



CORPORATE GOVERNANCE IN ROMANIA
PRELIMINARY CONCLUSIONS AND RECOMMENDATIONS

CORPORATE GOVERNANCE IN ROMANIA: CONCLUSIONS

GENERAL REMARKS

1. Romania is engaged in a comprehensive reform aimed at building a democratic and prosperous society, based on the market economic system.
2. As part of the reform measures aimed at creating a functional market economy, the enterprise reform initiated at the beginning of the 1990s led to a radical change in the corporate landscape. Private startups spurred by the liberalisation measures taken in 1990 and 1991 now dominate the economy, at least in number (over 300,000 active companies). A large number (over 12,000) of state companies have also been privatised. Nevertheless, most of the assets in the economy are still controlled by the state.
3. The newly established private companies are usually small and closely controlled by their founders. They tend to remain closed, family businesses even when they grow to become top players in their field. Currently, more than half of the top 200 firms in Romania ranked by turnover are private and a majority among them are controlled by small groups of interests – the few initial founders, families or foreign investors. For this reason corporate governance issues are relevant primarily for the large fully or partly privatised companies, which have open and diversified ownership structures due to privatisation. However, as many private companies will someday have to open up to outside capital and expertise, the interest in adopting good corporate governance practices is set to expand beyond state or former state companies.
4. In state firms, the corporate governance system had to be renewed early as administrative controls over companies collapsed in 1989, together with central planning. Romania chose to resume its pre-war legal tradition by reinstating, with the Company Law (no. 31) adopted in 1990, the continental European model of corporate governance. The General Shareholders' Assembly is the supreme organism of the corporate governance system; it designates a Board of Directors (known as administrators) with an overall responsibility for the administration of the company and a Censors' Committee for supervision.
5. The provisions of the Company Law are generally applicable to all commercial companies, state owned or private owned, domestic or foreign. Although some adjustments had to be made for the specifics of the state-owned companies, they do not distort the corporate governance environment and do not create a legal discriminatory treatment among similar organisations.
6. However a large part of the economic activities in “strategic” sectors were organised as “regies autonomes”, legal entities with a special status, that do not fall under the corporate governance standards and practices applicable to the commercial companies. Many of these “regies autonomes” have been transformed in the last few years into “national companies”, that fall under the general provisions of the Company Law, and some of them have made efforts to bring their organisation and procedures in line with standard corporate governance. But exceptions are numerous and the “regies autonomes” and their successors, the “national companies”, are some of the most important obstacles in the generalisation of best practices of corporate governance.

7. Many specialists have identified poor corporate governance as one of the major causes for mediocre economic performance, especially in the state companies. In spite of the efforts made to devise technical solutions for improvement, poor corporate governance remains one of the most serious problems of institutional reform in Romania. As an owner of economic entities, the state has multiple conflicting objectives that prevent implementation of an effective incentive system. What more, when the number of companies controlled by the state is large, monitoring and enforcement becomes extremely difficult and costly.
8. Poor corporate governance in state companies has a spill over effect on the economy. Private economic entities tend to adopt bad management and corporate governance practices that proved successful for the state companies – like for example building up payment arrears to the state budget.
9. As in many other transition economies, corporate governance problems persist in many privatised companies as well. These problems are frequently related to the privatisation methods used for disposing of state assets. Mass privatisation programs resulted in very dispersed ownership structures, which are less effective in monitoring the executives of the company. The cost for small shareholders of exercising their rights is high compared to the expected benefits – having as result a dominantly passive attitude of the mass privatisation programs beneficiaries, leaving the way open for various abuses. Companies privatised through management and employees buy-outs (MEBO) have their own set of corporate governance problems, from difficulties in setting clear objectives for corporate performance to conflicts between different categories of shareholders. There are many small and medium companies which by all standards are suited for a closely held type of ownership control but, as result of the privatisation programs, ended up as public companies, listed on the RASDAQ.
10. The awareness of the public regarding corporate governance is relatively low and misunderstanding widespread. Traditionally, specialists and decision-makers have tended to focus on some partial aspects, for example the specific corporate governance problems of the state-owned companies. In fact, it is only in year 2000 that corporate governance issues obtained a wider coverage in the media, on the occasion of the dispute around Ordinance 229/2000 concerning minority shareholders' protection. The same year the business and professional associations, including Chambers of Commerce, initiated a systematic debate on corporate governance and issued the first voluntary "Code" of good practice. However, understanding of the real complexity and critical importance of good corporate governance remains limited.
11. Companies' managers and their boards of directors rarely realise that good corporate governance is in their best interest and are inclined to adopt a minimalist approach – they do whatever is needed to avoid legal conflict, but see no benefit in adopting higher standards. Although some theoretical understanding may be promoted through awareness campaigns dedicated to corporate managers, a real change of attitude is to be expected only when credible examples that good corporate governance pays off multiply.
12. A loosely regulated capital market started to operate as early as 1992. Without proper regulation, supervision and enforcement, the market was prone to abuses and failings. Periodically, a combination of fraudulent

schemes and improper management led to ruin a large number of overconfident investors and undermined the emerging capital market credibility. It was only in 1994 that the Securities and Stock Exchanges legislation was adopted and the newly created National Securities Commission was assigned a regulatory and supervisory role.

13. The Bucharest Stock Exchange contributed substantially to setting higher corporate governance standards in Romania. A pool of “blue chips” listed on the Stock Exchange provided models of transparency and disclosure and, as better informed investors were more demanding in terms of performance and corporate governance practice, they put pressure on all corporate players to improve their behaviour. The public at large was exposed to constant and consistent information issued by the Stock Exchange – a very practical way of educating people on capital markets.
14. Irregularities and even some fraud cases that occurred on the Stock Exchange were treated with a certain tolerance; the regulatory bodies (both the Stock Exchange Committee and the Securities Commission) preferred a soft approach, fearing that tough measures would damage an already fragile institution. The stance of the regulatory authorities changed starting with year 2000, when stricter monitoring and enforcement was promoted, and continued in 2001, when higher standards for listing were adopted. As a result, from August 6, 2001 a number of 36 companies were removed from the BSE listing. Along the same efforts for improving standards, the Stock Exchange recently initiated an informal “transparency tier”. Are listed on the “transparency tier” companies that voluntarily adopt and apply a set of high standards of corporate governance.
15. The National Securities Commission has embarked on an ambitious project of reshuffling the relevant capital market legislation. Several draft laws are expected for October 2001. Amending the legislation in order to adjust to new conditions and integrate lessons from recent experience is a necessary and natural process. But any legislation, no matter how good, is ineffective if proper implementation and enforcement is missing.
16. The RASDAQ over the counter exchange is the second pillar of the Romanian capital market. The RASDAQ has successfully accomplished its initial mission of providing a trading environment for the mass privatisation program. After a few years however, it ended up as a cluttered system, with thousands of companies listed, but few of them actively traded. Repeated irregularities and fraud, including operations of theft of shares masterminded by authorised brokers, suspected market manipulation, eroded the system’s reliability. At the end of 2000, confronted with financial difficulties, RASDAQ was on the brink of a crisis. The National Securities Dealers Association was short of ideas on how to overcome the problems and its members insufficiently motivated for exacting a solution. An upward trend of the market in 2001 eased the tensions, but the basic problems remain.

ENFORCEMENT AND IMPLEMENTATION

17. Despite progress in developing the legal framework of the corporate governance regime, a number of weaknesses persist. Although there is always room for improvement in the legislation, it should be regarded

as a long-term and continuous process, which should not prevent from taking action now. Too often in the Romanian reform, the focus on improving the legislation has become an excuse not to address the problems at hand.

18. Putting in place the legal framework and creating the appropriate organisations are necessary but not sufficient steps for setting and maintaining standards of corporate governance. Enforcement is equally important and an efficient justice system is critical for the task. The Romanian judiciary has difficulties in dealing with the large amount of cases coming from the commercial and corporate new legislation and abuse or alleged corruption in the court system were occasionally reported.
19. The current accommodations for the National Securities Commission are inadequate in terms of floor space and facilities. The Commission was repeatedly on the point of being evicted by the owner. Archiving a proper organisation of activities is rendered impossible by the lack of space. The Commission is understaffed because of the same constraint – lack of floor space makes hiring new personnel impossible.
20. Although the Commission has its own revenues from taxes collected on transactions taking place in the capital markets, its budget is approved every year by the parliament. As parliamentary procedures take a long time, the Commission is confronted every year with financial problems.
21. The current staff (around 80 people) is insufficient considering the Commission's increasing responsibilities. Recently, the Securities Commission was given responsibilities in the areas of commodities exchanges and treasury bills trading.

THE RIGHTS AND EQUITABLE TREATMENT OF SHAREHOLDERS

22. The institutional framework introduced by the law assures in principle all basic shareholders' rights: secure ownership registration; the right to convey or transfer the shares; the right to obtain relevant information on the company on a timely and regular basis; the right to participate and vote in the general shareholders' meetings; the right to elect members of the board; the right to share in the profits of the company. Important decisions concerning the company, like changes in the statutes or by-laws, extraordinary transactions etc. have to be taken under the special rules of the extraordinary shareholders meeting.
23. However, the degree to which some of these rights are effectively secured varies in practice, depending on factors like the ownership structure in different companies, shareholders' activism, managerial attitude etc. Violations of the minority shareholders' rights are the most serious and best documented.
24. As amendments of the legislation can never fully cover all species of abuses, effective legal redress for shareholders' rights violations is the ultimate protective mechanism. Although granted by the law, redress is frequently ineffective because of long and costly procedures or unpredictable outcomes.
25. In most leading companies there is a core ownership which attends general shareholder meetings and votes. Institutional investors also regularly attend general meetings and vote, even when they have minority positions. Individual investors generally participate in a small proportion of General Meetings. Overall, shareholder participation in the general meetings is poor.

26. Many individual shareholders are not aware of the dates of annual general meetings. Even if they were, it would be more than their shares are worth to embark on a journey across the country to vote on an issue over which the majority shareholder had the deciding voice.
27. Many other issues related to shareholders protection deserve closer examination, although they have not been brought up in previous debates: knowing the beneficial owner in some corporate controlling structures is sometimes impossible – especially when off-shore vehicles are utilised; proxy voting is sometimes manipulated by executives of the company; shareholders' ability to place items on the agenda of the general meetings is very limited, etc.
28. Because the Romanian Company Law admits only two types of shares (voting and non-voting) and all voting shares have equal voting power, equitable treatment of all shareholders is largely assured in theory.
29. Discrepancies may arise in practice between the insiders and outsiders. Although prohibited by the law, insider trading and self-dealing are poorly defined, making monitoring and enforcement difficult.
30. The obligations of the managers and members of the board to disclose any material interest in transactions or matters affecting the corporation are poorly defined and therefore difficult to be enforced.

THE ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE

31. The corporate governance framework is less specific on other stakeholders' rights – except for the bondholders, which are covered by the Company Law. Employees' rights are derived from labour legislation, but are not specified in the corporate governance context. Creditors like banks are poorly protected from insiders' abuses and redress procedures are complicated, long, costly and with unpredictable outcomes. Other stakeholders, like local groups of interests, are not sufficiently organised to have an influence except for the local authorities, which usually have multiple, administrative as well as informal relations with the corporate population.

DISCLOSURE AND TRANSPARENCY

32. The obligations of the companies to publicly disclose a wide variety of information, from bylaws and ownership to financial information, are sufficiently well specified by the law and sanctions for violation are adequate. The companies listed on the Stock Exchange assume even more stringent disclosure requirements, which would be adequate if strictly observed. However, it is precisely in this area that most violations occur without being sanctioned.
33. A serious barrier to independent voting decisions by different groups of shareholders is access to information. Insiders are better informed and outsiders have to rely on what they are told. To date the NSC has not applied sanctions on companies breaching information requirement provisions.
34. The Trade Register, which is by law the main depository of corporate information, is not properly equipped for tracking violators and imposing sanctions. Therefore, the information available with the Trade Register is usually more than one year old and sometimes is completely missing.

35. On the other hand, the Ministry of Public Finance, which has the most accurate, updated and complete database, together with the instruments to identify infringement and sanction culprits, does not have an obligation to disclose that information to the public (although in practice it started to do so by opening an INTERNET access to its financial statements database).

THE RESPONSIBILITIES OF THE BOARD

36. In spite of the critical role the boards of directors have in corporate governance and performance, systematic and objective information on how the boards are actually organised and function is largely missing. Anecdotal evidence suggest that boards' practice varies widely and cases of formalist operation (rubber-stamp boards) are frequent when insiders dominate.
37. Many board members do not have adequate qualifications for the job and in general there is little experience regarding the functions of the board and the responsibilities of board members.
38. Currently, major shareholders, insiders and incumbents may appoint all members of the board.
39. At present, boards do not have separate identity in the company and are rather a continuation of management. Board power is thus quite limited. Few boards have independent directors and in the ones that do, non-executives have only few responsibilities.
40. In practice, the board often does not have the ability to obtain relevant information on the corporation on a timely and regular basis.
41. The accountability of the board and board's members to the company and to the shareholders is in practice poorly defined, understood and enforced. There are extremely few cases when boards and boards members have been found responsible for damages suffered by the companies and by shareholders. The role of the Censors Committees and its relation with the board remains ambiguous.

PRELIMINARY RECOMMENDATIONS TO IMPROVE CORPORATE GOVERNANCE IN ROMANIA

1. Privatization and Consolidation

- 1.1. Successful privatization of the National Companies must be the highest priority. **To prepare the National Companies for privatization, the greatest efforts must be made to improve their corporate governance practices**, both directly, and by enhancing the corporate governance environment for all companies.

After a decade of reform, state owned enterprises, primarily the National Companies, still produce well over 30% of GDP and control the majority of the country's capital stock. Substantial efforts have been made to reform the management of the companies, however their performance still lags that of the private sector, and there is general consensus in favor of their privatization. **The government could use state ownership and the process of privatization as an opportunity to make National Companies corporate governance leaders** and thus ensure a high valuation and better access for these firms, whose success has economy wide repercussions. In preparation for their privatization, a process of transferring control of these companies to a Privatisation Authority, either the State Ownership Fund, or a new body, from the ministries that currently control them, should be initiated. Independent boards should be installed. Preparations must also be made for the adequate regulation of privately controlled utilities. An effective competition policy must also be put in place.

- 1.2. **The process of consolidating and delisting many of the small and medium companies on the RASDAQ is essential to improving corporate governance in Romania.** To facilitate this process, a fair and equitable system of tender offers must be developed. This process may also include the establishment of an authority or authorities to assist in tracing ownership, consolidating claims, and directly purchasing and consolidating stock from dispersed owners.

Given the limited liquidity of the Romanian stock markets, the administrative burden faced by publicly listed (open) companies, and the costs to regulators of policing such a large number of companies, consolidation seems the most appropriate strategy for the majority of companies currently listed on the RASDAQ. The development of a suitable tender system must be central to this process. For example, a fair and equitable offer may be one that was adequately advertised in the media, and received a substantial response from a wide number of outside shareholders. For those shares still outstanding, a price should be set through a fair and independent appraisal of their market value. The independence and accountability of any authority or authorities established as part of the consolidation process is crucial.

- 1.3. **Bankruptcy reform must play a critical role in any consolidation process.** Where a company can be restructured its creditors should be allowed to agree with the shortest possible delay on a restructuring without undue administrative or other obstacles. In cases where a companies net present value is clearly negative, and restructuring is unlikely to be successful in restoring the net assets to a positive position, the transfer of ownership and control to the companies creditors should be expedited.

2. The Rights and Equitable Treatment of Shareholders

2.1. The process by which shareholders are informed of forthcoming general shareholder meetings must be improved

- Any such meeting shall be announced through the Official Gazette, and the best means available to reach a large number of shareholders, which in practice could include both national and international media.
- The 15 day notification deadline must be extended to allow for proper preparation for the meeting.
- The methods of notification should be the same for all shareholders.
- Beyond notification, greater effort should be made to provide shareholders company information in advance, including: location, date, time, registration procedures, and agenda for the forthcoming meeting.

2.2. The right of all shareholders to attend general shareholder meetings should not be abridged through the use of onerous identification requirements, the scheduling of the meeting in a remote location or other techniques designed to prevent participation.

2.3. The use of proxy voting should be further developed. The involvement of professionals and shareholder / investor groups to assist companies and investors in organizing and facilitating proxy procedures, especially the consolidation of minority shareholder votes at general meetings might prove useful in this respect.

2.4. Dividends agreed to at the general shareholders meeting shall be paid promptly-within at least 90 days

2.5. The SIF's and the newly emerging pension funds should be encouraged to formulate and adopt explicit ownership policies, especially with regard to voting in the general shareholder meeting. To facilitate this, regulators should review the legal framework for active and informed investment fund involvement.

2.6. Company law should ensure that **no change in share capital of any kind under any circumstances occurs if the preemptive rights of shareholders are violated**. In general, the waiver of such rights should not be allowed.

- The general shareholder's meeting must approve any change in the capital structure. The meeting must follow all the standard procedures, including requirements for notification and attendance required for other general shareholder meetings. In announcing the general meeting, it must be made clear that said meeting will be considering a change in share capital, and the terms of the change must also be made clear.

2.7. **'In-kind' contributions for share capital should be restricted**. When such contributions are made, then a mechanism must be developed to determine the fair market value of such contributions through a truly independent assessment.

- 2.8. **Joint stock companies should not use nominal book value as a basis for pricing new shares in the context of a capital increase.** Whenever possible, a fair market value based on an independent assessment should be used to price newly issued shares.
- 2.9. Any transaction with another company or party affiliated with or controlled by a member of the board or management, or their relatives or close associates, should be disclosed to shareholders and approved by the board in such a way as to avoid conflicts of interests.
- 2.10. Any transactions involving major assets must be approved by the board in such a way as to avoid conflicts of interests. Very large transactions should be approved by a general shareholders' meeting.

3. The Role of Stakeholders

- 3.1. Large international institutions increasingly demand information on stakeholder treatment in order to invest in a specific company. **Romanian enterprises might find it increasingly important to address up-front key stakeholder issues**, such as their environmental record and labor relations, in order to successfully tap international capital markets and contracts.
- 3.2. Large listed companies should provide for compliance mechanisms that ensure that they respect outstanding legislation related to the right of stakeholders.
- 3.3. During the privatization process authorities should assure that labor and other interested parties have been consulted to ensure consistency in government policy.

Also see recommendation 1.3

4. The Responsibilities of the Board

- 4.1. Legislation should clearly stipulate that the Boards' duty is to serve the best interest of the company and all its shareholders. Directors' duty of care and loyalty should be well defined and specifically mandated in the Company Law.
- 4.2. In order to improve the quality of Boards, a Director's Institute should be set up for training, sharing experience, setting up and checking qualification requirements, and building-up a database of suitable Board members, domestic as well as foreign ones.
- 4.3. The nomination process of Board members has to be more transparent and allow minority shareholders to influence the process. All shareholders should be timely, adequately, and effectively informed about nominees. Procedures for nomination should be included in legislation. Company by-laws should provide for the possibility of cumulative voting.
- 4.4. Listing requirements should stipulate that companies have a sufficient number of independent directors, i.e. non-executive not related to the company or the controlling shareholders. Independence should also relate to any thing, such as political parties, that may influence decision making in a way that takes the focus away from the business perspective.
- 4.5. The structure of the Board should be strengthened through the use of specialized Committees composed in majority of independent members of the Board who are not members of the Directors' Committee, if the latter exists. Such specialized Committees should especially include an Audit and Compliance Committee.

- 4.6. In order to insure dully informed and independent decisions by the Board, Board members should have full access to all relevant information. It should be clearly stated that the provision of such information is the obligation of the management.
- 4.7. Board responsibility should include deciding on company objectives, evaluating performance and deciding on remuneration of management.
- 4.8. The Board should be responsible for putting in place a structure of corporate governance that assures compliance with relevant legislation.
- 4.9. The remuneration of Board members and management should be checked by the Audit Committee and disclosed in Financial Statements.
- 4.10. The Board should certify that the financial statements provide accurate and relevant information on the state of affairs of the company.
- 4.11. In the process of the Company Law debate, the Censor's Committee's responsibilities could be given to the Board and possibly to the Audit Committee.

5. Transparency and Disclosure

- 5.1. Listed companies should be responsible for disseminating all relevant information equally to all market participants. In this respect, companies should consider proper use of modern information and communication technology.
- 5.2. The Annual Report should include disclosure of all important corporate governance arrangements in the company, such as Board membership and Board committees.
- 5.3. Romanian accounting standards for large companies should evolve towards IAS.
- 5.4. Present accounting standards should be improved with respect to timeliness disclosure of items that affect the business.
- 5.5. Consolidation accounting for business groups should be improved.
- 5.6. Liability of outside auditors should be enough to ensure their increased and adequate level of statutory independence.
- 5.7. The integrity of the accounting and auditing profession needs to be strengthened in order for the profession to fulfil an important self-regulatory role. Current challenges include:
 - participating in the development of standards based on international norms
 - ensuring the quality and availability of relevant training
 - organizing the testing and certification of accountants and auditors
 - developing and enforcing a Code of Ethics for the profession
 - publishing relevant material for members of the profession
 - liasing with the government and relevant international fora, including the South East Europe Program for Accountancy Development.

- 5.8. The licencing and regulating of the accounting profession has to be done in an efficient and independent way. The body in charge of this should also monitor the implementation of standards regarding accounting and auditing.
- 5.9. The companies should significantly improve the disclosure of their ownership and control structures. Both domestic and offshore beneficial owners or combination thereof holding over 5 per cent of the shares should be disclosed. Such disclosure should be filled with the National Securities Commission by the holders.
- 5.10. In order to improve compliance with disclosure requirements and facilitate enforcement of sanctions, regulatory bodies, including the Stock Exchanges and the National Securities Commission, need to develop specific monitoring mechanisms. In addition, effective sanctions should be credibly adopted.
- 5.11. The recent initiative of the Bucharest Stock Exchange to create a “transparency tier” for companies that adopt a set of higher corporate governance standards should be encouraged and supported.

6. Enforcement and Implementation

- 6.1. **All areas of enforcement are in need of strengthening and of increased resources.** This includes the courts, the supervisory authorities, the stock exchanges and private settlement mechanisms.
- 6.2. Raising the awareness of the shareholding public at large is a *sine qua non* condition for improvement in corporate governance.
 - It is recommended that educational and public awareness programs be initiated in order to allow for a better understanding of corporate governance issues. Support from international institutions could play an important role.
 - Journalists and media representatives should be invited to conferences and seminars dedicated to corporate governance issues in Romania and abroad.
- 6.3. **For the National Securities Commission to carryout its mandate as Romania’s principal securities regulator, its financial and human resources must be significantly increased.** This includes budgetary stability, regular staff training, and exchange of experts with similar institutions in the region and the world.
- 6.4. **The vigilance and diligence of the self-regulatory organizations must be improved.** This must include setting high standards for ethics and honesty amongst their members. This is especially true for the National Association of Securities Dealers, which must be encourage to improve its performance sufficiently to allow it to qualify for self regulatory control over the RASDAQ market. Technical assistance programs should be initiated in order to identify the weaknesses and needs of the self regulatory organizations and to address these needs.
- 6.5. **Effective enforcement and implementation requires a strengthened Judicial System**
 - The training of lawyers and judges in commercial law and procedures, especially with respect to bankruptcy and company law, needs to be expanded. Multilateral and bilateral assistance could play an important role in this process.

- The compensation of judges and other court personal should increased to ensure the education, experience and independence required for the position.
 - Greater specialization of the judiciary should be encouraged .
 - Court written opinions and decisions should be made public to increase public awareness and enhance the performance of the legal system.
- 6.6. To provide shareholders an adequate and efficient means of redress, **stock exchanges should provide for professional arbitration mechanisms to settle disputes between companies and shareholders.**
- 6.7. **The violation of shareholders rights**, including but not limited to the rights to be notified and attend the general meeting, vote in the general meeting, participate in capital increases, be notified on insider transactions and not be subject to fraudulent and abusive behaviour, **must be addressed in a credible way.**

Improving the legal redress mechanisms for shareholders should be examined by, for example, allowing collective action through shareholders' associations, or allowing the Securities Commission to file lawsuits on behalf of individual shareholders

- 6.8. In order to develop state of the art mechanisms for implementation and enforcement, **Romanian authorities are encouraged to participate in various international fora** committed to improved corporate governance. This includes active participation in the South East Europe Round Table on Corporate Governance.