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CORPORATE GOVERNANCE IN CONSTRUCTION COMPANIES IN CENTRAL AND EASTERN EUROPE

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Abstract: *For the economies of the Central and Eastern European (CEE) region, the decade preceding the financial crisis was a period marked by rapid growth. Foreign investors had been investing widely throughout the region, whilst local entrepreneurs were also growing their businesses quickly. The impetus for this growth and development came in part from the privatisation and deregulation of many areas of business, as well as EU membership, which helped to facilitate cross-border trade and open up new financing opportunities for local companies. Against this background of rapid growth, considerations of proper corporate governance often took a back seat in the race for market share and profit, particularly in the absence of co-ordinated pressure from investors, or any consistent drive by regulators and governments to prioritise this area. For anyone who is familiar with the corporate governance environments that have developed in recent years in other markets, the corporate governance picture in the CEE region looks markedly different in a number of ways. The key reasons for this are the relatively short histories of the CEE countries as market economies and the absence of powerful investor groups across the region. In the case of Romania and Bulgaria, relatively recent EU accession has also meant that these jurisdictions are still in the process of adapting themselves to take account of EU-led initiatives such as the European Action Plan on Company Law and Corporate Governance, as well as relevant legislation such as the Transparency and Prospectus Directives.*

Paper/Main text: More recently the global financial crisis has served to remind policy-makers and businesses in the CEE region, as elsewhere, that there is always a balance to be struck between allowing companies to operate as freely as possible from the burden of compliance, and the need to protect the interests of investors (or other stakeholders) against the abuse of power by corporate insiders. Even so, the corporate governance picture in the CEE region has not changed a great deal since the onset of the crisis, in part because the attention of both businesses and regulators has again been diverted by the need to keep individual businesses – and the wider economy – afloat, against a background of high borrowings, withdrawal of credit and foreign investment and the drying-up of the formerly lucrative construction and foreign export markets.

Establishing a proper understanding of governance is the first prerequisite to the construction of a governance framework for the construction industry. Governance is not the sole preserve of either government or corporations: governance has to do with how relationships within societies are regulated. These relationships include how governments and social organisations interact, how they relate to citizens, and how decisions are taken in a complex world (Graham et al: 2003).

Governance is therefore a dynamic interaction at global, national, institutional and community level. A significant characteristic of the globalising world is the dynamic shifting of relationships within the four sectors of society situated among citizens at large (business, the institutions of civil society, government and the media) both intra- and internationally. In many countries, governments are transferring many of their functions to national and multinational businesses either as part of a global trend toward privatisation e.g. infrastructure, or through Foreign Direct Investment (FDI) patterns. The relationship between governments and civil society is going through a similar transition driven, in part, by the notion of Public Private Partnerships (PPPs). In most countries globalisation is reconfiguring states and shifting power across borders into a broader regional context.

The European Commission has expressed its commitment to developing an ongoing competitiveness strategy for the construction sector. It states that the competitiveness of the European Construction sector relies on the following factors:

- the commitment of market operators towards a better quality policy;
- sustainable development objectives;
- research and innovation activities;
- improved skills and qualifications of its workforce and management. (European Commission, 2009b)

The Building and Construction industry, like every industry, is exposed to investment capital competition, globalisation, investor activism and risk. This means that sound corporate governance is of central importance to its economic, social and environmental performance. More broadly, sound governance in the construction industry is important to society because construction is a key developmental industry with widespread social economic and environmental responsibilities (van Wyk and Chege, 2004). The industry is charged with creating and maintaining the built environment, which consists of homes, workplaces, schools, hospitals and other public amenities as well as essential infrastructure such as roads, water and electricity and telecommunications essential for our day to day living (ABS, 2007). Furthermore, the industry’s products account for 23% of total greenhouse gas emissions, it directly employs about 875,000 people, represents about 6% of GDP and invests about $158bn each year on new construction. In particular, the increasing trend for procurement of public services via public-private partnerships that place the delivery and management of critical public infrastructure and services in private company hands, has brought issues of sound corporate governance to the fore (PPP Forum, 2008). PPP projects such as the Sydney airport rail link, Sydney Harbour Tunnel and the recent $900m redevelopment of the Royal Children’s Hospital in Melbourne demonstrate the public significance of the projects being undertaken.

Given the above, it is surprising that the issue of corporate governance in the construction industry has received little attention. One notable exception is the work of Chang et al. (2006) who investigated the relative compliance of CEE listed construction companies with the disclosure requirements of the CEE Combined Code compared with the top 50 companies listed in CEE. Their research determined that CEE listed construction companies: (1) demonstrated lower levels of disclosure of corporate governance information than the top 50 group, (2) had lower levels of board independence based on the separation of the CEO and chairperson position and independence of directors, and (3) made less use of external consulting services for advice. They noted that the disparity between the construction group and the top 50 group was a concern which could potentially lead to adverse effects on the construction companies' performance.

Fundamental to the corporate governance structure of any organisation is the board of directors. This is the body, elected or appointed by the shareholders, to act on their behalf in directing and controlling the affairs of the organisation (Matheson, 2004). The board of directors must satisfy a range statutory, common law and fi duciary responsibilities to the shareholders, other stakeholders and the organisation itself (Lawler III et al., 2002). This includes ensuring compliance with all relevant legal and regulatory requirements and promoting organisational performance. The latter is achieved through advising the CEO in the formulation of strategy and direction, evaluating CEO and senior manager performance, the acquisition and allocation of key resources, setting policies that guide and constrain management action and organisational culture, ensuring systems are in place to manage risk effectively, and ensuring the continuous improvement of the organisation's performance through constant monitoring and supervising of executive management (Scherrer, 2003; Nadler, 2004).

Directors are elected to boards for their industry or general business experience and expertise that they are expected to bring to the organisation in the form of advice and guidance for the CEO and the other members of the executive management team (Colley et al., 2003). Despite considerable research into the performance implications of board composition, it seems the only conclusion to draw is that there is no 'best practice' when it comes to board composition (Ingley and van der Walt, 2003; Matheson, 2004). It is widely accepted that board size is a refl ection of three key factors (Kiel and Nicholson, 2003): the size of the organisation (board size increases as organisation size increases); the type of organisation (listed organisations tend to have larger boards); and the organisational structure (as more diversifi ed organisations require representation from a wider array of business units and regions). The size of the board should be large enough to provide required skills and experience, yet small enough to ensure effi cient interaction and director participation (Murphy and McIntyre, 2007).

Kolk and Pinkse (2006) and Glass and Simmonds (2007) focused specifically on stakeholder management and community relations practices respectively within the construction industry through case studies. The latter have identified that often, the employees of construction companies lack knowledge and training when dealing with the community. Lingard et al. (2008) have analysed one specific issue of ethical human resource management from the point of view of the employees.

In the analysis presented so far, ownership concentration arises because corporate insiders cannot commit not to take advantage of outside shareholders. Corporate insiders would be better off if, at the time they sell securities to the public for the first time, they could commit not to take advantage of outside shareholders. Unfortunately, their ability to make such a commitment depends on the institutions of the country in which the firm is located. In this conclusion, some issues associated with corporate governance reform are discussed.

As first stressed by Bebchuck and Roe (1999), incumbents who have already sold securities find governance reform that makes it harder for them to consume private benefits expensive. The incumbents have paid for their private benefits by selling securities at a lower price. Reform that makes it harder for them to consume these benefits means that they paid for the benefits in full. Insiders will only find reform valuable if it allows them to sell part of their stake, so that they can diversify their holdings, and if it enables them to sell securities at a higher price. Above that the main issues in Corporate Governance for the CEE region remain low transperency,corruption, briberies and local legislation issues.

Equal treatment in gender as well as other disadvantaged groups also seems to be an issue seen from “outside”, as surveys show little effect on job satisfaction (Merllié, Paoli, 2002). Construction has the highest gender employment gap and a significant gender pay gap compared to EU average, especially in low pay areas (Eurofound, 2002). Strong discrimination can be found concerning ethnic minorities: low skilled, low paid, precarious, and sometimes illegal conditions are overrepresented among migrant communities (Byrne et al., 2005). On disabilities, the sector tends to be one of the major “producers” of disabled persons, but tends to “export” them into other sectors and early retirement (Newton, Ormerod, 2005). Nevertheless, perceived equal treatment is slightly positive compared to other sectors (Eurofound, 2002).

The future perspectives in the construction sector in Eastern Europe are represented in the Table 1 bellow:

Table 1

Construction and its impacts on resources, like land, materials, energy, water and human/social capital	Bourdeau	1999
Future scenarios of construction in 2050, utility of future studies	Harty, Goodier, Chris, Soetano, Austin, Dainty, Price	2007
Future of performance-based building regulation, emerging threats and hazards, changing demographics	Meacham, Bowen, Traw, Moore	2005
Built environment within the context of climate change, adaption to weather extremes through microgeneration, low energy design, future advances to 2050	Roberts	2008
Housing Stock Issues, Trends towards housing forms and occupation, energy efficiency and performance, consumer demands, and technology	Ravetz	2008

Source: Construction sector- literature on future trends

In conclusion, more research and development is needed to better understand the linkages between goals, objectives, test methods, risks, design tools, and methods concerning the construction sector. Further development concepts will have to be about life cycle of the building, use, and the material needed. Future work has to be about performance-based building regulation, and must address spatial planning, changing demographics, adapted innovation in construction and building materials, and risk management in order to respond appropriately to climate change and its effects. However, the physical form of the building stock is very much dependent on the linkage between buildings, and their functions and values. Hence, the future depends on continuing flows of activity, financial investment, and cultural identity. (Meacham et.al. 2005).

In essence, the construction delivery process remains a complicated and complex delivery system involving multiple participants such as clients, financiers, developers, investors, professional consultants, contractors, subcontractors, specialists, materials suppliers, inspectors, and users in a dynamic process. Its impacts on the natural and built environment, the community in which it is located and the communities its serves, remain for decades and sometimes centuries.

The paper proposes a framework for the global construction industry that aligns construction enterprises with global characteristics of corporate governance. In so doing, it proposes a fundamental paradigm shift by all participants in the construction industry to enterprise development and management, a shift based solidly on probity and respect. The paper argues that such a commitment by industry participants could lead to an enabling environment for effective delivery and for growth, improved performance and continuous development of the industry. Good corporate governance is after all, about the values supporting excellence as well as the creation of an ethical culture.

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КОРПОРАТИВНОТО УПРАВЛЕНИЕ В СТРОИТЕЛНИЯ БИЗНЕС НА ЦЕНТРАЛНА И ИЗТОЧНА ЕВРОПА

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Ключови думи: *корпоративно управление, строителни фирми, Централна и Източна Европа*

Резюме: *За икономиките на Централна и Източна Европа (ЦИЕ), десетилетието, предхождащо финансовата криза е период, белязан от бърз растеж. Нарастват чуждестранните инвеститиции в региона, като в същото време местния бизнес нараства бързо. Поводът за този растеж и развитие дойде в следствие от приватизацията и дерегулацията на много области на бизнеса, както и членството в ЕС, което помогна да се улесни трансграничната търговия и да се отворят нови възможности за финансиране на местни компании. На този фон на бърз растеж, съображенията за правилното корпоративно управление често стояха на „задната седалка” в надпреварата за пазарен дял и печалба, особено при липсата на координиран натиск от страна на инвеститорите, или на последователен стремеж от регулаторните органи и правителствата да дадат приоритет на тази област . За всеки, който е запознат с околната среда, на корпоративно управление, което се е развило през последните години и в други пазари, картината на корпоративното управление в региона на ЦИЕ изглежда подчертано различно в редица направления. Основните причини за това са сравнително кратка история на страните от Централна и Източна Европа като пазарни икономики и липсата на мощни групи инвеститори в региона. В случая на Румъния и България, относително скорошното присъединяване към ЕС също така означава, че тези юрисдикции са все още в процес на адаптиране към ръководените от ЕС инициативи като: Европейския план за действие относно дружественото право и корпоративното управление, както и съответното законодателство, като например директивите за прозрачност.*