

THE VIEW ON CORPORATE GOVERNANCE IN TRANSITION ECONOMIES: EXECUTIVE COMPENSATION IN CROATIA. CORPORATE GOVERNANCE IN MACEDONIA AND ROMANIA

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Abstract

Corporate governance issues are especially important in transition economies, since these countries do not have the long-established financial institution infrastructure to deal with corporate governance issues. Before the fall of the Berlin Wall and the collapse of the Soviet Union, there was no need to discuss corporate governance issues because all enterprises were owned by the state and there were no shareholders. All that has changed since 1989. This paper discusses the view on corporate governance in some transition economies. Highly limited knowledge on executive pay in (post)transition economies creates demand for research in this field; this paper explores executive compensation structure in Croatia. The research was conducted among Croatian public limited companies during December 2010 through February 2011 at a response rate of 18,44%. Paper also covers specificities of the development of the corporate governance structures and practices in the Republic of Macedonia.

Keywords: Corporate Governance, Compensation, Board of Directors, Transition Economies, Shareholders, Auditors

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1. Introduction

The corporate governance issue has been gaining importance in the developed market economies as well as in the transition economies. Basic reasons for such a trend are the same, but socio-economic environments are different and therefore, the analytical issues seem to have quite different weights in different groups of countries. Corporate governance represents a set of “rules of the game” through which companies are managed internally and supervised by Boards of directors, aiming to protect the interests of corporate stakeholders. A strong corporate governance foundation is important for a growing market economy. It has to include the integrity and transparency of financial and corporate operations, checks and balances in compliance with applicable laws, the practices of sound financial and corporate operations and accounting practices that are in accordance with international standards. In the legal sector, laws that are enacted must be timely and consistently enforced. The laws must be clear and consistent: in areas of orderly entry and exit of firms, property and asset protection of investors and transparency of the legal system. Establishing effective corporate governance is of particular importance for transition countries because its success is crucial not only for the growth of a healthy corporate sector but also for sustaining a healthy market economy. Bekaert et al (2001) find that the liberalization of financial markets in transition

countries increases economic growth by about 2 percentage points per year. Some countries like Romania, Ukraine, and Georgia have very low effective corporate governance with high incidences of corruption and fraud in the political and economic systems. Other countries like Poland, Hungary and Latvia have established relatively effective corporate governance with greater achievements made toward market-based economies. Corporate governance issues have gradually become important in Albania during the last decade. Such development is in line with the country’s efforts to create a sound business climate, attract new investments and develop capital markets. Executive compensation encompasses compensation for the set of employees who, by theory, have crucial impact on the definition and implementation of an organization’s strategy and overall firm business. Compensation paid to top executives is among top topics with popular press, with critics claiming that amounts paid to executives are too high. However, the *issue* of executive compensation has diverse scope in different countries; although abundant executive compensation academic literature covers numerous theoretical and practical issues within top management compensation, most of these contributions are being based on data from Anglo- Saxon countries, mainly classified within Anglo-American system of corporate governance.

Majority of these countries implemented full transparency in compensation through legislation that prescribes revealing the data on executive

compensation to potential investors and the general public. At the same time very little is known about executive compensation within continental system of corporate governance, especially among European (post)transition economies. The executive compensation package can, and most often does, contain many components. These components have different effects on employee motivation and risk, as well as various costs for the corporation. The most common components of compensation are salary, bonus, stock options and stock grants, pensions, benefits and perks (Balsam, 2001). A well-designed compensation plan must make tradeoffs between the components to maximize the net benefit to both the corporation and the executive. Such compensation package can motivate executives to use corporate resources to increase shareholder value, thus rewarding simultaneously executives and shareholders. Furthermore, executive compensation is important because it affects compensation levels and composition throughout the organization. Designing an optimal executive compensation plan for the set of circumstances has overall effects and consequences for various aspects of an organization's functioning and needs to be taken special care of. In case compensation is too low relative to executive's best alternative opportunity, he or she could leave creating additional costs for the corporation. Executive compensation theory is mostly founded within agency theory framework. The separation of ownership and control in contemporary publicly traded organizations creates a situation where managers rule and coordinate all firm activities, however except for their possible job loss and lost pay, do not bear any financial loss in case of firm's malperformance. This problem of managerial power and discretion, also known as the agency problem, creates prerequisites for potentially conflict interests of top managers and owners (Jensen & Meckling, 1976, Fama & Jensen, 1983, Mehran, 1992) in case top managers engage in self-serving behaviours and make decisions suboptimal from owners' point of view. Academics refer to executive compensation as a mechanism of corporate governance. The solution to the separation of ownership and management functions, or the agency problem, is to determine executive pay based on the shareholder's wealth. Implementing incentive compensation in the form of variable pay for performance minimizes the agency problem through linking executive pay to shareholders wealth. Executive's compensation package is to be structured on different basis, regarding on its intended purpose. The focus of this research was to determine the structure executive compensation packages among public limited companies in Croatia in order to comment on the role of executive compensation within corporate governance. Considering the two tiers corporate governance system present among Croatian firms with formally separated executive directors and supervisory board, the focus of this

paper includes compensation for executive directors only. The corporate governance in the Republic of Macedonia gained in significance in parallel with the process of privatization. This is when the companies started to get privatized and it became obvious that for the general economic development and growth it was not only important to denationalize the state-owned companies, but it was also important to have a proper system of corporate governance, which would preserve and add value to the companies. It became obvious that the type of management control, supervision and reporting and the transparency of the whole process do matter for the wellbeing of the companies. Corporate governance is often seen as a major obstacle to business in Central and Eastern Europe (CEE). Corporate governance refers to mechanisms that ensure that managers act in the owners' best interest. In the transformation from central plan to market economy, privatization had a central place in policy agenda, yet the transfer of ownership alone does not suffice to create appropriate incentives for managers.

According to the literature, corporate governance mechanisms are seen as an indicator which has already established link to gross domestic product and foreign direct investments. Corporate governance is a concept of particular importance for transition economies. Due to different privatization methods used and the philosophy of the political forces leading the process in these countries, corporate governance has its own characteristics. Moreover the particular features of development, culture and other factors have an influence on corporate governance systems on their application. The implementation of corporate governance in transition economies, where Albania is one of the countries that have implemented such corporate governance principles, require a suitable legal framework and relevant protection of minority shareholders.

2. CEO compensation in transition economies

Publicly traded companies within transition economies often have a controlling shareholder or concentrated ownership structure. When ownership and management are arranged in this way, managers do not have as substantial power as in Anglo-American countries. This modifies the size of the agency problem and the role(s) to be given to executive compensation. Nevertheless, in these countries executive compensation is given status of classified data and lack of transparency in executive compensation limits available knowledge of executive compensation in transition economies. Central and Eastern European economies have undergone transition process which has established new ownership structure featuring also a change in managers' profile. A key feature of new markets for

executives in countries that for one or two generations practiced egalitarian compensation is the high level of compensation relative to other wage earners (Eriksson, 2005:660), often calculating pay of top managers as a low multiple of the average firm wage. There is very little systematic evidence on senior executive compensation in transition countries. We are only aware of Jones & Kato (1996) study of CEO compensation in Bulgaria followed by later Jones & Klinedinst (2006) work, Eriksson (2005) study examining managerial pay and executive turnover in Czech Republic and Slovakia and Slapničar et. al. (2005) paper on social comparison as a determinant of senior executives' compensation in Slovenia. Structuring executive compensation packages in transition economies does not necessarily follow theoretical expectations established within Anglo-American system of corporate governance where equity based compensation in the form of stock options has been considered a reason for a high growth in the overall amounts received by top executives (Jensen & Murphy, 2004).

Slapničar et al. (2005) within their paper reveal some facts on senior executive compensation in Slovenia. The institutionalized Criteria on Senior Executive Pay approved by several Slovenian associations and chambers defines fixed salary of CEOs as the sum of the average employee salary and average salary in the economy multiplied by 4 for large companies, by 3 for medium companies, and by 2 for small companies. The criteria suggest that on the top of fixed salary a maximum bonus of 25% is to be paid if a company performance exceeds the one of the industry measured as net earnings, ROE, increase of export and increase of retention of employment level. Authors argue that the average amount of senior executives' compensation bonus typically comprises around 10-15% of the total compensation according to earlier researches available, although in-depth interviews with senior executives revealed that variable part is practically non-existent. In about 25% of the sampled companies the second performance-

contingent part of compensation is managerial profit sharing; subject to year-end negotiations between managers and Supervisory Boards, often with no predetermined relation between corporate performance and managerial share in profit. The study performed (based on 2003 questionnaire) revealed that firm performance does not influence executive pay but its power is contingent upon other characteristics of corporate governance such as ownership concentration and managerial entrenchment. On average, senior executive pay exceeds the employees' pay by 5,8 times.

Jones & Kato (1996) argue that in Bulgaria during 1995 the annual CEO compensation was about 3,07 times the average workers wage, as such being rather lower than what has been reported for western countries. Exploring pay for performance for Bulgarian CEO's revealed that the only performance variable which is found to influence changes in CEO pay is total assets. However, this pay for performance sensitivity appears to be rather modest, amounting to 0,004% change in CEO pay for every 1 growth in assets. The absence of pay-profitability relationships (profits, ROA or profit margin) according to Jones & Kato (1996) suggest that executive compensation is still largely structured so as to provide incentives for managers to increase size (or resist downsizing) and pay no attention to profitability. Eriksson (2005) in his paper wrote about managerial pay in Czech Republic and Slovakia. In Czech Republic CEOs earn 60-80% more than the other executives at the next level of the hierarchy in the firm, whereas Slovak CEOs earn 30-40% more than the consecutive managerial level. Managers in Czech state-owned firms obtain the same pay as in privately owned firms, with the impact of ownership being larger for Slovak managers. Czech managers have reasonably strong incentives to increase profitability of companies they are heading as there is a statistically significant and a positive relationship between the changes in pay and change is corporate performance measured in profit/sales.

Table 1. Description of senior executive compensation in transition economies

- Ratio senior executive pay to employee pay: 5,8 (Slapničar et. al., 2005) - Bonus to total compensation of senior executives: 15% (Slapničar et. al., 2005) - In about 25% of the sampled companies the second performance- contingent part of compensation is managerial profit sharing - Stronger ownership concentration does not bring to a stronger link between pay and performance (Slapničar et. al., 2005)	- During 1995 the annual CEO compensation was about 3,07 times the average workers wage (Jones&Kato, 1995) - The only performance variable which is found to influence changes in CEO pay is total assets (sensitivity of 0,00004) (Jones & Kato, 1996)	- CEOs earn 60-80% more than executives at the next level of the hierarchy in the firm (Eriksson, 2005) - Managers in Czech state-owned firms obtain the same pay as in privately owned firms (Eriksson, 2005) - statistically significant and a positive relationship between the changes in pay and change is corporate performance measured in profit/sales (Eriksson, 2005)	- CEOs earn 30-40% more than executives at the next level of the hierarchy in the firm (Eriksson, 2005) - Ownership structure affects executive compensation (Eriksson, 2005)
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There is an obvious lack of comparative analysis of executive compensation in transition economies due to lack of relevant data transparency and especially methodological consistency. Although prior mentioned studies are not based on the consistent dataset, given the general scarcity of studies on executive compensation in these countries they provide at initial information on the conception of executive compensation in this area.

3. Methodology of research

This paper explores executive compensation among public limited companies in Croatia. The actual study of executive compensation among public limited companies quoted on Zagreb Stock Exchange included triangulation approach. Preliminary phase of the research was performed through several interviews with public limited companies' CEOs, followed by a questionnaire survey. The preliminary phase revealed that Croatian CEOs' are not willing to reveal any information of the exact monetary value of compensation amounts received in different forms of compensation, even for academic purpose. They were willing to discuss compensation setting processes, the components of the compensation package, and their perceptions of the ideal compensation package, however, questions about the exact monetary value of

specific compensation components were not answered.

A questionnaire survey was sent out to all public listed firms in Croatia. In the period from December 2010 through February 2011 a response rate of 18,44% was achieved. The aim of the survey was to detect the components of the compensation package for Croatian managers with relative proportions of different components in the package in 2009. Also, it included questions on executive compensation negotiations, influence of different parties in the executive compensation negotiation processes, changes in compensation etc. The nature of these data is inevitably executive perception.

Respondents to both qualitative and quantitative research were executive directors, meaning executive members of the board of directors. There were 78,95% male respondents and 21,05% women.

The average ownership concentration indicators are shown in the following table. The data show a highly concentrated ownership structure since the average ownership percentage of the largest shareholder averages to 55,23%. Average ownership concentration for top five owners according to ownership amount averages to almost 80%. State ownership is quite widespread among public limited companies in Croatia since the average amount of state ownership among sampled firms is 10,8%.

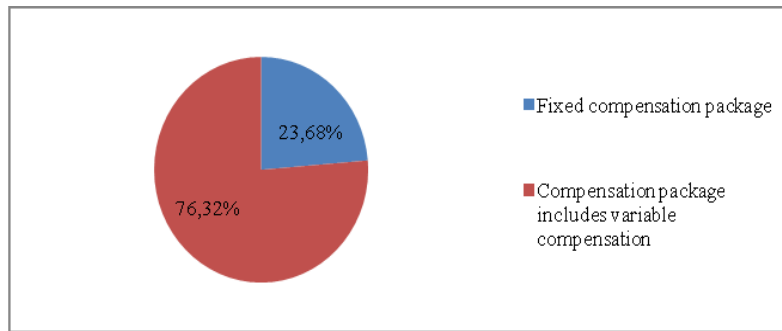
Table 2. Description of ownership structure for sampled firms

Ownership indicator	Mean
Ownership amount of top blockholder	55,23%
Ownership concentration (5 major owners)	79,93%
Ownership concentration (10 top owners)	85,75%
State owned	10,80%
Owned by institutional investors	14,52%
Owned by foreigners	12,10%

4. Executive compensation in Croatia

The exploration of executive compensation packages among Croatian managers was based on the relative amount of compensation received by top managers. As seen from Figure 1, 23,68% of examined firms did not implement any form of variable or incentive compensation, providing only fixed compensation to their executives. Additional research has shown a

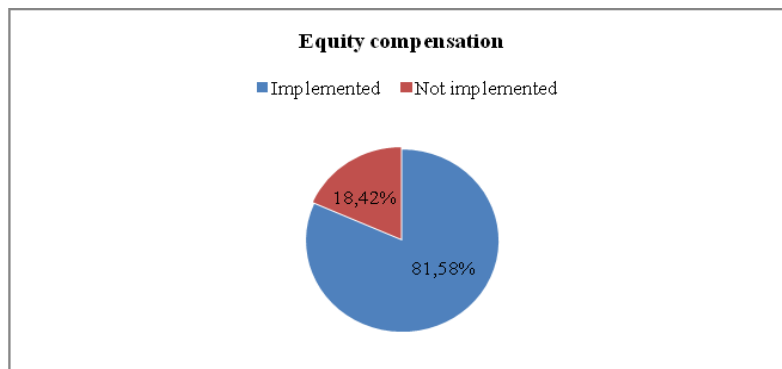
strong ownership concentration among these firms: these firms have a single controlling shareholder, either the state or a known private owner. In the context of corporate governance, such compensation packages do not have as strong impact on executive motivation and behaviour as variable compensation, and the role(s) it can take within corporate governance are doubtful.

Figure 1. The use of variable compensation among Croatian firms

Equity compensation in the form of stocks, stock options and other forms of equity compensation (performance shares, restricted shares, phantom shares, SARs etc.) explicitly ties owners' and managers' interests and thus is generally known for forming the largest part of long term compensation. The use of equity based compensation had a massive increase in the past, this trend was created mostly in the USA where in the beginning of the 21st century almost 63% of total compensation package was paid in the form of equity compensation, a trend followed by European countries (Kaplan, 2006: 38).

The percentage of equity based compensation to the executive's total compensation package should not be so large as to cause the executive to focus only on the price of the company stocks while neglecting

the operational performance. Our data show that at the time of the research, equity compensation was a marginal component of executive compensation for Croatian firms. Equity compensation as a component of the compensation package was used by only 18,42% of all examined firms. However, we must emphasize that the research was performed during the global economic crisis, which might have had an impact on these findings for Croatian managers. The survey revealed the structure of the overall compensation packages for Croatian top managers in 2009. The total compensation amount received by Croatian executive board members in 2009 included an average of 82,92% of fixed pay and 17,08% of variable pay.

Figure 2. The use of equity compensation among Croatian firms

With 76,32% of firms in Croatia that employ some form of variable compensation and 18,42% of firms that use equity based compensation in the

following step we explored the exact structure of the compensation package for top executives.

Table 3. Descriptive statistics of executive compensation in Croatian firms

	% of total compensation in 2009			
	Fixed compensation (basic pay)	Variable compensation	Cash bonus	Equity based compensation
Average	82,92	17,08	13,34	3,47
Median	80,00	20,00	12,50	,00
Std. dev.	14,026	14,026	12,600	10,547
Variance	196,723	196,723	158,772	111,229
Minimum	43	0	0	0
Maximum	100	57	50	57

Variable pay can be paid out in the form of cash bonus or equity based compensation. Cash bonus amounted on average to 13,34% of the total compensation package. At the same time equity based compensation in the form of stocks and stock options was more an exception than the core component of compensation packages. Equity based compensation on average amounted to only 3,47% of the total compensation package. Still, as can be seen from Table 3, overall variance in executive compensation was pretty high, as the maximum amount of equity based compensation was 57%. Unlike USA, Continental Europe is generally known for its disinclination to excessive executive compensation. Mahoney (1979) suggested that the differential in

compensation judged appropriate for adjacent hierarchical levels in the organization hierarchy is approximately 30- 40%. He infers that corporate compensation practice reflects social perceptions of differences in rank and evolves to a structure of relationships consistent with social norms of rank differentials. The ratios vary somewhat from one industry to another. Horizontal and vertical pay disparity can have economic and behavioural effects (Henderson & Fredrickson, 2001). We still lack unified empirical evidence on the relationship among the size of the disparity and corporate performance, and whether it is low or high pay disparity that is related to better performance results.

Table 4. Executive to average firm pay

Pay ratio	Percent (%)	Cumulative percent (%)
2:1	18,4	18,4
4:1	31,6	50,0
6:1	21,1	71,1
8:1	18,4	89,5
10 or more:1	10,5	100,0
Total	100,0	

Analysis of CEO pay disparity in Croatia revealed that vertical pay dispersion in Croatia is comparable to other transition economies; however lower than among Anglo-American countries. In most cases (31,6%) the ratio of executive pay to average firm pay amounts to 4:1. The ratio of executive pay to average firm pay of 10 or more to 1 is found among only 10,5% of examined firms. Cumulative percentages show that half of sampled firms have executive pay that is up to 4 times greater than the average firm pay.

5. Discussion

Agency model postulates that the separation of ownership and control functions creates circumstances for a potential conflict of interest among management and owners in case executives' decisions are suboptimal from shareholders' point of view. The same theory suggests that this conflict of interest can be reduced through executive compensation system, management share ownership or by corporate control. Control over executive behaviour is dependent upon established system of corporate governance; prominent mechanisms of corporate governance can have different impact on executive and firm behaviour (Shleifer & Vishny, 1997). Core issue within corporate governance is the establishment of mechanisms that will assure executive behaviour in firm's best interest, with executive compensation being recognized as one of such mechanisms (Zajac & Westphal, 1994, Beatty & Zajac, 1994). In the agency setting the extent of the potential conflict of interest among managers and

owners is influenced by the firm ownership structure. Ownership concentration is one of the key distinguishing factors among Anglo-American and continental system of corporate governance.

Traditional view of corporate governance is based on the assumption of dispersed ownership, an attribute of the Anglo-American system of corporate governance. However, the foundations on which continental system of corporate governance developed, including South-Eastern European post-transition economies (Croatia included) do not share this feature (Lubatkin et al., 2005; Pederson & Thomsen, 1997). Continental systems of corporate governance with concentrated ownership have different set of fundamental problems and corporate governance features. The issue here is not how to discipline executives but how to protect minority shareholders (Enriques & Volpin, 2007).

The amount of research addressing the question of how executive compensation affects managerial decision making and firm outcomes is minimal in comparison with the large volume of work on pay-for-performance relations (meta-analyses by Gomez-Mejia & Wiseman, 1997; Devers et. al., 2007). Thus it is unrewarding to comment on the components of the optimal compensation package. Optimal compensation package should be structured taking into account all potential determinants of executive compensation, such all those related with economic or governance conditions and the manager itself.

The structure of the executive compensation in Croatia, as found with this research, is consistent with executive compensation in other transition economies, especially Slovenia. However, these compensation

packages vary greatly in comparison to the compensation packages in Anglo- American countries. The most important compensation component in Croatia is fixed compensation (82,9% of the total compensation package). The relative amount of fixed pay differs among countries, however it is still worldwide the core component of the compensation package and this information is not unusual. However, there are 23,68% of Croatian public limited firms that offer only this form of compensation that has a low incentive potential to motivate executives to take desirable actions.

Assigning a role to executive compensation within corporate governance would request for compensation components to modify executive behaviour in a manner so that they behave as owners themselves would do. Fixed compensation does not bring to this goal as from manager's point of view it is a risk-free form of compensation that is granted during certain period (Wiseman & Gomez-Mejia, 1998:140) and the only incentive related to basic pay is that losing management position would infer losing fixed pay as well (Van Herpen et al., 2005).

Examining relationship among pay and performance is mostly performed as confirmatory analysis, measuring compensation as a reward for prior performance, or as a means of ex post setting (Fama, 1980). Furthermore, most cases assume a linear relationship among executive compensation and firm performance. Very limited research covers the issue of consequences that executive compensation packages create to firm performance. For example, Hayes and Schaefer (2000) show that current CEO compensation can serve as an indication of future return to equity. Still we find the issue of relationship among executive pay (amounts and structure) and behaviours to be under researched compared to the importance of executive's actions. Pay for performance is implemented among Croatian firms, variable compensation on average amounts to 17,08% of the total compensation package. Considering the possibilities for monitoring from share block holders through their representation in the supervisory boards this relative amount might satisfactory for corporate governance purposes.

5.1 Corporate governance in Macedonia

"Corporate governance deals with the rights and responsibilities of a company's management, its board, shareholders and various stakeholders. How

well companies are run affects market confidence as well as company performance. Good corporate governance is therefore essential for companies that want access to capital and for countries that want to stimulate private sector investment. If companies are well run, they will prosper. This in turn will enable them to attract investors whose support can help to finance faster growth. Poor corporate governance on the other hand weakens a company's potential and at worst can pave the way for financial difficulties and even fraud." *OECD, OECD webpages*

There were several researches that were conducted in the Republic of Macedonia on the topic of corporate governance. This topic was commissioned to be analyzed by EBRD, IBRD and IMF, especially through the Report on Observance of Standards and Codes (ROSC) report, IFC, Foundation for Open Society in Macedonia, OECD, USAID etc. They were all assessing to some extent what the corporate governance status in the Republic of Macedonia was. Many of them and more specifically the ROSC Report in 2005 examined the level of achievement of the 6

OECD corporate governance principles in the Republic of Macedonia:

- Framework for effective corporate governance;
- Shareholders rights and basic ownership functions;
- Equitable treatment of shareholders;
- Stakeholders' role in corporate governance;
- Disclosure and transparency; and
- Board of directors' responsibility.

There are several institutions involved in developing and maintaining the corporate governance framework. Probably the crucial ones are the Security Exchange Commission, the Macedonian Stock Exchange and the Central Depository. There are other organizations, such as Institute of Directors, Association for protection of shareholders' rights "Shareholder 2001", Corporate Governance Council, Institute of Auditors, Council for Supervision of Audit, Chamber of valuers etc.

Macedonian legislation defines the following forms of companies:

- General Partnership;
- Limited Partnership;
- Limited Liability Company;
- Joint Stock Company; and
- Limited Partnership by Shares.

Table 5. Comparative analysis of companies

Feature	Listed companies		Publicly held companies	Other companies
	Super listing	Stock Exchange		
No of shareholders	At least 200	At least 100	At least 50	At least 1
Foundation capital	At least 10 mil. €	At least 0,5 mil. €	At least 1 mil. €	At least 25/50 thousand €
Shares for public	At least 20%	At least 15%	No requirement	No requirement
Scope of disclosure	Maximum: Corporate Governance Code is obligatory	Maximum: Corporate Governance Code is obligatory	According to the Company Law and Securities Law	

The main bodies of the joint stock companies are the shareholders' Assembly and the managing body/ies. The Assembly is not a managing body. The type of managing bodies depends on whether the Company has a one-tier or two-tier managing system. The one-tier managing system has a Board of Directors and a Director. The Board of Directors can have at least 3 and at most 15 persons. They are nominated by the shareholders' Assembly. The Board of Directors has two types of members: executive and non-executive members of the Board. One fourth of the non-executive members need to be independent members. The non-executive members control and supervise the work of the executive members of the Board. The non-executive members nominate the President of the Board from the non-executive members. The two-tier system has two managing bodies: Supervisory Board and Managing Board. The Supervisory Board members are nominated by the Shareholders' Assembly. The Supervisory Board can have between 3 and 11 members. One fourth of the non-executive members need to be independent members. The Supervisory Board has the leading role within the corporate governance system. The Supervisory Board defines the mission and the objectives of the company, it takes care of the interest of the company; it takes care of the protection of the shareholders and controls and supervises the members of the Managing Board and the managers of the company. The managing body, or the Supervisory Board of the Company can decide to establish various committees, the activities of which will be to assist in the decision making process and the information that will nurture the decision making process. The Company Law recommends that such committees are established and the Corporate Governance Code defines which committees might be established: audit committee, remunerations and rewards committee and elections and nominations committee. The Banking Law provides for mandatory establishment of audit committee in the banks. As of 2010, the Audit Law provides for mandatory establishment of audit committee in all joint stock companies, which have special disclosure obligation. The majority of the Audit Committee should be members of the Supervisory Board. The Audit Committee should

have at least five members. At least one of them should be experienced in audit and accounting. As already discussed, the provision for the Audit Committee was not transferred to the Company Law, so that it has still not been implemented. In addition to the committees, the companies can nominate persons, internal legal advisors, or corporate secretaries that would take care about proper implementation of the legal and statutory requirements of the managing bodies. This role has practically not been developed in Macedonia yet. The regulation on management and governance defined in laws and by-laws is very much harmonized with the best practices. However, in practice, there are deviations and the board responsibilities area is one such area. On "paper" everything is as should be. The major drawback is the fact that the non-executive directors and the members of the supervisory boards seem not to be aware of their responsibilities and many of them do not possess the skills and the expertise on how to perform their duties for the wellbeing of the companies they are governing.

5.2 Corporate governance in Romania

Corporate governance systems have been reformed through the issuance and the adoption of best practice codes. The implementation of corporate governance principles into the practices of enterprises is a non-mandatory practice, but it is subject to market pressure for conformance. As we speak, there are more than 180 corporate governance codes worldwide, which have a great degree of similitude and convergence regarding their formulations and content (Aguilera, Cuervo-Cazurra, 2004, pp. 417-446). Corporate governance is recognized as a key element in attracting investment and increasing economic performance and competitiveness in the long term. Globalization of financial markets has contributed to reducing the gap between advanced and emerging economies, in terms of corporate governance implementation. However, due to cultural, economic and social factors, emerging economies cannot yet speak of a comprehensive approach, especially when compared with developed economies. In Romania, corporate governance has

emerged in its regulatory and conceptual form 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. The new code is applied voluntarily by companies traded on a regulated market operated by the BSE. The indicators used in this study are derived from attributes of the Board of directors: the size and structure of the Board, the independence of directors, the separation between the chairman of the Board and the executive officer, as well as the degree of disclosure in relation to these elements.

5.2.1 The size of the Board of directors

The number of members in the Board depends, in principle, on the relevant regulations specific to each country and to the sector to which the company belongs. The analysis conducted by Maier (2005, p. 8) reveals a great diversity concerning the size of the Board, with an average number ranging from 7.2 in New Zealand to 22.8 in Germany.

The BSE governance code provides that the Board must have a membership that guarantees the efficiency of its ability to monitor, analyze and evaluate the work of directors, as well as the fair treatment of shareholders. For companies in the sample, the average number of Board members is six. This average number is consistent with the Romanian Company law which provides for a minimum of three and a maximum of 11 members. Romanian average is lower than the European average of 12.5 members (Albert-Roulhac, Breen, 2005, pp. 19-29), a result which can be explained by the size of local companies and their ownership structure.

5.2.2 The structure of the Board of directors

Three indicators were used to analyze the structure of the Board: internationalization, age and diversity of members. Results showed that, in Romania, the share of foreign members of the Board of directors is 16%. Although the value is identical to the European average (Albert-Roulhac, Breen, 2005, pp. 19-29), it should be noted that only three of the 15 sample companies have foreign citizens as members. Moreover, for two of the three companies, the percentage of foreign members is over 70%, which is explained by the weight that foreign capital plays in these companies. The average age of Board members is 51 years. Board member's average age is 55 in Europe. On average, directors have been 5.6 years on the same Board, which is higher than in Romania (around four years).

5.2.3 The frequency of Board meetings

BSE governance code sets the minimum frequency of Board meetings. These should meet whenever necessary for the effective discharge of its

responsibilities but it is advisable to have at least one meeting per quarter. The frequency of meetings for companies in our sample is six per year. In Europe, the average frequency of meetings for two-tier Boards is 6.7, while for unitary Boards it is 9.3 meetings (Albert-Roulhac, Breen, 2005, pp. 19-29).

5.2.4 The independence of Board members

The BSE Code of corporate governance states that the Board structure should ensure a balance between executive and non-executive members so that no person or group of people can dominate, in general, the Board's decisions. Moreover, a sufficient number of board members must be independent directors, meaning that they should not have or have recently had, directly or indirectly, any business relationship with the issuer or persons involved, of such importance to influence the objectivity of their opinions. The analysis carried out on companies listed on BSE showed that 27% of them are reporting a high degree of independence of the Board of directors, while for 53% this attribute is lacking. Twenty percent of companies did not provide information on board independence. Analysis carried out by Maier (2005, pp. 9-10) showed the average percentage of board independence on a scale ranging from 1.5% in Germany to 81.3% in Switzerland. According to the BSE Code of governance, the Board should establish an audit committee to assist in fulfilling the Board's responsibilities in the matter of financial reporting. This committee should be composed exclusively of non-executive directors and should also contain a sufficient number of independent directors. For our sample, 80% of companies did not ensure independence of the audit committee. The other companies did not provide relevant information to make an objective analysis on the independence of audit committee members. The study by Maier (2005, p. 10) found, on average, a degree of independence of the audit committee of 64.5%, varying from 4% in Japan to 95% in Canada, US, Ireland, UK, Netherlands and Luxembourg.

5.2.5 The disclosure of director and executive remuneration

External users are interested, in addition to other information about the company, about the remuneration policy for board members and managers. The remuneration is the most influential factor on the level of participation directors and executive exhibit in relation to running the business. The BSE governance code provides that companies must benefit from the services of directors and executives with a good professional and ethical profile, in conjunction with a reliable remuneration policy, consistent with the strategy and long-term interests of those entities. The study by Maier (2005, p. 11), based on a sample of firms from 24 countries,

showed that disclosure of information on remuneration of Board members and directors has an average of 84%. None of the Romanian companies analyzed has disclosed information on executive or director remuneration. The absence of such information leads to an impossibility to corroborate director remuneration with Board meetings, as to compute an average compensation per meeting. In Europe, the average compensation per board meeting in 2005 was EUR 7301 (Albert-Roulhac, Breen, 2005, pp. 19-29).

Corporate governance is recognized as a key element in attracting investment and increasing economic performance and competitiveness in the long term. Globalization of financial markets has contributed to reducing the gap between advanced and emerging economies, in terms of corporate governance implementation. However, due to cultural, economic and social factors, emerging economies cannot yet speak of a comprehensive approach, especially

when compared with developed economies. In Romania, corporate governance has emerged in its regulatory and conceptual form 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. The new code is applied voluntarily by companies traded on a regulated market operated by the BSE. In this context, our research aimed to analyze a sample of companies listed on BSE, regarding the perceived importance of corporate governance principles in Romania. The collected indicators are related to attributes of the Board of directors: size, structure, frequency of meetings, independence, separation between the chairman and chief executive officer, and information disclosure.

Results showed that most sample companies do not meet the recommendations of the BSE code of corporate governance regarding the independence of directors and audit committee members. In addition, for most of the Romanian companies in our sample, the degree of transparency is much lower than that of other European companies.

There is much scope for further research in this area. Thus, the sample could be extended to companies in the banking sector, which would serve to verify if the situation is the same with entities from the financial industry. In addition, one could explore the incentives behind the Romanian companies' decision to implement the recommendations of the code of governance. The corporate governance impact on performance could also be established through a quantitative research employing other contextual predictors (economic, political, social, and cultural) of company performance.

5.2.6 Albania

Albania is a developing country that is still undertaking structural, economic, social and legal reforms –most in light of the country's EU integration process. However, despite accomplishments to date, the country is still stuck in the long-lasting transition that started in year 1992.

With regard to the corporate governance legal framework, the main legislation includes:

- Company Law
- Public takeover law
- Securities Law
- Registration and Disclosures Law
- Banking Law
- Accounting and Financial Statements Law
- Certified Accountants Law

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Conclusion

Governance provides the structure through which corporations set and pursue their objectives, while reflecting the context of the social, regulatory and market environment. Governance is a mechanism for monitoring the actions, policies and decisions of corporations. Governance involves the alignment of interests among the stakeholders (*from Wikipedia, the free encyclopedia*).

Corporate governance has also been defined as a system of law and sound approaches by which corporations are directed and controlled focusing on the internal and external corporate structures with the intention of monitoring the actions of management and directors and thereby mitigating agency risks which may stem from the misdeeds of corporate officers. In contemporary business corporations, the main external stakeholder groups are shareholders, debt-holders, trade creditors, suppliers, customers and communities affected by the corporation's activities. Internal stakeholders are the board of directors, executives, and other employees.

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The study contributes to the evidence of compensation practices in European (post)transition economies. We showed a concentrated ownership of Croatian firms, where we can expect owners of larger share parts to take the effort in firm governing and constrain managerial discretion. In such circumstances with stronger shareholder monitoring the need for executive compensation to take additional roles (besides direct remuneration for the effort and time employed) is lower than in Anglo-Saxon countries. Our data show that there are similarities in executive compensation in (post)transition economies which is consistent with the recognized relationship among executive compensation and corporate governance system. Among public limited companies in Croatia, fixed compensation in the form of base pay is the most important compensation component. On average, it amounts to 82,9% of the total compensation package. Incentive compensation (on average 17,1% of the total compensation package) is paid out either as cash

bonus or equity based compensation, with cash bonuses amounting to 13,3% of the total compensation package and equity based compensation 3,5% of the overall compensation package. We can expect that among 76% of examined Croatian firms with implemented incentive compensation executive compensation can take additional roles within corporate governance.

There is some evidence that when a country's overall corporate governance and property rights systems are weak, voluntary and market corporate governance mechanisms have limited effectiveness. But only a few studies have analyzed how to enhance enforcement in such environments. In general, enforcement needs to be studied more to find answers to the following questions:

What is the role of voluntary mechanisms? More evidence is needed on how voluntary mechanisms (such as cross-listings, codes of best practices, or international accounting standards) can be most valuable. The interaction of cross-listings with domestic financial development is a further potentially useful research area, since it could be that cross-listing undermined domestic financial sector development.

What is the corporate governance role of banks? In many countries, banks have important corporate governance roles, because they are direct investors themselves or act as agents for other investors. And, as creditors, banks can see their credit claim change into an ownership stake, as when a firm runs into bankruptcy or financial distress. Enhancing banks' corporate governance in specific ways may thus be an effective means of improving overall corporate governance. One area of focus of the Financial Stability Board and others has been the design of compensation for traders, risk managers, credit officers, and others in financial institutions (see Financial Stability Board 2009).

Note: The view on corporate governance in transition economies. Executive compensation in Croatia. Corporate governance in Macedonia and Romania, is a paper that has a lot of information about corporate governance in transition economies and presented at the conference in Rome, Italy (October 17-18, 2013).

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