THE NEED OF AN INTERDISCIPLINARY RESEARCH METHODOLOGY IN EVALUATING THE CORPORATE GOVERNANCE IN THE STATE-OWNED ENTERPRISES IN ROMANIA

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Abstract

The present paper aims at highlighting the opportunity of applying the principles of corporate governance of state enterprises. Considering the state of the research field and management created around corporate governance, two theoretical and methodological components are concerned: (i) a brief analysis of the literature that assesses the importance of corporate governance; (ii) setting a methodology for configuring an interdisciplinary governance index at the level of corporate enterprises controlled by the state. In general, concerns for the construction of such an index have been concentrated in private companies, listed on the stock exchange. Building an index by which to be evaluated for state-owned enterprises (SOEs) corporate governance is not only a theoretical challenge, but also a practical one, knowing the size of the corporate sector in the former socialist states and its implications for the overall functioning of the economy.

Key words

Corporate governance, public sector, state owned-enterprises, governance index, interdisciplinary methodology.

INTRODUCTION

Humanity is currently facing economic turbulence whose size is situated at the height of the last '80 years. The causes of the current crisis are common and consist essentially of irresponsible financial sector, public debts became unsustainable and unequal global competitiveness. There is however a common place for all these reasons that the type of governance is anchored deeply deficient, promoted a much too long and whose limits were achieved with enough time before the onset of the crisis. Better corporate governance, seen as consensual objective, should constitute an articulated and coherent conception, management and control mechanism that includes the principles of democracy, sustainability, efficiency and transparency, at the same time.

Corporate governance usefulness is evident regardless of the level of reporting (micro or macro) or property nature of the actors involved (public or private). Improving corporate governance application in the former socialist countries is less urgent than in the private sector, gaining particular relevance in the current context. At least these reasons justify such a position:

- this sector has significant contribution to GDP creation and use of resources, especially human ones;
- key role in the economy by focusing on strategic industries (production and extraction of mineral resources, energy and fuel production, post, rail and air transport system, etc.)
- preparing them for privatization;
- internal dysfunctions accumulated over time and their contribution to the emergence of macroeconomic imbalances;
- a belief in significant improvements in their efficiency.

State-owned enterprises (SOEs) are met in the current context of financial crisis and competitive markets with major challenges. The current mode of operation of these enterprises is marked by a kind of poor management, long practiced without an attempt to reform their management functionality. This finding available for most of the former socialist countries is significantly amplified in Romania.

The differences between SOEs and private companies are multiple. Among them there are those of the specific objectives, both economic and social, and relationships with stakeholders. SOEs domain enjoys also a special protection for the takeover or bankruptcy. The context in which they operates, the assimilation of technological changes by competitors, openness to international trade and globalization risks not only require urgent intervention in the manner of corporate governance, and process innovation in the sense of building or at least specific to the field or adapting those who have demonstrated the viability of the private companies. In addition, the state must recognize a clear separation of ownership from that of regulator, the premise of promoting the best practices of corporate governance and the full realization of his property rights in the public benefit.

All these arguments led to major efforts in recent years to explore the issue of exercising control and management in enterprises. In this regard, recall efforts centralized within international organizations, notably the OECD approach to achieve in 2005 a study on the corporate governance state-owned enterprises. The opening of this report, which fully supports the previous arguments, explicitly states that "Problems of undue political interference, passive boards and inadequate transparency have prompted public concern, and a number of serious efforts at reform" (OECD 2005, p. 3).

A. LEGISLATION ON CORPORATE GOVERNANCE IN ROMANIA

Romania is an economy with a significant presence of state enterprises. By some estimation, the number is closer to 1,000. Public corporate governance reform started late despite its necessity with the first signs of major economic and financial imbalances. Regulations in the 1990s, adopted in the absence of clear criteria on legal form, rules applied to joint stock companies, which added political interference in decision-making process, have led to accumulation of large deficits.

In general, there has been some progress in governance with some changes in adoption of Law no. 31/1990 and the promotion of the Ordinance on the Activities of the audit, for example Ordinance 75/1999 or other special provisions regarding corporate governance in state owned companies (Ordinance 49/1999). Measures for improving corporate governance have been adopted since 2000. Thus, in 2001 it was adopted the Corporate Governance Code of the Stock Exchange and in July 2003 it was founded the

Institute of Corporate Governance. In December 2001 the OECD published the report - *Corporate Governance in Romania*.

More recently, Romanian Government adopted the Emergency Ordinance no. 109/2011 (GEO) by which it tries to reform the system of governance in SOEs and the adoption of recommendations that can be found in OECD studies and commitments to international financial institutions. The general context in which it was adopted this bill was rather grim. As an example, we mention temporary austerity devoid of economic justification and inconsistent implementation, unsustainable fiscal consolidation, high quasi-fiscal deficit in relation to an amount of arrears of 5 billion Euros, of which 50 % came from 22 companies.

GEO 109/2011 is the first significant step of establishing a sustainable corporate governance framework for state companies. In this respect, the obligation is to carry out regular independent external audits, report and publish quarterly financial data, to strengthen the rights of minority shareholders. Also, managers, elected after an international selection process, must have sufficient autonomy to enable them to effectively manage these companies.

B. EVALUATION OF CORPORATE GOVERNANCE

Importance given to the corporate governance is highlighted by intense research in recent years related to the assessment of its application. The first steps, initiated in early 2000, aimed to identify a criterion of security investments by institutional investors, in correlation with the corporate risk assessment. The assessment relied on the opinions of ratings from unbiased and well informed individuals about the quality of corporate governance (Page 2005, p. 58).

Specialized literature and practice often call for the calculation of corporate governance indices to identify the extent to which companies are proving effective in implementing corporate governance, both financially and managerially. Currently, international progress on the development of tools to provide a rating for measuring the effectiveness of an enterprise system corporate governance are the result of efforts by consulting companies and internationally recognized academics. As an example we mention the

Corporate Library (for 2,000 companies in the U.S. and 500 in the biggest international companies), Governance Metrics International (for companies in North America, Europe, Japan, Australia and New Zealand), Institutional Shareholder Services (on more than 5,500 companies U.S. and nearly 2,000 companies from around the world), Rotman School of Management at the University of Toronto (Toronto Stock Exchange for listed companies and included in the S&P). All these organizations provide ratings of corporate governance but for listed companies.

Corporate governance indices are undergoing continuous improvement, becoming relevant both from the perspective of the investor and the company. For example, Institutional Shareholder Services (ISS) offers starting with 2013 a new index - ISS Governance Quick Score, useful for the investors, by better understanding certain governance aspects on firm performance, risk analysis and company in terms of identifying the signals concern investors in risk governance. This indicator is constructed through quantitative methodology that examines correlations between factors of governance and financial factors. Governance factors, introduced with weightings based on correlations identified, are classified into four categories: board structure, compensation of board members, shareholders' rights and auditing practices. In turn, financial factors are grouped into categories such as marketing, profitability, and risk assessment.

Interest of researchers for the development of performance measurement models corporate governance was part of the need to examine the relationship between corporate governance practices and firm value, initially being used various discretionary assessments of corporate governance systems. In this respect, the main factors taken individually were represented by the structure and ownership concentration, the market for corporate control, remuneration of managers, the number of directors and the board structure. Later, researchers have focused on developing more comprehensive systems for measuring corporate governance at company level, appealing to build indexes for assessing the quality corporate governance (Monda and Giorgino 2013, p. 3; Gupta *et al.* 2009, p. 294). As an example it can be mentioned G- Index, E-Index, Gov-Score index, etc.

In general, corporate governance index results from the aggregation in a single numerical indicator of a variety of variables, following selection by the researchers dedicated to the performance of corporate governance features (ownership structure, investor rights, board structure, provisions against takeovers, etc.). Quantifying the corporate governance takes place, in most cases, by providing the numerical values 0 and 1 and combining into a single value which reflects the performance of corporate governance (Larcker and Tayana 2011, p. 448). Although the literature on the construction of indices of corporate governance recognizes that some dimensions may give them greater weight in the composite and a proper weight dimension may depend on the presence or absence of a dimension, dedicated approach, especially for the sake of simplicity, is the allocation of equal weights (Bebchuk *et al.* 2004, p. 16).

C. METHODOLOGICAL HIGHLIGHTS OF AN INDEX FOUNDATION OF CORPORATE GOVERNANCE IN SOES FIELD: THE NEED FOR INTERDISCIPLINARY METHODOLOGY

Specialised literature in assessing corporate governance in the developed countries proves consistency. Although theory devotes specific links between corporate governance and management practices, such research in the emerging countries are modest. Moreover, scientific studies focus less on the issue of state-owned companies in terms of corporate governance. From this perspective, but also in the context of major constraints imposed by Ordinance 109/2011, the option of building an index for assessing and improving the application of corporate governance in state companies proves compelling.
The construction of such an index requires the fulfilment of several conditions and several steps:

- Identifying the main factors and corporate governance groups factors (corporate governance components/dimensions) relevant for Romanian companies with majority state from OECD principles for state companies (2005), Corporate Governance Code of the Bucharest Stock Exchange, GEO 109/2011 on corporate governance of public enterprises, as well as other documents and legislative proposals (e.g. the European Commission's legislative proposal on corporate social responsibility-CSR reporting aimed at large companies); select data to be in agreement with aspects that ensure quality variables, namely: relevance accuracy, timeliness, accessibility, interpretability and coherence (OECD 2008, pp. 23, 46-48);

- Construction of a questionnaire consisting of questions grouped by categories in which they will find issues relating to both financial ratios and the perception of stakeholders;
- Development of a tool for measuring the performance of corporate governance in the public Romanian companies. Index construction methodology will be based on established practice, presented in the reference literature, including one proposed by the Organization for Economic Cooperation and Development (OECD) for the construction of composite indicators. Corporate governance is identified by the components and subcomponents that are subject to weighting. Various components and dimensions of corporate governance have specific importance and relevance for state companies. Most studies show equal importance for each of these dimensions of corporate governance. In other cases there may be different weights, which are based on the evaluation of researchers and whose subjective component is obvious. The main drawback is the lack of support in the first case of statistical and empirical knowledge which can hide the failure or absence of causal relationships of a consensus on the evaluation. On the other hand, when the factors are grouped into dimensions, some dimensions may gain more weight due to the higher number of factors included (OECD 2008, p. 31). Provision of different weights based on statistical analysis, may be an element of improving measuring the corporate governance at the methodological and practical level. When any component corporate governance is statistically more significant, equal weights may be accepted, which are justified, as stated by the high degree of transparency and ease of interpretation (Drobetz *et al.* 2005).
- Analysis on identifying groups statistically significant using multivariate analysis methods. Thus, it outlines a profile of similarities and differences within the governance practices at national and sectorial levels. In this way is referred to both corporate governance index and a number of variables that characterize the performance of companies analyzed, such as:
    i. financial variables - relevant for business and financial performance of companies (indicators of profitability, liquidity indicators, risk/debt indicators, management indicators) in order to enable the profile corporate governance performance - financial performance;

ii. activity sector - relevant in terms of the industry in which the companies and their importance to the national and European level;
iii. other variables, quantitative or qualitative - important in the evaluation corporate governance practices: company size, partnerships, during the company's presence in the market, perception of internal and external recipients on quality products and services provided, etc.

All these indicators must be relevant, sustainable, verifiable and consistent with the analysis.

- Robustness and sensitivity analysis using OECD methodology.

Interdisciplinary methodology that we propose has as specific function the production of information in a market where managerial culture and organizational culture, in general, are relatively different from private companies. Connecting management with dynamic state-controlled enterprises of various types of government and public policy, changes in legislation, etc., opens the way to a culture where informal component occupies a significant and much higher role than for private enterprises. In these circumstances, we believe that the introduction of research tools in the qualitative methodology of the social sciences as well as in-depth interviews, focus groups, laboratory experiment (comparative analysis by isolating a case-set of cases with control group, etc.) becomes a necessity.

The interdisciplinary model aimed at underpinning the construction index, thus integrating values and quantitative data obtained from corporate governance index financial indicators and perception and satisfaction of the various categories of stakeholders (customers, employees, business partners, members of the local community).

As a conclusion, the research we are proposing by this project has not only a theoretical relevance by the mere export of a certain measurement and evaluation instrument towards a new research universe – the domain of the state owned enterprises. By constructing and applying the governance index to the SOEs, we intend specific empirical results related to the strategic decision making process inside the Romanian economy. So, the Index generated by the research project and the results that it will produce when applied to each case-study on the SOEs market in Romania have not only a theoretical utility. As a specific public utility result, we propose the valorisation of applied research results by building a *public platform* on corporate governance performance indicators. If it is constantly updated and accessed by decision makers, such a *public platform* could become a rational basis and real-time decision-making instrument related to measuring and improving the performance of state owned enterprises in Romania.

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