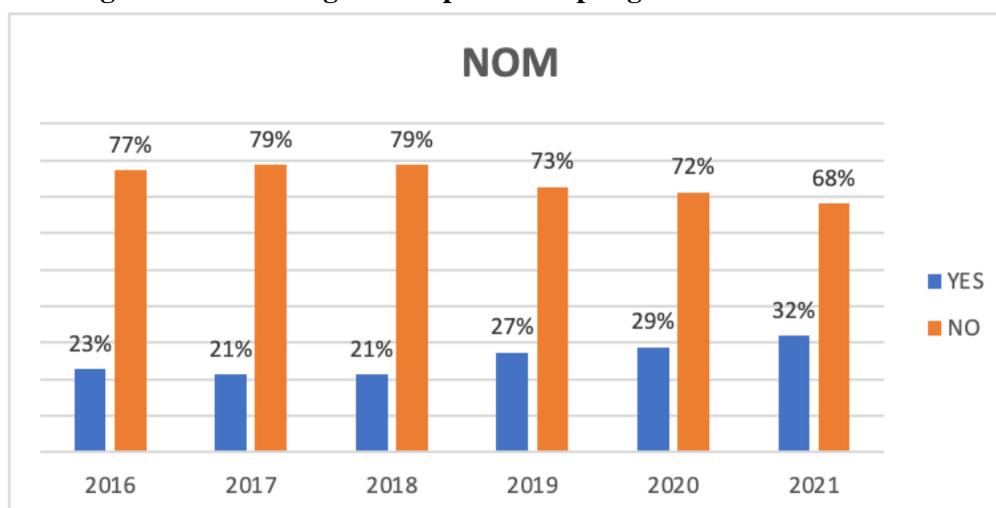
Figure 9: Percentage of companies adopting the INDEP characteristic



Source: Own processing

The nomination committee (NOM) must be formed from non-executive members, which will lead the process of nominating new members and write recommendations. Most of the nomination committee must be independent. Thus, in Fig. 11, we can see a rather pessimistic illustration on the degree of adopting this characteristic. Starting with 2016, we can see that the majority of the companies do not comply with this element. A rather optimistic trend can be seen during the years, meaning that businesses, in a slow rhythm are starting to comply with this element. This is confirmed by the decreasing trend for the selected years. The presence of the nomination committee will make sure, that the process of selecting new members, as it is required, is in their responsibility, so the Agency Theory can be mentioned here. The members from the nomination committee will act as agents for the best interest of the stakeholders (Abdullah&Valentine, 2009).

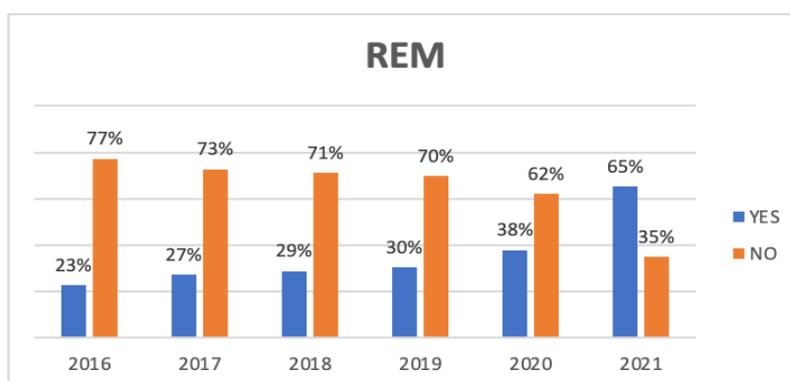
Figure 10: Percentage of companies adopting the NOM characteristic



Source: Own processing

In Fig.12, the trend of REM elements is illustrated. This component, assumes the fact that businesses must publicly display the remuneration policy, and also include in the annual report a statement in which they implement this policy. Starting with 2016, a very small number of companies adopted this element from the comply-explain statement. Generally, the trend of the companies which do not comply is decreasing, as the year passes by. A sudden increase is seen from 2020 to 2021. Almost 50% of the companies adopted the principle from 2020, to 2021. The remuneration characteristic, is a very sensitive one. It stands in the bonuses receive by the management, conditioned by the pre-established targets. So, it is quite important to set the remuneration policy in such a way as to allow the shareholders to understand the principles and arguments underlying the remuneration of the members of the Board and the General Director, as well as the members of the Directorate in the dual system. In all this process, as also the Hazard Moral theory mentions, people can get out of the track and forget that they must fulfil certain tasks and follow their own interest (Achim&Borlea, 2013).

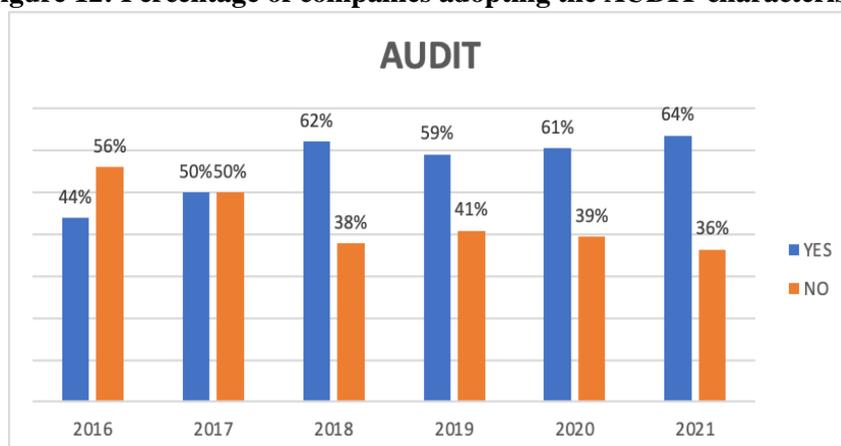
Figure 11: Percentage of companies adopting the REM characteristic



Source: Own processing

The board must establish an audit committee in which at least one member must be an independent non-executive director. In Fig. 13, the trend for the selected sample can be seen. It is almost, a balanced trend between the ones who comply and the ones who don't. Since 2019, an increased trend, from a year to another can be observed, for those who comply. In case of the audit committee, they must act in the best interest for the stakeholders. This concept is connected very well with also Agency Theory but also trough Stewardship Theory. They must follow and comply with the stakeholders requirements. Moreover, the audit committee must supervise the activity, and make sure that the well-being of the company is assured.

Figure 12: Percentage of companies adopting the AUDIT characteristic



Source: Own processing

All the five elements contained in the comply-explain statement have its unique role. It is important to note the fact that in case of Romania companies, the trend is increasing by time, this meaning that the businesses are getting more and more conscious about the benefits on the long run by applying these characteristics.

Table 1: The division of the companies in the sample, by the industry, presence of females in board, ownership and the Corporate Governance average score

Sector of activity	Number of companies	Presence of female in boards	State owned by industry	CG 2016	CG 2017	CG 2018	CG 2019	CG 2020	CG 2021
Manufacturing industry	40	0.24	4.44	21	22	25	25	25	24
Wholesale and retail trade	3	0.20	14.89	38	37	38	38	38	39
Hotels and restaurants	4	0.31	12.19	25	26	28	28	30	32
Information and communications	1	0.00	0.00	14	14	14	14	36	38
Construction	5	0.21	12.72	15	16	20	22	21	19
Transport and storage	4	0.16	14.62	27	30	31	32	32	31
Real estate transactions	1	0.00	0.00	30	30	30	30	0	39
Extractive industry	4	0.26	22.66	23	23	27	28	28	28
Health and social assistance	1	0.00	0.00	7	35	38	39	40	40
Production and supply of electricity	3	0.22	47.05	39	40	38	39	39	39
TOTAL	66	0.23	9.47	23	24	26	27	27	27

Source: Own processing

To further analyse, we have divided the companies from the sample, by the sector of activity, and have made an average of the number of females in boards, for the state-owned companies and for the corporate governance score, for each year. As it can be observed, we have the most companies in the manufacturing industry. The evolution of the corporate governance score in this case, has a positive evolution. We can see that most of the companies from the industry have a private capital and the presence of female in boards is very decreased. The least companies from a sector of activity point of view, are information and communications, real estate transactions and health and social assistance. For all the three industries, the adoption of the best practices, has a positive, trend from a year to another. All of them have no females in board and are 100% private owned companies. The group which has three companies in a sector of activity are wholesale and retail trade and electricity. Also, in this case the corporate governance reporting has a performing evolution. Both of the industries have a decreased presence of woman in board and are part of them stated owned. In the case of hotels and restaurants, transport and storage and the extractive industry, we have four companies for each group. It is the same case in which the corporate governance score has an increasing trend, as well as the presence of female in board. A decreased part of them is also state owned, while the increased part is private owned. For the construction industry, we had in our sample five companies. In this case until 2020, the corporate governance score is increasing, while in 2021 it decreases. Also in this case, most of the companies are private owned, while a small percentage is state owned. A decreased number of females in boards is also seen in our sample. Studies have shown the importance of the industry in corporate governance reporting. In the literature, Salo (2008), while conducting consistent research, has identified "industry"

as an important factor in influencing the corporate governance reporting. On the same note, Halme&Huse (1996) consolidates the importance of the corporate governance best practices adoption.

The division between the industries from the sample, are unbalanced, due to the fact that for analysing the Comply-Explain Report we had included in our sample only the companies which are listed on the main market. From our analysis, we concluded the fact that most of the companies have a very decreased number of females in boards, as well as most of them are private owned, rather than state owned.

5. Conclusions

Corporate governance is a topic of great importance for the research world as it is also for the economic environment. The topic has been the focus for several researchers during the time.

In the case of Romanian countries, particularly taking the corporate governance score, it started on average from a low value, to an increased one. This is a positive aspect, meaning that businesses might start to acknowledge the fact that a qualitative reporting will assure the long-term benefits for the companies.

From the analysis on the corporate governance elements, it could be seen that in the case of board members equilibrium, during the analysed period, starting with 2016 an increase was observed, until 2020, followed then by a small decrease. Several reasons can stand behind this aspect, but since it was the epidemiologic crisis, we could also place this aspect into this perspective. Though, a closer look should be set, to further understand these fluctuations, take into account the external factors. In the case of board independence, a rather constant evolution was seen, for the selected companies. It was not a positive trend, rather a fluctuating evolution. The nomination committee, is the least adopted practice, from the selected elements. Even though, the scores do not present generally a qualitative reporting regarding this element, it could be seen a small, but a positive increase, starting with 2016, to 2021. The remuneration policy has very important implications, by adopting as a principle. Since 2016, to 2020, the adoption of the practice has a decreased evolution. A sudden increase was seen from a year to another. This is a positive aspect, meaning the companies acknowledged the importance of its implementation. The last but not least, audit committee, revealed a rather constant evolution during the years. Most of the companies adopt the practice, and during the time, more and more of them starting to do so. In the case of the industry, for each sector that we had included in our sample, it could be seen an increased trend, which indicates the fact that it has a meaningful impact. By analysing the gender composition for the selected sample, by industry we have concluded the fact that, at the level of Romanian companies, for the main market, the presence of females in boards is very decreased. As well we can state regarding the ownership structure. Most of the companies, listed on the main market, are private owned.

We can conclude with the fact that hypothesis 1, 2, 3, 6, 7 and 8 were validated through our study, while hypothesis 4 and 5, for the studied sample were not confirmed.

The current study has important implication in the context of the policy makers, with a direct impact over the interested parties and for the general users. The limitations of the study are found in the sample, which has a mixture in terms of industry. At the level of Romanian companies, from the available data on the analysed companies, can be concluded a general positive evolution in terms of corporate governance practices.

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