



Emerging Markets Queries in Finance and Business

Compliance assessment regarding corporate governance requirements applied for Romanian investment firms

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Abstract

We based our research on the assumption that an efficient implementation of corporate governance requirements allows prudent supervision of Romanian investment firms by the Financial Supervision Authority. Moreover, some significant weaknesses in corporate governance has facilitated the emergence of extremely delicate circumstances in which some Romanian investment firms lost their brokerage licenses as a result of fraudulent operations that favoured misappropriation of client assets. Improving the effectiveness of governance structures would help to prevent the occurrence of similar future events, restoring investor confidence in the Romanian capital market mechanisms and institutions. The main focus of our research is to assess the compliance level with relevant corporate governance requirements applied to Romanian investment firms.

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1. Literature Review and Problem Formulation

Corporate governance plays a crucial role in improving the efficiency of the capital market through its impact on corporate operating efficiency and effectiveness, and the integrity and quality of financial reports

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(Rezaee, 2004). According to Calder, 2008 the “greed is good” business philosophy of the 1980s and 1990s seemed to give way at the end of the 20th century to a “looting is good” approach. Unfortunately, this reality is verified even on the Romanian capital market, taking into consideration the major scandals that shook investors’ confidence in the Romanian investment firms over the period 2012-2013 (see the cases of WBS Romania and Harinvest). This decline in trust and its implications for financial institutions represent one major driving force behind corporate governance reform (Solomon and Solomon, 2004). One positive response may come from the institutional investors who may strengthen corporate governance by acting more activist in their approach to their investee companies and more proactive in intervening in underperforming companies (Mallin, 2006). Nevertheless, Romanian investment firms are not significantly subject to institutional investors’ control or influence. Under such circumstances, we need to find alternatives to improve corporate governance practices within these entities. Although the discussion is focussed on how to best protect shareholders from fraudulent behaviour on the board of directors (Anand, 2008), we see the problem of client protection more relevant.

Firstly, we need to assess the current level of compliance with relevant requirements, in order to set out goals for improvement. One powerful instrument that we suggest for a quantitative assessment regards a score-based method, respectively a Score Function. The Score Function is designed to allow a quantitative assessment of the level of compliance with the relevant principles, best practices and corporate governance rules applicable to investment firms, as synthesized in the Code of Corporate Governance for Investment Firms. The Score Function allowed the transformation of declarative and qualitative data, in numerical, quantitative data (Spatacean and Ghiorghita, 2012). In the construction process of the Score Function, we performed the following steps:

(a) *Establishing the relative importance associated with each significant area of corporate governance.*

Defining significant areas of corporate governance allowed us to prioritize them by setting relative importance percentages, based on the assumption that areas with greater importance should gain more of our focus in preparing the questions and reviewing the responses. The significant areas of corporate governance, along with their relative importance are described in Table 1.

The significant areas of corporate governance were defined in close relation with OECD Corporate Governance Principles, as referred to in the “Comply or Explain” Statement currently required to all security issuers listed on the Bucharest Stock Exchange (BSE) regulated market. Consequently, the questions addressed to those in charge with governance for investment firms, related to:

- *Ensuring a General Framework for Effective Corporate Governance* (internal rules and procedures; corporate governance structures – e.g. special committees, management, control and internal audit, risk assessment; business administration models, etc.).
- *Rights of Shareholders and Equitable Treatment* (protection of shareholders’ fundamental rights; equitable and fair treatment; protection of minority shareholders’ rights, particularly against related party transactions).
- *Role of Stakeholders in Corporate Governance* (institutional investors’ interests in strengthening corporate governance processes; cooperation between shareholders, within the limits of market abuse generated by concerted actions; communication with financial analysts and the community of investment advisors; corporate social and environmental responsibility).
- *Disclosure and Transparency* (effective communication with shareholders; corporate information between confidentiality and disclosure obligations; disclosure of the remuneration policy for the Board members; detailed explanations for the lack of compliance with corporate governance principles).
- *Responsibilities of the Governance Board* (clear demarcation of functions and responsibilities; efficient and effective recruitment policies; periodic external evaluation; balance between executive and non-executive or independent members, to avoid conflicts of interest; financial and non-financial reporting process, internal control and risk management; IT governance).

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