CORPORATE GOVERNANCE IN THE DEVELOPING COUNTRIES

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Summary: During the past years, developing countries have become extremely interesting for researchers, as well as for capital investors. Even if they lack macroeconomic indicator stability or sufficiently mature financial markets, they provide a quick growth and the perspective of a solid development as long as these countries identify measures that will stimulate foreign investors to invest. One such measure is increasing the quality of corporate governance at the level of small and medium-sized enterprises, where it is currently almost absent. This article aims to help raise awareness of the need to implement good corporate management practices at the level of companies in developing countries and especially in Romania. This paper uses a questionnaire in order to evaluate the state of the corporate governance in Timis county and offers some suggestions on what should be done for a higher corporate governance quality in the case of small and medium-sized companies in Romania, with the purpose of establishing a connection between governance quality and business performance of SMEs.

Keywords: corporate governance, SME, information asymmetry, protection of minority investors

1. Corporate governance evolution

The quick development of the international markets and the high level of connectivity between these markets have generated the need for systems that would allow the participants on the globalized markets to understand the rules. The level of organization on each market is highly dependent on the maturity of the market.

The mature markets have applied complicated governance systems for a long time now. Still, the developing countries are behind. The Latin word „gubernare“ was accepted by the literature under the form of “governance”, which can be translated as „to direct”, „to lead” or „to govern“. The concept started to develop at the end of last century, when, as competition grew on the international markets and companies developed further and further, the ties between managers and shareholders grew increasingly weaker. In 2012, Tricker wrote that countries should stimulate the development of a set of corporate laws that could constitute the basis of complex corporate governance codes, needed in order to offer companies the guidelines of how they should be led and controlled.

The „corporate governance“ sets the „rules of the game“ within the company, being made up of a set of control elements operating together to regulate the relationship between all those that have an interest in the company, also known as stakeholders but also making reference to the social responsibility undertaken, to business ethics, to the truthfulness of financial data provided to third parties, to institutional and reporting transparency.

The first general set of corporate governance principles was offered by OECD and was centred round the transparency of financial-accounting information. OECD considered that the quality of the disclosed information plays a significant role in the decision-making process and therefore, for the stability of the integrated financial markets, a set of rules is needed. The
principles they issued, were meant to improve the regulation framework concerning the company management, to protect the interests of both majority and minority shareholders. Corporate governance has developed a lot during the last few decades and generated a few different approaches. The first corporate governance theory was the agency theory, which is based on the assumption that the main role of organizations is to maximize their owners’ wealth. This theory studies and solves the differences arising between the principals (shareholders), that entrusts the management of their own interests to agents, and the agents (managers). A big problem of this theory is that in many companies, the connections between shareholders and managers or boards of directors are weak, meaning that even if managers are the employees of the owners, they keep their independence and try to reach their own goals which can be very different from those of the owners. The power of the managers increases when the shareholding is scattered and the owners are uninformed. Information asymmetry is very important and increases the tensions between the different stakeholders. McCahery et al. (2006) point out that a high-quality system of corporate governance requires institutions and mechanisms to ensure a management focusing on shareholders’ welfare, a management board made up mainly of non-executive managers, and a corporate regulating system to protect minority investors. In 2001, Mulili and Wong (2001) talk about an adverse selection, when a principal cannot ascertain whether an agent uses his/her powers to do the job he/she is paid for. They also talk about the moral hazard, which is when the principle does not know for sure that the agent is making all efforts to meet the goals for which he/she has been granted power of attorney.

Another theory is the stakeholder theory. This theory considers that managers serve a complex system of people, which includes shareholders and managers, creditors, clients, suppliers, the state, and other people from the company’s environment, each of them having their own set of objectives and purposes. This theory was developed by Richard Edward Freeman. The goal of a company’s management is to integrate and administer the relations between investors, suppliers, creditors, employees, customers, the community, and other groups that can guarantee the organization’s success in the long run (Fontaine et al., 2006) and for the success of the company, none of the stakeholders can be excluded. The company needs to create value for all the interest groups around it, without any difference among them. This is based on the concept of corporate social responsibility.

Managers are believed to be people whose activity is guided by a set of fundamental ethical values and principles, based on altruism and good reputation, to the detriment of their individual interest and their personal short-term financial purposes. This and some sociology and psychology theories stood at the basis of the stewardship theory. It is based on the idea that managers put the collective interests above their own, the main reason of such a behaviour being that when the company is well, the manager will also benefit. Managers work to obtain high profits for the company and higher returns for the shareholders (Donaldson & Davis, 1994), without taking advantage of the opportunities that arise for themselves as individuals. They take into account stakeholders’ wishes and expectations and carry out their activity in a responsible manner in relation with them. Still, the big managerial faults that lead to major companies bankruptcy, have proven this theory to be wrong.

The political model of corporate governance, present in Turnbull works (Turnbull, 1997), considers that the allocation of corporate power is determined by the political factor. On the other hand, companies also play a part in shaping political, legal, and regulatory systems. The managerial hegemony theory shows that managers are the ones controlling the companies, having the central and dominant role, while the owners have no direct implication in the decisions took. Organizational behaviour, the decisions being taken, and the company performance are most often influenced by such authoritative managers; even the appointment
and approval of independent members of the management board is strongly influenced by executive managers’ power, dominance, and personality. Pfeffer and Salancik (1978) consider that organizations depend on specific resources. The company management lies between the company and the resources needed for meeting goals. The resource-dependency theory views the environment as the main source of the resources needed for business; in order to obtain these resources, the company needs to establish relations with other individuals. All of these theories just support the ideas of Sir Adrian Cadbury, who believed that the main preoccupation of governance should be to maintain balance between the company’s economic and social goals, as well as between individual and collective goals, in an attempt to „align as much as possible the interests of individuals, of the company, and of society”. Taking all of this into account we aim to test the following hypothesis: H1: That the approach towards corporate governance used by small and medium size companies in Timis county is similar to the one present in developing countries

2. Methodology and results

In order to test our hypothesis, we have applied a questionnaire upon 100 small and medium size companies from Timis County, from different fields of activity, between 2008 and 2013. The questionnaire used as a data collection instrument was highly structured and contains mostly closed questions, with a few open ones as well. In the questionnaire we have included questions regarding both financial aspects (financial indicators, evolution from the financial point of view), as well as questions regarding the principles that apply in the company and to what extent corporate governance principles (even if not clearly stipulated) apply.

The study showed that only 62 of the 100 companies that we’ve investigated are still operating normally, while 32 are bankrupt and the others have ceased to operate for economic and personal reasons. We have found that the companies that willingly closed down were generally small companies (with up to 5 employees), having a turnover of less than 50,000 Euros. One of the big problems of these companies was that there was no information transparency even between departments, so that problems identified by the financial-accounting department were not even signalled to the company management.

One important aspect that we took into account was that the companies we’ve investigated are companies that perform their activities into a developing economy, where economic activity is dominated by growth and industrialization, the macroeconomic indicators are very volatile and there is a high degree of risk regarding investments. Transition countries are similar between themselves but not identical as their past is very different: some were developed before the rise of communism, and private property had generated a strong economy, based on small and medium-sized enterprises, others did not experience a mentality based on public property. A feature of developing economies is that there are a small number of large companies, with high financial potential and that the small and medium-sized businesses, do not usually have corporate governance codes. Authors generally believe that the rules, standards, principles, and practices ensuring good corporate governance are found in joint-stock companies, which is why approaching corporate governance in developing countries is a delicate undertaking, as we are talking about the quality of corporate governance in companies for which this cannot be imposed in any way. Bollard (2003) claims that corporate governance codes imposed in their cases could make a significant change. Economic development can only occur by stimulating the development of sustainable entities, created based on sound principles and closely supervised by well-defined regulation and control institutions.
In the 90’s, many developing countries attempted to implement corporate governance principles as those used in Western countries, without taking into account the lack of the needed institutional structure. In the case of the 8 economies that joined the EU in 2004, EU has provided the stability and guidance needed for institutional restructuring, increasing their credibility in the eyes of investors. Even though the application of Western governance models has not yielded the desired results in all cases, the literature shows that most transition countries still apply models taken from Western countries, they still have a weak institutional structure concerning corporate governance. This was also proven by the answers to our questionnaires. In Romania, corporate governance is a relatively new concept and the corporate sector is still dominated by acute informational opacity. This lack of transparency, doubled by the lack of a sound system for governing corporations, sends a negative signal to potential foreign investors, who have no guarantees regarding the stability of the business environment. The analysis of the activity of the 62 companies in Timis county that survived the 2008-2013 crisis period reveals that, even though they had no actual written codes of good practices, they did apply corporate governance principles. Their business organization revealed a series of common elements: rigorous procedures for management supervision and control and for eliminating the risks of wrong or fraudulent management; analysing and rethinking activities by eliminating unprofitable ones; reorganizing the company by eliminating inefficient positions; the existence of a regularly updated manual of accounting procedures with the presentation of accounting rules and treatments; systematic cash-flow monitoring; drafting revenue and expenditure budgets and making sure to stick to them at all times. The study shows that most bankrupt companies (73.08%) did not implement a risk control system. Also, quite many of them (92.31%) did not draft a good practice guide or defined a risk management system. 30.77% of them believe cooperation between management and accounting to be just necessary.

3. Conclusions

The study allowed us to identify problems at the level of the Timis County SMEs, problems that are in many cases connected with the absence of corporate governance rules, which increases the opacity of information provided to third parties, lowers the protection of minority shareholders, decreases the definition of tasks within the entity’s management bodies, and last, but not least, generates a negative impact on the performance obtained. Corporate governance becomes an “umbrella” that offers a frame for the control and reporting based on the risk management and also offers an efficient internal control system that can insure the reaching of the companies’ goals in terms of performance and management responsibilities. A company where the shareholders have control over the business and applies corporate governance standards offers an insurance for the shareholders as the predictable risks can be anticipated and managed in the right manner. Still, this does not ensure the success of the company but only a reasonable chance for the company to remain on the market. The study still needs to be developed and we are going to look at the 7 pillars that are considered to stand at the basis of the corporate governance. We intend to see to what extend these main aspects of corporate governance can apply to small and medium size companies, especially in the case of companies located in emerging markets. We also intend to develop the study in order to cover not only the county level but also at the whole country level.
References


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