
IMPLEMENTATION OF THE CORPORATE GOVERNANCE CODE AS A MEASURE OF AN EFFICIENCY INCREASING PROCESS IN CORPORATE MANAGEMENT

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Abstract

The majority of leaders of economic entities in Moldova should recognize the role of effective corporate management for the proper development of their activities. Therefore, to ensure obtaining competitive advantage, the leaders must accept the fact that the policy of improvement of corporate management becomes a major component of enterprise development, and using the principles and best practices of corporate governance are already highlighted both at the level of their enterprises and at international level. Therefore, the authors of the article present some measures to streamline corporate management.

Keywords: corporate management, corporate governance, corporate governance code.

Introduction

The financial crises in Asia, Russia, Latin America showed that corporate governance procedures ineffective in practice presents a huge danger for both economic entities and for society. The corporate governance failures can be just as destructive as any other economic shock [7, p. 146].

After the Asian financial crisis, the former governor of the Bank of Thailand, Chatu Mongkol Sonakul said [5, p. 10]: "I have no doubt that to recover from economic crisis the Asian government and corporate sector should collaborate better. I do not want to say that because of the recent economic crisis has been insufficient cooperation between them, rather, they have worked very well and they cooperated among themselves ... The Asian financial crisis showed that if there is no transparent control process, the rights of shareholders are not respected and boards of directors are not responsible, even strong economies may collapse quite quickly when the investors confidence disappears. "

Whatever the cause of the apparent worsening financial situation is, the main cause of the crisis in any organization is the low level of professionalism of company's management.

Under these conditions, the authors consider that an entity and all its employees can comply with certain provisions, rights and obligations provided that they are stipulated in various laws, regulations, instructions, orders etc.

The authors come to the idea that the diagnosis of economic potential of an entity should be absolutely mandatory for all economic entities carrying out entrepreneurial activity within the territory of republic of Moldova (regardless of the type of activity, form of ownership, legal form).

And talking all about enterprise and at the enterprise level, the authors consider that one of the most feasible and most effective ways to ensure the effective corporate management is an appropriate diagnosis of potential economic entity. The managers of the entity can do this diagnosis or at their request, only if these managers will have the social responsibility towards both the owners and employees of the company. In turn, the enhancement of the managerial responsibility is a goal that can be achieved by developing and adapting the codes of corporate governance, among which principles is the effective management!

1. The essence of corporate management

In Republic of Moldova, the Corporate Governance Code was developed and approved since 2007 through the decision of National Commission on Securities (currently National Commission of Financial Market) which was valid only for implementation within joint stock companies. It was including provisions relating to shareholder rights; tasks of General Meeting of Shareholders, of Company's Chairman of the Board, the Executive Body; the enforcement mechanisms for protection of shareholders' rights, etc.

It is indeed the first legal document that explains in detail the "corporate", "corporate governance" concepts. According to this code, a key element to improve the economic efficiency is the proper administration of corporations; corporate management or corporate governance is the system by which a company is managed and controlled [3].

The Code of corporate governance contains principles and concrete guidelines which the persons involved in company management (executive body members, board company supervisory bodies, shareholders) should follow in mutual relations.

The Principles were developed as the best national and international practice situations and represent a set of standards of governance to guide the company's management and shareholders for the implementation of general principles of efficient management within a company.

It should be mentioned that on 04.03.2016 the Corporate Governance Code as described above is repealed because a new Code of Corporate Governance entered into force, approved by the National Commission of Financial Market on 24.12.2015 [2].

Under this Code, the corporate governance involves a set of relationships between council of Joint Stock Company (hereinafter - Company), the executive body, shareholders and other interested parties (Stakeholders), namely the employees, partners, creditors of the company, local authorities etc. [2]. However, this code comes to list and explain more detailed all the rights and obligations of the General Meeting of Shareholders, to the Board company executive.

The novelty of the new corporate governance code recommendation is to establish a corporate secretary who would contribute to the interaction between shareholders and governing bodies of the company in the context of corporate governance.

Another novelty of it consists in the obligation of public interest entities (an entity that is of particular importance to the public because of the domain (type) of activity and that is a financial institution, an undertaking for collective investment in transferable securities, an insurance company, a non-state pension fund, a company whose shares are listed on the stock exchange [4]) to comply with its provisions for 6 months from the date of entry into force (which was not foreseen in the previous code); but for other joint stock companies the compliance is voluntary [2].

Nevertheless the corporate governance has emerged as a result of numerous failures in the private sector in a short time, which led to loss of investor confidence in the ability of managers to lead and manage large corporations or public institutions; or in the case of Moldova – as a necessity to reform and privatization of property, adoption of the Code of corporate governance and corporate management implementation should not be limited to joint stock companies.

The effective corporate management is the activity of the entity management throughout the lifecycle, by: planning, implementing, controlling, reporting able to generate expected effects and results. Corporate management, if implemented offers to economic entity and its founders offers a range of economic benefits (Figure 1).

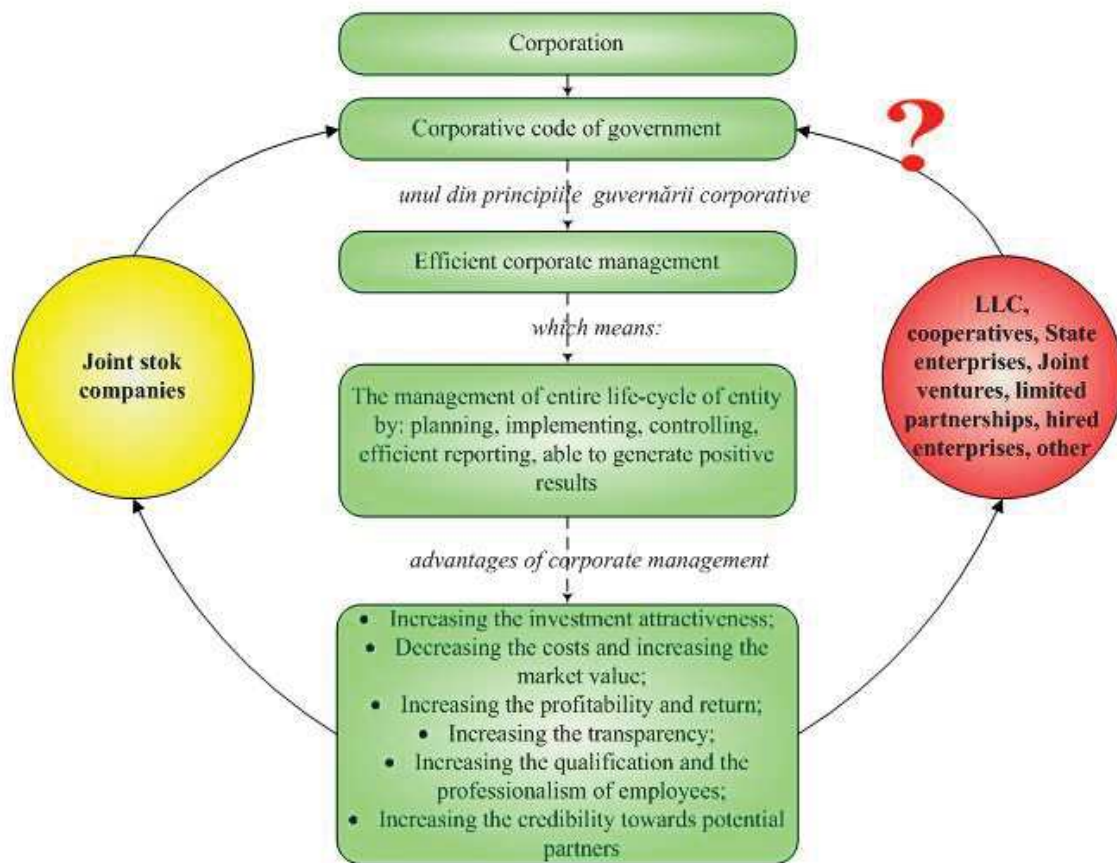


Figure 1. The necessity of corporate management

Source: elaborated by author

Therefore, arises the question: do the economic entities, with legal organizational forms different from joint stock companies, need to plan, implement, control, reporting in its work? Do they need to generate the expected results? Do they need the many advantages that the corporate management offer? They can not pretend or not need to implement corporate management?

Moreover, considering the fact that the Republic of Moldova, most entities have legal form other than joint stock company - only 4596 from 170 703 entities registered in Moldova on 01.06.2016 (table 1), increases considerably the need to improve the management of these entities.

Table 1. Juridical persons and individual entrepreneurs on 01.06.2016 in Republic of Moldova

| <i>Nr.</i> | <i>Legal Organizational form</i> | <i>Number</i> | <i>Share (%)</i> |
|--------------|---|---------------|------------------|
| 1. | Limited liability companies | 93673 | 54,87 |
| 2. | Individual Entrepreneurs | 61877 | 36,25 |
| 3. | <i>Joint Stock Companies</i> | 4596 | 2,69 |
| 4. | Cooperatives | 3945 | 2,31 |
| 5. | Non-commercial organizations | 1878 | 1,10 |
| 6. | State enterprises | 1566 | 0,92 |
| 7. | Other (limited partnership, rented enterprises) | 3168 | 1,86 |
| TOTAL | | 170703 | 100 |

Source: elaborated by author based on bibliographic resource 9.

The structure of economic entities in Moldova, according to legal form is shown in Figure 2:

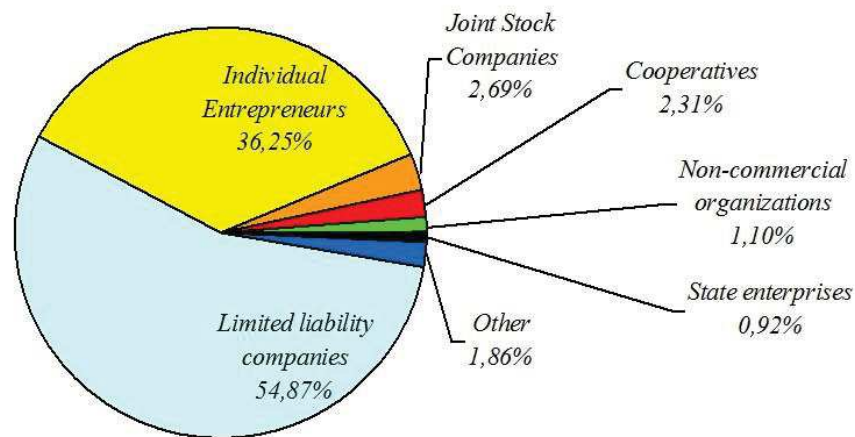


Figure 2. The structure of economic entities in Moldova, according to legal organizational form, at 01.06.2016

Source: elaborated by the author based bibliographic resource 9.

From Table 1 and Figure 2 is clearly seen the fact that that joint stock companies in Moldova at 06.01.2016 are only 4596, which means 2.69% of all economic entities in the country. If we keep the position that the corporate management should apply only for JSCs, what follows? The state is showing a considerable care to these entities: drafting the Code of

corporate governance, by it imposing the implementation of an effective corporate management. But what about the other economic entities?

The authors consider that, regardless of the legal form of the economic entity, its size, whether it is formed by association members, the implementation of corporate management by adopting a corporate governance code is required.

And though it may seem rhetorical question: is the Code of corporate governance for small and medium businesses, LLC and cooperative companies applicable?, the answer would be affirmative, according to the author, this code has the right to exist.

Once approved the first Code of Corporate Governance (UK), many countries of the world in order to streamline the management within entities have resorted to develop their corporate governance codes.

The dynamics approval of corporate governance codes is shown in Figure 3:

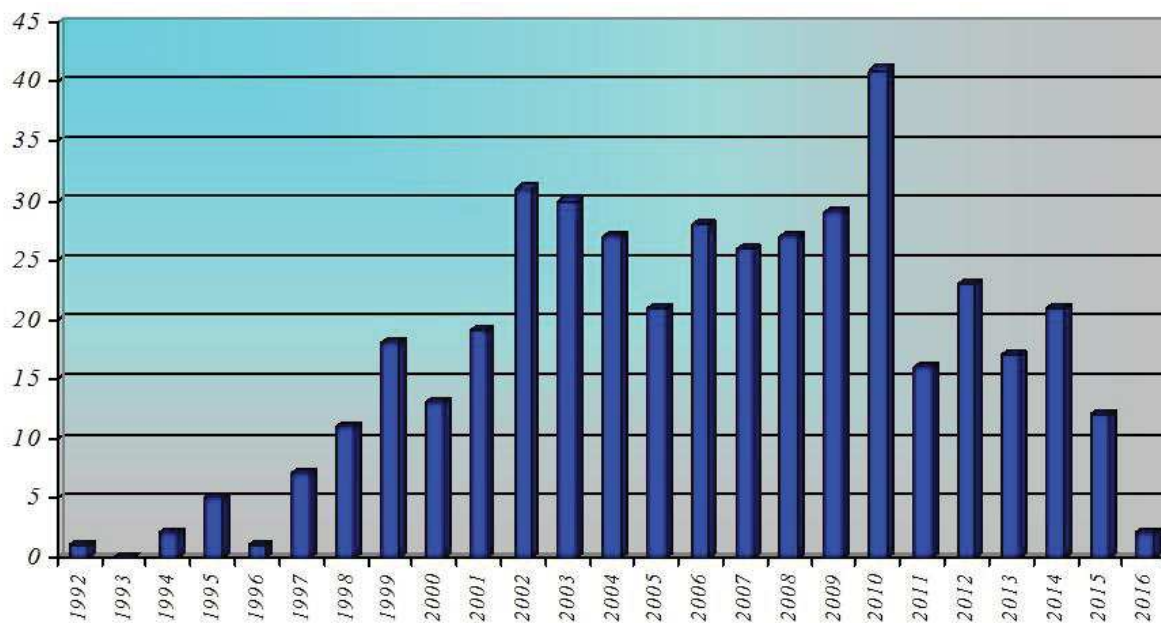


Figure 3. Dynamics of corporate governance codes (several country-level)

Source: elaborated by the author, based on 10 bibliographic source.

Until now, only 50 public interest entities in Moldova have approved their own codes of corporate governance (of which – 11 are commercial banks).

How it could be observed, namely commercial banks are the most disciplined adherent to the Code of Corporate Governance. In April 2010, the National Bank of Moldova (NBM) has imposed the mandatory development and compliance with the Code through a special document - Regulation on the control system of banks. Of the 11 functioning banks, there is no one who does not respect the principles of the mentioned regulation [6].

At one point, Moldovan banks have felt the need for a more efficient management to stay active and be competitive in the local market. Corporate governance code allows them to clearly delineate responsibilities in banks, to devise development strategies and internal risk management policy, which guarantees the financial stability and will enhance market competitiveness [6]. The financial stability is the state in which the economic mechanisms of price formation, evaluation, and financial risk management division, works well enough to help increase economic performance.

The corporate governance code includes a set of rules and principles that lead those involved in management, strategic planning and actions of the economic entity, but one of the basic principles thereof, the otherwise responsible for increasing the profitability and return of economic entity, is the principle of effective corporate management.

According to the new code of corporate governance, which entered into force on 03.04.2016, absolutely all economic entities of public interest, in accordance with its provisions should comply with its rules for 6 months, from the date of entry into force, hence the scope of this provision fall entities that are of particular importance due to the public domain (type) of its activity:

- financial institution,
- an undertaking for collective investment in transferable securities
- insurance company,
- a state pension fund,
- company whose shares are listed on the stock exchange.

2. The importance of developing codes of corporate governance

The importance of developing codes of corporate governance is illustrated by the fact that in Moldova annually starting up thousands of business entities, which unfortunately, that largely are subjected to bankruptcy because of mismanagement. Figure 4 shows the dynamic registration and cancelation of enterprises to / from the State Registry for the period 2000 - I quarter of 2016:

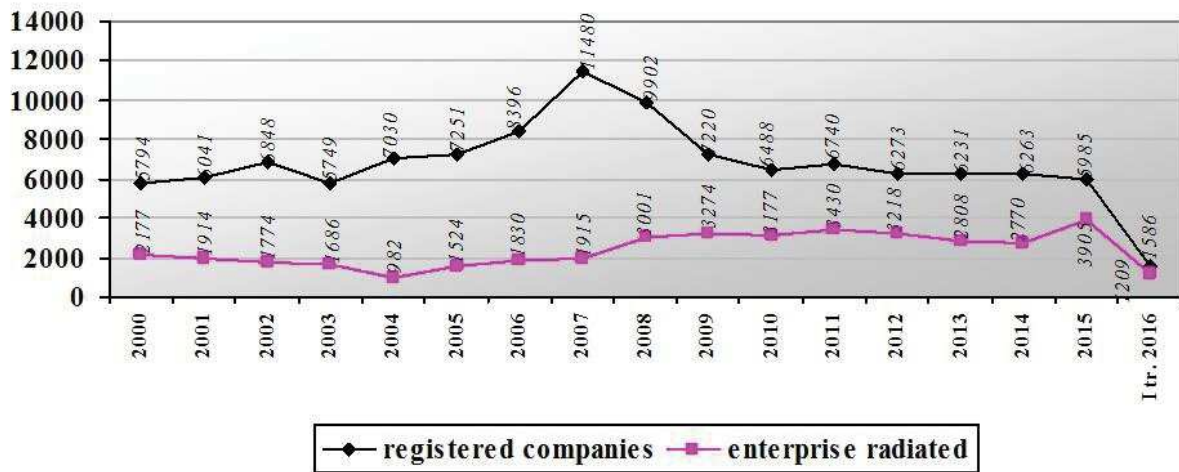


Figure 4. The dynamic registration and cancelation of enterprises to / from the State Registry for 2000 - I quarter of 2016

Source: elaborated by the author, based on source 9.

Data analysis shown in Figure 4 demonstrates an increase in the rate of registration of enterprises from 2000 to 2007, while since 2008 the situation changed suddenly registering a decrease of number of registered entities. For example, only in 2007 were registered 11,480 enterprises in the State Register, while in 2015 only 5985 (which means that the number of registered companies decreased by roughly half of that year). Another situation that is close to ring the alarm is the increasing number of companies removed from the State Register. This is more noticeable for 2015: when 5985 enterprises were registered and 3905 were removed. A situation even tougher is viewed for the first quarter of 2016 when 1586 enterprises were registered and 1209 enterprises were removed.

Another argument for developing the Code of corporate governance by including in it the principle of "effective management" is illustrated by the fact that the efficient management of economic entities depends on the fate of their employees. And if we refer to limited liability companies, then we talk about a number of employees 257 147 which represents 69.70% of the total number of employees in the Republic of Moldova referring to 2014 [1].

If we refer to the country level, then surely that turnover in economic entities with legal form - LLC - recorded for one year and that, on the one hand is the key indicator characterizing the efficiency of their work, and on the other - the main source of taxable income should be an index that increases arguments for emphasizing the discipline within economic entities by requiring them to carry out profitable activities under a code of corporate governance.

By figures 5 and 6 the authors present the correlation between the number of employees and turnover according to the organizational-legal forms of economic entities practicing entrepreneurship in Moldova:

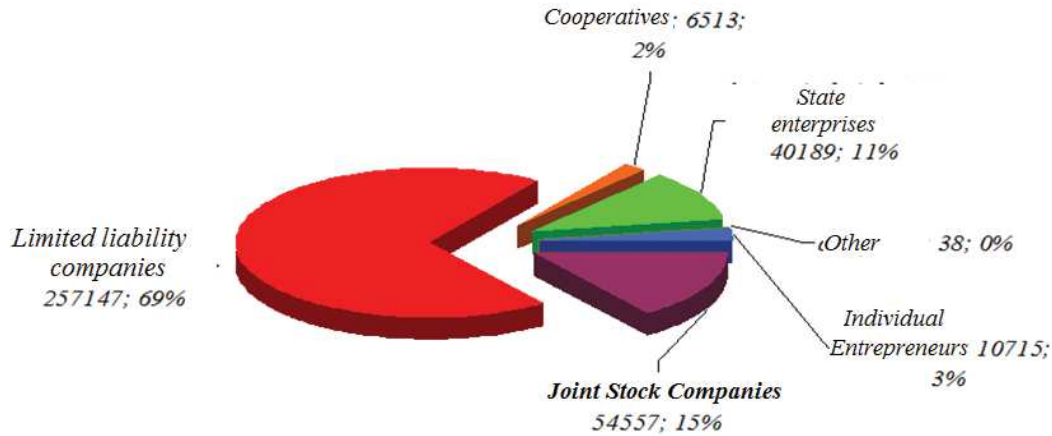


Figure 5. The average number of employees in enterprises on legal forms for 2014 (persons,%)

Source: elaborated by the author, according to 7.

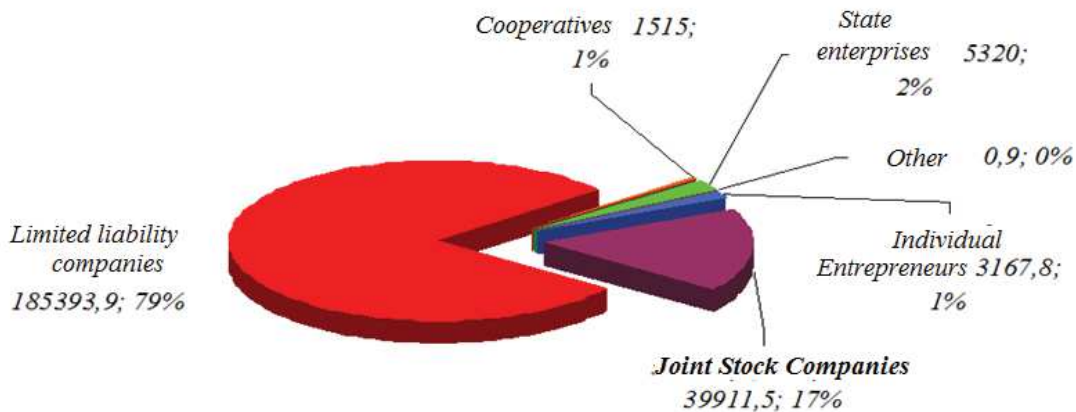


Figure 6. The turnover at the enterprise level, based on legal forms for 2014 (thousand,%)

Source: elaborated by the author, according to 7.

From figures 5 and 6, it is surely obvious that the importance to be given to Limited Liabilities companies by discipline and accountability of managers is colossal because of efficient management of these entities does not depend only !!! the profit of owners (which also is quite important), but also the job security and the future of 257 147 people; and also on the efficient management of these entities depends the value of accumulated budget revenues

through income taxes paid by them to the state budget - sources that will later serve to cover state spending. Therefore, the more empowered managers are and efficiency oriented activities they manage the more secure the jobs of employees are, the lower the unemployment rate will be, the more stately will be the prevailing income to the state budget, in the form of income taxes paid by these entities.

The implementation of corporate governance in the economic entities with at least 2 founders involves the following steps:

1. The separation of strategic management from operational. The transfer of management positions with the entity from owners to managers allows the owner to focus on broader strategic objective of its work.
2. The organization of the Management Board and managers. An effective corporate governance provides the incentives for board members or managers to comply with the interests of business owners. Typically, the company's financial results is severely affected by the imbalance of interest to management, because each manager tends to be responsible only for its scope of activity, without focusing on the big picture.
3. The introduction of financial and managerial transparency. Compiled in accordance with International Financial Reporting Standards (IFRS) financial statements of entities allow the company to "provide" financial results before the end of the fiscal year and the offer time to take measures and implement them to achieve a better result. In the absence of international financial reporting, the management of economic entities operate blindly, and the owner sees absolutely unexpected result only after completion of the managerial year.
4. Determining the factors of value for the company. The company managers must think like owners, so their remuneration should depend on their activities, helping to create value. The factors of company's value can be measured by key performance indicators, which include the customer retention rate, gross profit, storage costs, shipping costs, etc. While motivating other workers motivation should be linked to key performance indicators for which they are responsible.

A corporate management that is conducted effectively based on a code of corporate governance will provide the mechanism to protect the interests of all economic agents, including investors. It is obvious that such negative effects of a corporate management deficient as the theft of assets or cash flows of the entity by managers, shareholders by

entering disputed transactions, constitutes a direct violation of the rights of investors and therefore lead to decrease solvency entity.

A deficient corporate management generates a struggle for control between various interested subjects: current and potential shareholders, managers, staff representatives. The most often used tool in these misunderstandings is the bankruptcy. This struggle for control of the property distract managers and shareholders from operational and investment activity. All these factors generate the negative consequences for the entity's financial situation.

The imperfections of corporate management (or - instability of property rights) makes both shareholders and managers to stress less on the reputation of the company and its credit history. As a result, often there is a short-term financial policy and high risk, and sometimes even reluctance on debt repayment.

A perfect corporate management system - is a prerequisite for restructuring an entity by replacing inefficient owners and managers who have failed to achieve a profitable and financial stability. Therefore, an inefficient corporate management can lead to the situation when a financial entity is not capable of generating financial flows required to settle the debt.

According to the authors A.Shleifer and R.Vishny in companies with high concentration of capital are observed inadequate corporate governance problems, in particular the violation of the rights of minority shareholders [8, p. 995]. Often, major associations, relying on concentration of ownership, do not require the consent of minority shareholders to approve certain decisions.

Therefore, in the absence of effective mechanisms to protect the rights of members interested in the prosperity of the business (especially in cases where their share is minor), the patrimonial entity loses its ability to raise additional capital through attracting co-founders. Such limitation of financial flexibility enormously affect the solvency of the company.

The insurance to protect the interests of shareholders, corporate control system development - was the recommendation given by economists Hîncu R. and Biloacaia S. in their article "*The comparative analysis of the development of capital markets in developed and developing EU and Moldova based on indicative functional approach*". Based on EU practice, the authors consider that is mandatory for companies admitted to trading on the SEM to adopt the Code of corporate governance, or to argue, in accordance with the principle of "comply or explain" the impossibility of approval, are solutions that would ensure the development of domestic Securities Market.

The corporate management is also an important factor in making an investment decision. Therefore, according to the statistics, over 80% of investors are willing to pay more for shares of a society that is characterized by an effective corporate management compared to shares of companies with a deficient corporate management.

An equitable corporate management practice is a guarantee that the entity considers the interests of a wide range of stakeholders, and that the leadership of this enterprise is responsible for the work. This in turn helps to maintain investor confidence, both domestic and foreigners ones and attract more long-term investment.

The low level of corporate management practice has a negative impact on attracting investment and contribute to the emergence of national and regional problems.

Since the mid-90s investors, authorities, managers, both in countries with a developed economy and in those with economies in transition, turned their efforts towards the improvement of corporate management and the instrument used to achieve this goal was namely the development and implementing the corporate governance codes. Their objectives are to ensure the disclosure of user information necessary to assess the fair value of the performance and management practices of companies and not prescribing detailed corporate behavior.

Previously, it was noted that in Moldova the Corporate Governance Code was first adopted by the National Securities Commission Decision no. 28/6 of 01.06.2007 (published in the Official Gazette no. 86-89 of 22.06.2007) [3], followed by approval of a new corporate governance code approved by the National Commission of Financial Market Decision no. 67/10 of 24/12/2015.

Conclusions

The importance of the development and application of this Code of corporate governance in Moldova depends on a number of factors, including:

- integration into the globalization processes, which implies the need to harmonize domestic legislation with international standards
- the possibility of achieving an efficient management to develop successful business by owners;
- the possibility of preventing possible conflicts under the Code of corporate abuses service reduction and reduce the level of corruption of persons holding responsible positions of companies;

- the possibility of applying conflict resolution practice corporate enterprise level up to appeal to the courts;
- the possibility of promoting a positive image of enterprises across investors and partners;
- the possibility of settling under the Code the issues that are insufficiently regulated by existing legal framework, etc.

However, in practice, firstly, the need to improve the normative and legislative acts in force and the continued expansion of the legal framework, developing standards and regulations of the aspects of the management system Corporate hitherto they were not met.

Another problem, more important, is to ensure the most effective implementation and enforcement of normative and legislative acts in force. Therefore, the level of corporate governance in the country will depend largely on the level of applicability of the legal framework.

Particular attention should be paid to the increasing level of business culture in Moldova.

Thus, for improving the system of corporate management is need a push from the outside by applying in business sectors ideas and principles developed and used in countries that have stable and efficient mechanisms.

In order to improve corporate management, both organizations and national and international institutions, are organizing round tables (with the theme - Corporate Management) provides various projects to enhance the quality of corporate management, through these are:

- The Organisation for Economic Co-operation and Development has initiated the organization of several round tables;
- The European Bank for Reconstruction and Development (EBRD - provides project financing for banks, industrial and commercial enterprises, addressing both new initiatives and existing companies; also works with public sector companies to support their privatization, restructuring and improving the municipal services or utilities);
- The National Commission of Financial Market (autonomous authority of the central government, responsible to Parliament, which authorizes and regulates the activity of financial market participants and supervise their legal compliance), etc.

However, it is very important that these measure to be supported by efforts of economic entities (managers, investors, and other interest groups).

A perfect and efficient corporate management will ensure:

- The protection of the rights of all shareholders (including foreign ones) by providing access to information and its transparency;
- To streamline the processes to improve financial indicators of entities, enhancing export volume and profits
- Increasing the credibility of entities to foreign investors that will stimulate the flow of financial resources in the national economy;
- Strengthen the skills and professionalism of employees of entities;
- Cultivating a culture of ethics and corporate governance.

Therefor the measures taken to improve the corporate management must become part of the strategy of development of society. And for this it is necessary the active participation in the program all participants to the market. Otherwise, all actions will be limited to the adoption of declarations, projects that have little in common with corporate business environment.

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