CONSIDERATIONS ON THE MANAGEMENT OF STATE COMPANIES BY CORPORATE GOVERNANCE

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Abstract:

Over 20 years of market economy in Romania showed that the State is unable to manage companies in which it is a stockholder (wholly or majority). This situation is proven by the large amount of arrears in the general consolidated budget as well as the acceptance of significant annual losses for those companies. The main reason is the poor quality of management practices resulting from the appointment of top managers and members of the boards of directors for these companies, not by a rigorous professional selection, but as sinecure granted by policymakers. This approach has been noticed by the Romanian opinion leaders as well as the IMF experts who perceived the damaging consequences of this attitude and conditioned the further assistance granted to Romania putting an end on this situation. The solution is to outsource the management for state companies so they can be managed by corporate governance rules the way private companies are.

Key words: *inefficiency of public management, corporate governance, public company, arrears*

1. General framework

The current economic climate influenced by the effects of prolonged financial crisis, the euro zone crisis and inefficient public management require economical recovery actions through legislative and administrative interventions. An important economic sector requiring such interventions in order to be more efficient is the one of state owned companies. Autonomous administrations, national companies and companies in which the state owns all or majority of capital, constitute another important segment of the national economy and those companies liquidity, solvency and functionality influence the stability of the economy, and general economic equilibrium.

Relevant conclusions on low economic performance of state owned companies it is showed in the analysis presented below regarding the weight of state companies in the economy.

State owned companies weight in economy		
Indicators for 1st semester of 2011	State owned companies	
	Value	% of whole economy
Number of state owned companies	645	0,3
Added valued(billion lei)	43	11,5
Turnover (billion lei)	55.8	6,1
Arrears (billion lei)	28	31.2
Employees	354.271	9.8

Source: Fiscal Council Report for 2011, macroeconomic and budgetary developments and prospects

The data presented above show that although they have a low numerical weight in the economy (0.3%) state owned companies provide 11.5% of added value and 6.1% of the turnover in the national economy. The negative aspects related to those companies appear when the economic and financial relation between them and the consolidated budget are analyzed. In 2011, the state owned company's debt share of the total outstanding debt at the consolidated budget represented 28 billion lei , or 31.2% of the total arrears recorded in the economy (The total arrears of state owned companies in 2011 was 28 billion lei , down by 1.1 billion compared to 2010, according to data from Fiscal Council Report for 2011. The Top 10 state owned companies ranked in terms of overdue payments are accountable for over 50% of the total arrears of state owned companies – National Coal Society - 5.2 billion lei , CFR SA-4.5 billion lei, Oltchim - 1.6 billion lei , CFR Marfa - 1.2 billionlei , Electrocentrale Bucharest - 900 million lei , Cugir SA - 400 million lei , CFR Passengers - 400 million lei, Termoelectrica - 300 million lei , Uzinele Mechanice Orastie - 200 million lei and Electrica Furnizare - 200 million lei).

State owned companies sector in Romania is still oversized compared to other Eastern European countries, lacks transparency and it is inefficient, acting as a brake on the economy (IMF's Annual Report on the economic situation of Romania). State owned companies are controlling 53% of energy and 34% of the transport sector.

Even if the economic policies of the governments who have succeeded in the past four years were overseen by the IMF, Romania has failed to return to a robust economic growth. In fact, recent "alarming" analyses of the IMF assert that an increase in the eurozone crisis could cause a drop in GDP of 5% and 15-20% depreciation of the leu against the euro.

As a professional, politically neutral structure, the Fiscal Council (Fiscal Council Report for 2011, macroeconomic and budgetary developments and prospects) notices the medium term risk on fiscal sustainability represented by the accumulation of losses and arrears in the state owned companies.

The occurrence of large arrears in the state owned companies is influenced by the following factors:

- State-owned companies' budgets are approved without having the appropriate authorities insurance that those companies will be able to honor their budgetary obligations.
- The existence of legal provisions leading to breaches in the financial discipline (example: utilities suppliers).
- The use of compensations, debt reductions or exemptions which motivate and reduce state owned companies motivation and responsibility to pay their budgetary obligations (In 2011, through the two budgetary rectifications, two schemes for "chain" extinguishment of budgetary arrears were implemented. Through those corrections, 2.5 billion lei were transferred from the state budget to local budgets and to several state owned companies and ministries to settle overdue budget obligations).
- Lack of financial management performance in state owned companies (The Fiscal Council considers that progress is needed towards improving the financial management of state owned companies and recommends urgent implementation of Government Emergency Ordinance No 109 from November 2011 on the corporate governance of public companies.)

Related to the management of state owned companies, most opinion leaders (researchers, analysts, business environment, etc.) recognize that the legislative framework has important gaps in regards of the management of state owned companies that influence negatively the economic performance, competitiveness and the performed management. Also, the basic legislation for commercial societies is not adapted to the specifics of state owned companies. This legislation does not offer rigorous legal support for the state sector to work effectively and to be a vector of economic recovery.

The data mentioned above, regarding state owned companies lead to the need of reconsideration on how to manage them, for economic and legal reasons but also for the necessity to use modern methods of management, resembling methods of private management. The reduction of arrears from and to the consolidated budget will be imperative starting March 2013, when EU Directive 7/2011 on combating late payment in commercial contracts will be implemented in EU Member States.

2. Concept of corporate governance, basic principles, definition

Corporate governance principles were developed by the Organization for Economic Cooperation and Development based on legal standards and good corporate practice. They were established leverages to ensure objectivity and transparency in management selection and professionalism and accountability in management decision. Corporate governance uses protection mechanisms for minority shareholders rights and provides transparency in the policies used by the state as a shareholder in some sectors.

Improving corporate governance of state owned companies is an objective assumed by the Romanian Government in agreements with international financial institution (Letter of intent to the International Monetary Fund, approved by the Government memorandum on June 7, 2011), the adoption of the legislation regulating this field ensuring compliance with commitments, with positive consequences in terms of real grounding of a balanced budget.

Corporate governance is a relatively new concept. It gained ground in the final decade of the last century, following the collapse of large corporations in developed countries like the UK and U.S. (Polly Peck, BCCI and Robert Maxwell's media empire in UK, Enron, Tyco and World Com in USA). The collapse of those companies, materialized in loss of tens of billions of dollars by shareholders, employees, customers and the state motivated the authorities of the two countries to review the concept of corporate governance and to impose uniform rules of management.

In the UK, corporate governance principles outlined in the Cadbury (1992), Greenbury (1995) and Hampel (1998) reports were consolidated into the Combined Code of Corporate Governance in 2003 and revised in 2010. Also in the U.S., the Sarbanes-Oxley (SOX) law from 2001 established new standards of management for all public companies, listed on stock exchange market. Perception that need stricter laws on corporate governance are needed was positive and laws such as SOX were subsequently adopted in other countries like France, Germany, Italy, Japan, South Africa, Australia, India and Turkey.

The normative acts mentioned above promote the basic principles (elements) of corporate governance, including:

- Transparent management of the company by a board of directors collectively responsible for the accuracy of financial reporting and long-term success of the company;
- Respect of the rights and interests of all shareholders (stakeholders);
- Division of responsibilities between the Board and the executive management of the company;
- Ensure representation in the Board of Directors for non-executive and independent members compared to the executive ones;
- The setting off by the Board of Directors of working committees, formed by non-executive members, with specific tasks (audit committee, remuneration committee, corporate governance committee, nomination and selection of new directors committee);
- Board of Directors obligation to have constructive discussions about the executive proposals and to develop the company's strategy;
- Annual review of the board of directors performance and the performance of its members individually;
- The Board Accountability in the determination of the nature and extent of the significant risks assumed in pursuit of strategic objectives and the enforcement of appropriate methods and procedures for risk management and internal control;

- Ensuring that the board members reach a level of skills, experience and knowledge that enable them to effectively fulfill their responsibilities;
- Integrity and ethical behavior of the management team.

These principles were added to those promoted by the OECD aiming to:

- provide a transparent framework in compliance with the legal frame;
- specify clearly the rights of shareholders;
- assure transparency of information;
- determine role of the Board in relation to the interests of shareholders;

In finance, a definition of corporate governance is given by Shleifer and Vishny (1997), which defines corporate governance as "a system of concepts and practices that include a number of mechanisms aiming to ensure the return of finance investments avoiding excessive manipulation of values through management and major shareholders."

The theoretical and pragmatic vision of Charreaux (1997), analyses corporate governance as "a set of organizational and institutional mechanisms that target different powers influencing directors' decisions and reducing their optional domain."

The definition of corporate governance for public enterprises is found in specific legislation (Art 2, GEO no. 109 from November 2011 on corporate governance of public enterprises) stating the corporate governance of public companies as "the set of rules governing the administration and control system of a public enterprise, relations between public authorities and the bodies of the public company, between the board / directors surveillance / directors, shareholders and other stakeholders ".

From a synthetic approach of the analyzed concept, we can say that corporate governance represents the totality of rules, procedures and mechanisms that ensure a system of management for a company, the responsibilities in the relationship between the guardianship authority and the company executive, as well as the relationship between the Board of Directors and the external environment of the company.

In Romania, corporate governance emerged from a conceptual point of view and has been regulated in the early 2000s. The first corporate governance code was adopted in 2001. In 2008, it was replaced by a new corporate governance code, which is based on OECD principles and it is applied voluntarily by companies traded on the regulated market.

In the public sector, the concept was enacted by Government Ordinance No, 109/2011 on corporate governance in public companies as a result of the IMF request. The enactment leaves the possibility for the current Boards of Directors to exercise their mandate until its expiration. For this reason, the enforcement of corporate governance constituted the exception the concept being inefficient for the lack of promptness.

Moreover, the enactment mentioned above can be considered as unclear in other respects, for instance .in the qualifications required for a state owned company manager. Beyond the company's area of activity, corporate board members regardless of their background should have in common the understanding of the funds flow inside the company. Regardless of whether the activity is to provide public services, consumer goods or perform works, **any business activity translates into financial results in profitability, efficiency and effectiveness.**

The new law applies to public companies, Romanian legal entities (autonomous and state-owned company) exempting companies in the banking and financial field and insurance companies , as well as companies providing activities related to the national interest particularly defense, public order and national security.

3. Benefits of good corporate governance

Board of directors responsibilities are not resumed solely at obtaining financial performance for the company. A major responsibility of the management is committed to shareholders (state, a territorial administrative unit or groups of territorial administrative units), employees or customers that are choosing a certain financial conduct compared with the company market behavior.

The introduction of private management in the state owned companies has created unease in the political environment and among employees due to the fear of change. It shouldn't be neglected the fact that in state-owned companies, human resource are crucial, professional and dedicated experts in various fields being able to directly influence the company's results.

The way management is approached in the frame created by the promotion of corporate governance has direct consequences on:

- economic growth reflected in GDP;
- reduction of arrears to and from the consolidated budget;
- the challenge to demonstrate that, despite resilience in mentalities, politically driven attitudes and market adversity, applying standards of governance similar to those of private companies can also lead to performance in the public sector;
- removal of barriers imposed by political interference in matters of effective management of public companies.

4. Conclusions

The "corporate governance" concept refers to the set of rules by which a company is administered (managed and controlled). Corporate governance is the combination of control elements working together to regulate the relationship between those who have an interest in the company: shareholders, company management, employees, customers, suppliers, etc. The legal frame for this type of relationships can be found in the laws concerning companies supplemented with the laws governing insolvency, taxation and various specific regulations in the financial and economic field. This legal frame is designed to prevent negative practices like money laundering or the use of confidential information in trading etc.

Researches and economic practice recognize corporate governance as a key element in enhancing long term economic performance and competitiveness. In

Romania, the use of corporate governance for state-owned companies in sectors considered vital for the national economy has no tradition and has not been enforced as a way to ensure performance, for political reasons at the expense of economical ones.

The message against the status quo of inefficient management of state owned companies is given by economic analysis and international financial institutions through the IMF, "The government should decide which businesses should remain controlled by the state because the market failure in a certain sector cannot be corrected through better regulation. A list of those companies needs to be published. All the other state owned companies would be privatized or liquidated. It is not necessary for the state to own mining companies or chemical companies." (IMF's Annual Report on the economic situation of Romania).

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