CORPORATE GOVERNANCE – WAY OF GOVERNANCE FOR MODERN COMPANIES

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Abstract: *Through corporate governance is aimed the building of a structure enabling a wide degree of freedom, within the law, and includes several changes of principle in accordance with international standards of transparency.*
A good governance within an organization mitigate risk, increase performance, pave the way towards financial markets, brings competitive goods and services on market, improves management style, show transparency towards all stakeholders and social responsibility. The lack of some mandatory rules and structures can lead to chaos in business.
The paper aims to present the role and the importance of the corporate governance for modern companies, as well as the principles on which this is based. In order to do that we also identified the main ways to quantificate the level of corporate governance, including also the non-financial performance criteria used by investors to assess companies listed on stock exchange.

Key words*:* corporate governance, performance, quantification, principles, success.

JEL Classification Codes: G34, F15, F23.

1. INTRODUCTION

The concept of corporate governance appeared in the last century, being influenced in turn by economic environments based on family property, bank capital, institutional investors or limited liability companies, medium dynamised by resounding scandals that have occurred over time. Surprisingly, the same moments of crisis have had a beneficial effect on identifying ways to improve the corporate governance concept that meets the new stage in the evolution of the economy.

At this process and have contributed professionals from countries like USA, UK, France or Italy, specialists that late in the last century have concluded in their "reports" on some of the key issues to be considered when we analyze the mechanism driving a company. We highlight Cadbury Report, Greenbury Report, Pebereau Report, Vienot Report, Arthuis, Marini and the recent report of the Sarbanes-Oxley Act.

The concept of corporate governance continues to be in a process of adaptation to the requirements of a modern economy, increasingly visible globalization of social life and also to the information needs of investors and interested third parties in corporate activity.

In an opinion, the corporate governance designates mechanisms by which a company is managed and controlled, or in another definition, corporate governance is all the systems and processes implemented to manage and control a company in order to increase its performance and value.

This new concept of "corporate governance" provided in International standards of internal audit, means leadership as a whole of the entire organization, by accepting all internal components that work together, but which in the end will be integrated to management, and

implementation of risk management within the organization (ERM) and of the financial management and internal control system (MFC), including internal audit.

From our point of view, Corporate Governance for modern companies is what democracy was for ancient states. Corporate governance is nothing more than the application of fundamental democratic principles in organizational typologies as a company is.

Definition of democracy says that this is a form of political organization and management of the company by consulting citizens, taking into account their readiness, interests and aspirations of the country's progress. It is government by the people, the supreme power returning to the people, being exercised directly by it or by representatives elected under a free electoral system.

Based on this, we can say that Corporate Governance is a form of organization and management of a company, in which the decision is taken based on shareholders consultation, taking into account their will and their interests. It is the government by shareholders, the supreme power belonging to them and being exercised directly by them in general meetings or indirectly through elected representatives, Board of Directors or Supervisory, in order to pursue the interests and aspirations of shareholders.

But corporate governance is not just that. It also relates to the effectiveness of management systems, mainly to the role of the Board and the Managing Directors, their responsibility and payment, to the reliability of the information provided and the effectiveness of risk management systems.

Corporate governance also refers to the set of formal and informal rules and procedures, internal or external, which are required by the competent bodies, or by national or international legislation implemented at strategic and operational level.

Corporate governance refers not only to maximize the company's value, although this is primarily its purpose, but also relates to the ethic side and the transparency, social responsibility (CSR), especially given that globalization makes some companies to be supranational entities which are often subject to multiple jurisdictions or can choose the jurisdiction that is more favorable. In those circumstances, the principles and rules of corporate governance, as they will be, enacted at a certain date will be generally available and universally applicable, and the values and principles that will guide them can’t be outside the scope and democratic values.

2. THE CORPORATE GOVERNANCE PRINCIPLES

The main organization that was focused on implementing a corporate governance regime is OECD. OECD principles aim to ensure a transparent framework and comply with current legislation, specifying clearly the rights of shareholders, transparency of information, establish the role of the Board of Directors so that it takes into account the interests of different groups of shareholders etc.

According to OECD the corporate governance principles are:

- ✓ Respect the rights and fair treatment of shareholders;
- ✓ Respect the rights and interests of all stakeholders;
- ✓ Define clearly the roles and responsibilities for the Board of Directors;
- ✓ Integrity and ethical behavior of the management team;
- ✓ Transparency and fair presentation of the results and future prospects.

Other interpretations:

- Corporate governance is the means by which providers of financial resources of a company ensures that they will receive the benefits they expect making this investment. (Shleifer & Vishny, 1997)
- Corporate governance specifies the distribution of rights and responsibilities between the different categories of persons involved in the company, such as: Board of Directors,

directors, shareholders and other categories, and sets rules and procedures for making decisions on a company's activity. (Cadbury, 1999)

- Corporate governance is a set of rules under which companies are directed and controlled, is the result of rules, traditions and behavioral models developed by each legal system. (CG Code, 1999)
- Corporate governance is the branch of economics that studies how companies can become more efficient through the use of institutional structures, such as the articles of association, flowcharts and legal framework. This branch is limited in most cases to studying how shareholders can ensure and motivate executives in order to receive the benefits expected from their investments. (Mathiesen, 2002)

These principles were set out in general terms leaving it to the discretion of countries to focus on one or the other issues listed. Although it states that it isn't wanted to impose a global model of corporate governance, long-term tendencies goes towards this result.

Thus, depending on the economic, social, policies, culture and mentality characteristics, implementing into practice the principles of corporate governance can be achieved in several ways, namely:

- mandatory codes - which can be imposed by stock exchanges and which to relate to the conditions for listing on one of the stock exchange categories;
- optional codes - which have the title of recommendation for companies (corporate governance codes or best practices, developed by regulators of the capital market or the stock exchanges);
- voluntary codes – which to be adopted by the issuers whose securities are traded on the stock exchange;
- by introducing specific provisions in the regulations, which in this way become mandatory for all companies.

3. THE IMPORTANCE OF CORPORATE GOVERNANCE IN MODERN COMPANIES

Corporate governance comprises a set of mechanisms by which is influenced the way of running a corporation, dealing with the wealth and purposes of stakeholders such as shareholders, board of directors, management, lenders and the economy as a whole.

Promoting the efficiency of the company along with getting a maximum fortune for all parties involved, are the main objectives of corporate governance. Therefore, in the center of the discussions on corporate governance is the idea that a firm, the more well-run, the higher are chances of getting performance, the shareholders attaching great importance to corporate governance systems implemented in their company, them being willing to pay extra for good results in this area because these are the only guarantee of fair and equal treatment.

In time, companies have become increasingly aware of this reality and that's why them gives it the real importance.

On international markets there are both positive and negative examples in this regard. On one side there are the companies that "spent" a lot of time and effort to achieve high standards of corporate governance, being able to maximize corporate value through systems and processes that allow their management to perform, and on the other side there are the companies that failed or were unwilling to apply the principles of corporate governance, thus failing to adopt any appropriate approach towards the various stakeholders. The deficiencies of the latter are starting to come to the surface and turns out to be more than inappropriate.

The way the governance model leads to accomplishing the mission and the strategy of a company in terms of shareholders' interests represents the ultimate test of its effectiveness. However, given the trends in the international market, we can say that a long time from now, corporate governance will remain on the list management and investors, everything reducing to a

simple reality: companies that adopt an efficient model corporate governance and a transparent culture will register a higher performance, while those who refuse to accept this reality became even necessity, will record worse results.

Economic uncertainty generated by the world crisis and by the market volatility has created the prerequisites for the management or other actors to act ethically incorrect, so the need for an effective model of corporate governance that meets the needs of all stakeholders but also creates added value, has increased.

In Romania, the concept of corporate governance is still a little known concept, representing a combination of control elements that operates together to regulate the relationship between all those with an interest in the company, namely: shareholders, customers, suppliers, management, employees, etc.

From a legal perspective, these relationships are governed by the laws on companies, insolvency or various financial regulations. Especially after the great scandals that shook companies like WorldCom or Enron, governments and supervisory authorities have focused attention on establishing a more effective system of corporate governance.

4. THE QUANTIFYICATION OF THE LEVEL OF CORPORATE GOVERNANCE

Based on OECD principles translated into quantifiable criteria, consulting companies, research centers, rating agencies have developed since 2001 a number of systems for measuring the level of corporate governance in a company, a market and even at a country level by granting ratings/scores:

- The system with 12 composite criteria, with a scale of 1 to10, used by Standard & Poor's and Moody's, which is best known rating system;
- GMI score - Governance Metrics International, with 600 considered variables, grouped into eight categories, with a scale of 1 to10;
- CGQ score - Corporate Governance Quotient calculated by International Shareholder Services.

The Standard & Poor's assessing corporate governance seeks two components as shown in Figure no. 1:

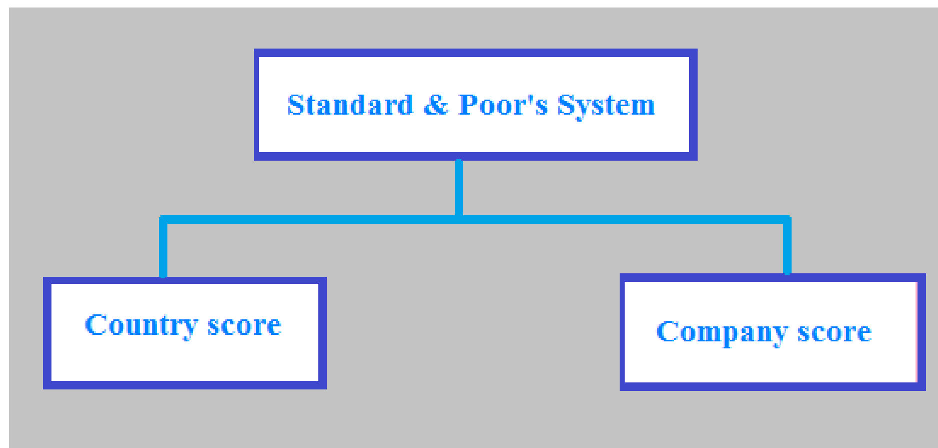

Figure 1. Components for assessing corporate governance

Source: Cadbury A., Financial Aspects of Corporate Governance, Burgess Science Press, 1999

To the practice of corporate governance are important the microeconomic components of as well as the macroeconomic ones.

The score a country is determined by analyzing the effectiveness of the regulatory legal infrastructure and market information on the company quality of corporate governance in relation to the way the external environment act, i.e. macroeconomic, while the score of a company is determined according the effectiveness of interaction between managers, shareholders and other stakeholders, at the microeconomic level.

The score given to companies is an expression of current standards level of corporate governance, an opinion on the functioning of the corporate elements within the organization, and less an opinion on the financial and business performance, on the company credibility or value of its shares. Therefore, according to Standard & Poor's, the score granted to companies, reflects the degree in which the company adheres to internationally recognized standards of corporate governance, namely the codes and its good practice principles.

Company score is determined by taking into account specific corporate governance elements present in the structure of the organization, grouped by chapters, as shown in Figure 2:

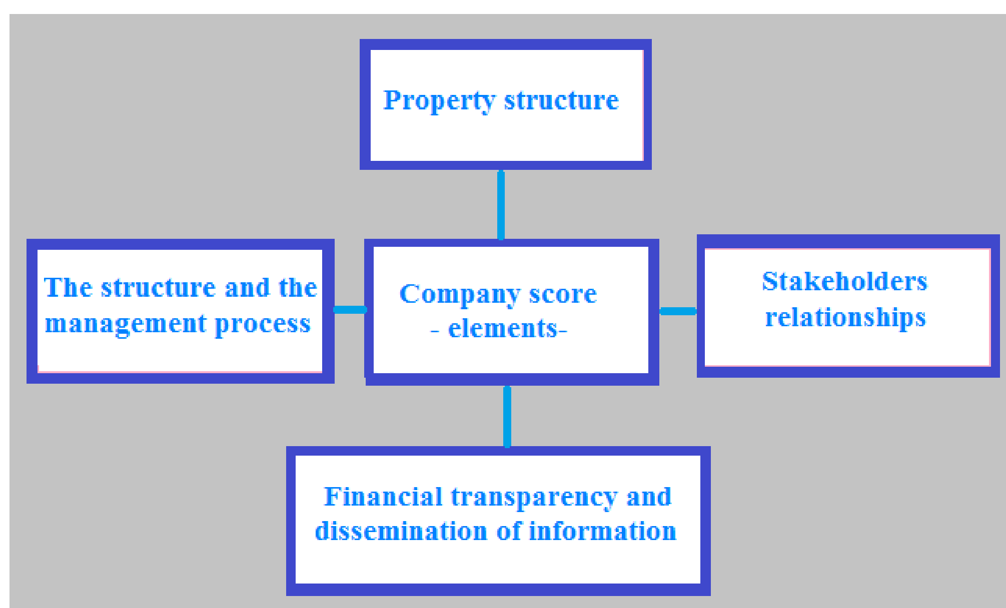

Figure 2. The elements used for establishing the company's score

Source: Cadbury A., Financial Aspects of Corporate Governance, Burgess Science Press, 1999;

For each of the four elements are analyzed the following coordinates:

1. Ownership structure (refers to the ownership structure transparency and to the concentration of influence of ownership structure on the company);
2. Stakeholder Relations (refers to the access to information regarding the General Meeting of Shareholders, voting process, shareholders meeting and property rights);
3. Financial transparency and dissemination of information (refers to the quality and content of the information considered public, programming and access to information dissemination, and company auditors' independence and position);
4. The structure and process management (is targeting structure analysis and efficiency of management structure, leadership role and composition, executive director’s role and level of independence, directors and management remuneration, the methods of assessment and succession).

Each component is represented on a scale of 1 to 10 and contributes to the determination of the final score, rated also from 1 to 10.

A 0 score earned by a company means that it is unable or isn't prepared to provide sufficient information for a meaningful analysis. A low score given to a country does not necessarily imply that the company will receive a low score; also a high score given to a country does not mean that a company can receive a high score for that reason alone, but, it can generate an important aid to national companies. In the same time, a well-run business can get a high score, even if is part of a country to which it was given a negative score.

When referring to the non-financial performance indicators, the persistence of the interest conflict between shareholders and managers signifies a poor corporate governance, which can lead to the decrease of the profitability of the firm, restricting business activity, decreasing dividends given to shareholders, excessive mobility of staff, the reducing of the stock exchange and its market prestige, or even bankruptcy and liquidation of the company or takeover by another company.

Corporate Governance is considering solving various inevitable conflicts that arise between the social partners of the firm, especially between shareholders and managers, as well as reducing agent costs.

Table 1. Criteria concerning non-financial corporate governance practice used by investors to assess the performance of companies

THE QUALITY OF THE COMMUNICATION SYSTEM WITH SHAREHOLDERS	SCORE*
The efficiency of the relations with shareholders department	31
The credibility of management	2
The quality of the published materials	34
The management availability	26
THE QUALITY OF EXECUTIVE MANAGEMENT REMUNERATION POLICIES	
Relation between the remuneration of executive management and remuneration of labor force	39
Remuneration policies based on relevant performance criteria	12
The harmonization of incentive management policy with the interests of shareholders	8
MANAGEMENT QUALITY	
Managerial experience	7
The quality of company strategy	3
The level of company strategy execution	1
Leadership style of management	24
Clarity of organizational vision	16
CORPORATE CULTURE	
Social and environmental policies	37
The quality of staff training programs	28
Ability to attract and retain talented people	5
Using teamwork	38
Quality of workforce	18
The quality of granting incentives system	23
THE QUALITY OF THE COMMUNICATION SYSTEM WITH SHAREHOLDERS	
The efficiency of the relations with shareholders department	31
The management availability	26
The credibility of management	2
The quality of the published materials	34

* The score for each non-financial criterion ranges between 1 (maximum) and 39 (minimum).

The level of the scores given by investors to these non-financial criteria of performance shows that the majority of criteria placed by investors among the top ten are related to the quality of the governance system of the company, according to Table. 2:

Table 2. Ranking the top 10 non-financial performance criteria

NON-FINANCIAL CRITERIA	SCORE
The advantage from research	10
The quality of production processes	9
The harmonization of incentive management policy with the interests of shareholders	8
Managerial experience	7
Market share	6
Ability to attract and retain talented people	5
The potential for innovation	4
The quality of company strategy	3
The management credibility	2
The level of company strategy execution	1

Source: Robu V, Research project CNCSIS 789 "Comparative analysis of the corporate governance system of Romanian and models used in EU countries", 2004.

The conclusion of this empirical study conducted by Ernst & Young Center shows that on average, 35% of the information used by investors in the placement of their capital is non-financial, and half of this information relates with priority to issues of the governance system.

3. CONCLUSIONS

The importance of corporate governance for the development of capital markets is undeniable. Good corporate governance is mainly focused on sending coherent signals to financial markets and investors. Thus, the corporate governance rating of a company is the most important decision criterion of institutional investors, in comparison with the for economic growth potential, financial performance, dividends and others, being effectively avoided companies with a poor corporate governance practice.

A study realized by the consulting McKinsey&Co.firm, in collaboration with the Global Corporate Governance Forum, based on the responses of 200 institutional investors (banks, insurance companies, pension funds, investment companies, mutual funds, venture capital) from 31 countries, reveals that 61% of American institutional investors and 50% of Europeans have decided not to invest or to sensible reduce investments in companies with poor corporate governance. Also, most of investors are willing to pay substantial premiums for shares of companies that have a high standard of corporate governance: 12- 14% on average for securities of companies in the US and Western Europe, 20-25% for investments in Asia and America Latina, 30% in Eastern Europe and Africa.

The best practice recommendations were present first in the developed countries but in time these were disseminated across borders. Some of the emerging countries adapted quickly these principles and codes but in order for it to have an impact on the economy these models need more than to be copied. It is a passage difficult to pass because of the widely damaging effects of negativesum game rivalry among powerful interest groups entrenched in local structure of political and economic power. Beside this, as the corporate governance systems proved to be beneficial for companies the regulators in emerging countries have made substantial effort for updating and improving accountability systems. Corporate governance systems have

been reformed through the issuance and the adoption of best practice codes which is in the best interest of the company as well as the country.

Though the globalization of financial markets had an important role in reducing the gap between developed and emerging economies, regarding the implementation of corporate governance, due to cultural, economic and social factors, emerging economies cannot yet speak of a comprehensive approach, especially when compared with advanced economies.

There is much scope for further research in this area. The analysis will be extended with case studies for Romania, other emerging countries and various areas of activities.

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