

# Corporate Governance and Law Enforcement in Albanian Joint Stock Companies

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Received: September 9, 2016

Accepted: October 4, 2016

Online Published: October 17, 2016

doi:10.5539/ibr.v9n11p201

URL: <http://dx.doi.org/10.5539/ibr.v9n11p201>

## Abstract

Proper implementation of CG regulations by the companies brings advantages both for companies and countries. Furthermore, the quality of legal rules determines the shape of the ownership concentration structure of the firm and, in many cases, assumes a monitoring role. In this sense for Albanian economy improving the use and enforcement of “good” CG practices will lead to higher foreign investment and soft passage towards modern economy. In this paper, we aim to analyze the evolutionary patterns of CG legal framework in Albania and, based on an application of the Delphi technique, provide development prospects considering the perceptions of a panel of Joint Stock Companies – JSCs- Chief Executive Officers –CEOs. Our essay demonstrates that CEOs expresses overall satisfaction with the CG legislation but its implementation isn't at the required levels. Additionally, larger gaps and variations exist in areas where regulations and guidelines are less demanding or enforcement is difficult.

**Keywords:** Delphi, corporate government, evolutionary patterns, law enforcement

## 1. Introduction

CG regulations across the world know that nowadays companies operate globally (*i.e.* companies have to comply with the developing standards of the market) (Aguilera & Jackson, 2010), and due to financial crisis there have been attempts to set-up supra-national governance codes. These universal standards represent common important features to “good” CG. The OECD principles suggest that a good CG framework should protect shareholders' rights; ensure the equitable treatment of all shareholders, including minority and foreign shareholders; recognize the rights of all stakeholders as established by law, and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises; ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including its financial situation, performance, ownership and governance; and ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders. According to Yuksel (2008), proper implementation of CG regulations by the companies brings advantages both for companies and countries. Following this one may assume that the quality of legal rules determines the shape of the ownership concentration structure of the firm and, in many cases, assumes a monitoring role. Improving the use and enforcement of “good” CG practices will lead to higher foreign investment and soft passage towards modern economy. In this sense, we believe that Albania, as an ex-centralised economy, will shows common features of regulation practices of this region and due to its national characteristics will adopt its own transformation of CG patterns even in difficult economic situations.

Based on this initial background, the present paper aims to: (i) understand the current state of maturity of CG legal framework (*i.e.* its evolutionary patterns); and (ii) provide development prospects based on the perceptions of a panel of Albanian JSCs CEOs. Methodologically, considering that the Delphi technique has proven over the years to be effective in forecasting trends (*cf.* Ferreira and Monteiro Barata, 2011), we believe that there is considerable scope to explore its applicability in the particular context of this study. For that purpose, our experiment involves a panel of several Albanian JSCs CEOs from the most representative city in Albania. We know of no prior work using the Delphi technique to analyze the evolutionary patterns and provide development prospects for CG legal framework. In this sense, the study contributes to current research by offering empirical results related to the application of the Delphi technique and forecasting e-Government evolutionary trends.

This paper is structured as follows: Section 2 presents the literature review; Section 3 presents a brief methodological background of the Delphi approach and justifies its application in the context of the present study; Section 4 presents the results of our investigation; and Section 5 concludes the paper.

### *1.1 Literature Review and Recent Trends in Corporate Governance*

Legal and regulatory environment is integrally related to CG due to constraints imposed to firms by law (Gillan, 2006). In every country corporate law and regulation deal with different kinds of CG potential conflict of interests such as the one between managers and shareholders, controlling shareholders against minority shareholders, and between shareholders and managers with other corporate actors such as employees or debt-holders (Aguilera and Jackson, 2003). Therefore, they can directly affect the linkage of the interests of management and shareholders. From this premise, regulation may be seen as an internal monitoring mechanism and reduces the impact of managerial decision on shareholder wealth (Booth *et al.*, 2002). Defining a good legal pattern is central to understanding that firms with better shareholders protection raise more funds from potential shareholders than to others firms (Bruno & Claessens, 2010). In fact, legal systems and Law not only protect the investors but give them power and residual control rights (*e.g.* voting rights, reorganization and liquidation rights, disclosure and accounting rules, receive dividends on pro-rata terms, vote for directors, participate in shareholders' meetings, subscribe new issues of securities on the same terms as the insiders, sue directors or the majority for suspected expropriation and book extraordinary shareholders' meetings). Firms can improve investor protection rights by increasing disclosure, selecting well-functioning and independent boards, imposing disciplinary mechanisms to prevent management, and controlling shareholders from engaging in expropriation of minority shareholders. The level of firm-level governance is strongly related to country-level measures of investor protection (*i.e.*, firms with large needs for outside financing have more incentive to adopt better governance practices in order to lower their cost of capital (Klapper & Love, 2004). Chen *et al.* (2009) find that legal protection of minority shareholders includes both the rights prescribed by laws and regulations and the effectiveness of enforcement. Diverse elements of countries' financial systems such as capital markets, the pace of new security issues, corporate ownership structures, dividend policies, and the efficiency of investment allocation appear to be explained by how well laws protect outside investors (La Porta *et al.*, 2000). Furthermore, Chen *et al.* (2009) show that the association between firm level CG and the cost of equity capital is stronger in markets that have weak legal protection of investors than in market that have strong legal protection of investors. Moreover, the premium price paid by institutional investors from around the world is higher in countries with weak legal protection of investors. There is consensus between all international bodies working on CG that regulations are not uniform across the world, and implementation, domestic circumstances and priorities should be taken into account (Yuksel, 2008; Aguilera and Jackson 2010). Different legal jurisdictions impose a diverse sort of constraints to reduce (or to enhance) the opportunism among the multiple constituencies of the firm (Aguilera and Jackson, 2010). Due to political and economic development, countries have made changes to their corporate legislation over the years (Martynova & Renneboog, 2011). Whilst substantial changes have been reported in different countries, it seems to exist two distinct legal groups of CG: *common law* and *civil law*. The former is based on jurisprudence and is commonly associated to Anglo-American countries; the latter is based on codes and is commonly associated to Continental Europe (Aguilera and Jackson, 2010). Several authors (*e.g.* La Porta *et al.*, 2000; Farolfi & Ciani, 2007; Martynova & Renneboog, 2011) agree on the fact that in the US (shareholder-based system) the main objective of corporate law is to protect corporate investors from being expropriated by the firm's management. In contrast, the systems prevailing in most European and Asian countries (stakeholder-based systems), the expropriation of investors by the management are typically prevented via monitoring by the firm's large shareholders, creditors or employees such that there is less need to address the problem at the regulatory level. For this reason, common-law grants higher minority shareholders rights encouraging dispersed ownership through developed and deep financial markets, better environment for self-regulation; while civil law offers weak minority shareholder rights and hence discourages ownership dispersion. According to La Porta *et al.* (2000) and Klapper and Love (2004), among others, cross-countries differences in laws and their enforcement affect the ownership of firms (*i.e.* firms in countries with poor investor protection may need concentrated control on the other side, and better minority shareholder protection is associated with higher dividend pay-outs). Kim *et al.* (2007) defend that countries with strong shareholder protection rights have firms with lower ownership concentrations and with more independent directors, dividend payouts availability and cost of external finance and market valuations. From this point of view, La Porta *et al.* (2000) show that the legal environment shapes the value of the private benefits of control and, thereby, determines the equilibrium ownership structures. Even in family controlled firms, as in Japan and China, which are typically managed by family members, managers appear to be kept on a tighter leash. Law and the regulation have an impact on the development of financial markets, namely in terms of bank lending development, markets' equity, number of listed firms, and rate at which firms go public). Through its effect on financial markets, investor

protection influences economy. Although the research on CG in transition economies is still in its infancy, the literature provides a basic framework for analysis. This framework identifies a number of areas in which the research has been focused and highlights a number of guidelines for dealing with CG problems in these economies (Bruno & Claessen, 2010). CG is playing a prominent role in ex-centralized economies of Central and Eastern Europe countries. Socialist countries had a legal tradition based on Soviet law (La Porta *et al.*, 2000) but recently the law of these countries has been changing rapidly. At the beginning of the implementation of CG mechanisms there was a debate on the choice between Continental and Anglo-American models, because it is not possible to “copy” an entire model into the Central and Eastern Europe context. This observation can be easily explained if we consider that the appropriate model depends on the country’s history, culture, politic and economic development (McCarthy & Puffer, 2002). Nevertheless, CG practices in these countries generally share some important features, such as weak legal and company law system. For this reason, the average firm-level CG is lower and firm-level CG provisions matter more in countries with weak legal environments (Klapper & Love, 2004). In this region, the stock market is poorly developed. Thus, active shareholder monitoring is one of the most important priority of CG. These countries have both a larger sector of state-owned enterprises and a growing private sector which face different governance problems. Ownership tends to be concentrated (Buck, 2003). “Concentrated owners”, who cannot rely on other institutions and arrangements designed to monitor and discipline managerial performance, have both the power and incentives to do this themselves. From this permise, although the separation of ownership and management is common, agency problems are likely to be tempered by direct involvement of owners in many important decisions and daily monitoring. Due to different methods of privatization that firms have chosen to implement, there have been different CG structures (Klapper *et al.*, 2006), which provide different combinations of owners and creditors’ rights and managerial incentives and autonomy. In many cases, many firms in these countries have chosen to voluntarily allow the use of self-regulation provision such as cumulative voting and proxy by mail although not prescribed by the company law or the commercial code of these countries. They do so to make themselves more attractive to large, minority shareholders (Klapper *et al.*, 2006). Following this, we can conclude that despite similarities in CG mechanisms in Eastern Countries, cross country variation will induct different corporate governance patterns and distinct relationship between shareholders and management.

The next section presents the background of the Delphi technique, which is important in understanding how the application of this method can assist in analysis of the evolutionary patterns and provides development prospects for CG law framework in Albania.

## 2. Methodological Framework: Basics of the Delphi Technique

Aiming to resolve problems for the US Air Force, the Delphi technique was developed during the 1950s by Norman Dalkey, Olaf Helmer and respective collaborators at the *RAND Corporation* (*cf.* Dalkey & Helmer, 1963; Hsu & Sandford, 2007). In broad terms, the Delphi approach begins with the development of a survey, which should be completed individually by experts on the target topic.

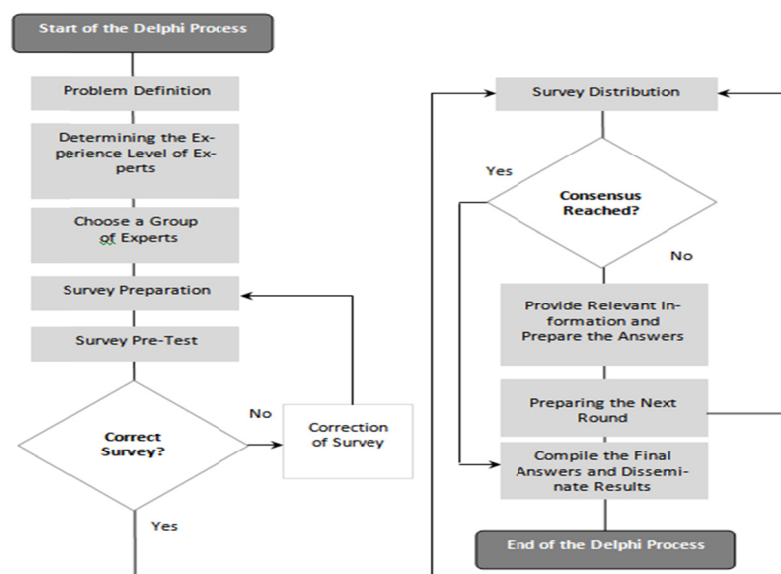


Figure 1. Operational structure of the Delphi technique (Source: Zapata *in* Ferreira, 2003, adap.)

While the method should allow for consensus, it is important to emphasize, however, that the final results should closely resemble reality. In this sense, the basic principles of a Delphi-based approach are: anonymity, controlled feedback and statistical treatment of responses. The method is mainly used when the problem under discussion cannot be resolved by precise analytical techniques, due to a lack of relevant data information about the problem, as is the case of CG practices in Albania.

The Delphi's operational structure is shown in *Figure 1* (further details can be found in Dalkey & Helmer, 1963; Hsu & Sandford, 2007; Ferreira & Monteiro Barata, 2011; Çipi *et al.*, 2014).

### 3. Results Analysis

Considering the research objective outlined for this study, the initial Delphi panel was composed of 80 CEOs from different types of JSCs (*e.g.* from banking, insurance and other financial services; both private and state-owned) located mainly in the largest cities in Albania (*i.e.* Tirana, Durrës, Fier, Vlorë, Shkodra, Tropoja, Elbasan, Gjirokastër, Lushnje & Saranda). After the first round, the number of panel members was reduced to only 37 members in the second round of the survey. It should be noted, however, that there is no ideal number of panel members for application of the Delphi technique (*cf.* Ferreira & Monteiro Barata, 2011). Therefore, responses from the 37 members in the final round provide the basis of our analysis.

#### 3.1 Sample Characterization

The reduction in the number of panelists from round to round is anticipated in the literature (*cf.* Ferreira, 2003; Ferreira & Monteiro Barata, 2011, Çipi *et al.*, 2014). Several factors can justify this reduction. In our case, the reduction in the number of panelists was mainly justified by the length of the questionnaire. As for the sample characterization, most respondents were *male* (70.3%) and between 43-47 years old (40.6%). Most of the panel members held a higher academic degree (67.6%), predominantly in economics or management (67.6%). The data obtained according to the structure of the questionnaire are presented in the next subsections.

#### 3.2 Law Obligation and Implementation

The objective of this section is to determine the level of implementation and availability in terms of law enforcement issues, the capacity of institutions and regulatory bodies in the implementation of current legislation and the impact of the implementation of this legislation in promoting the implementation of advanced standards of governance in the JSCs affected. Table 1 presents the results regarding the overall evaluation on the role of regulatory institutions in the implementation of the legislation and application of advanced governance standards in JSCs.

Table 1. Evaluation on the role of regulatory institutions in the legislation implementation [N=37]

Evaluation	(%)
Completely inappropriate	--
Low	13.5
Good	67.5
Very good	18.9
<b>Total</b>	<b>37</b>

Following the data presented in *Table 1*, we can easily see that although some panelists classified this role as *very good* (18.9%) or *low* (13.55), the most panelists consider this role to be *good* (67.5% votes). There were no negative evaluations.

In a similar manner (Table 2) presents the distribution of responses to the evaluation of the court proceedings in which the company may have been involved.

Table 2. The evaluation of the court proceedings in which the company was involved [N=13]

Evaluation	(%)
Costly	25.9
Effective	3.7
Less than appropriate	14.8
Too long	51.9
With significant impact	3.7
<b>Total</b>	<b>100</b>

The results presented in Table 2 indicate that the respondents consider the court proceeding to be too long in 51.9% of cases, costly in 25.9% of cases and less than appropriate in 14.8% of cases. Only few of them consider those procedure as effective (3.7%) and with significant impact (3.7%).

For the next question, we tried to collect information on the JSCs involvement in legal conflicts in the last 2-4 years. It turns out that 56.6% of interviewed companies have not been involved in judicial conflicts in the last 2-4 years (Table 3).

Table 3. Level of implementation of information technology and availability of informatics [N=37]

Responses	(%)
Yes	56.6
No	43.4
<b>Total</b>	<b>100</b>

In response to the question regarding the role of audit assessments in improving the internal functioning of the JSCs, most panelists see the audit's role with significant impact (51.4%). However, 27.0% say that it is *effective but costly*, while 21.6% affirm that it is very effective (Table 4).

Table 4. The evaluation on the audit role [N=37]

Evaluation	(%)
With no effect	--
With significant impact	51.4
Effective but costly	27.0
Very effective	21.6
<b>Total</b>	<b>100</b>

(Table 5) presents the overall evaluation on the bankruptcy legislation, its implementation and the impact on the protection of creditors' rights. According to the most panelists' responses they found it with intermediate role (51.4%). However 27.0% say that it has a considerable role and 16.2% say it has a *little value*. However, 5.4% found it to be with no value at all.

Table 5. The evaluation on the bankruptcy legislation and its implementation [N=37]

Evaluation	(%)
It has a considerable role	27.0
Intermediate	51.4
With little value	16.2
With no value	5.4
<b>Total</b>	<b>100</b>

### 3.3 Future Developments

This part of the survey sought to analyze the future perspectives of corporate executive directors regarding the implementation of CG.

The next question is related to experts' perceptions of the three main barriers to CG improvement (1 = main impact, 3 = third main impact). The final ranking was the following: first, insufficient legislation (42 points); second, costs of implementing and communicating CG policies (41 points); and third, lack of information or knowledge and lack of qualified specialists (40 points respectively) (Table 6).

Table 6. The barriers faced by the company for governance improvement [N=37]

Barriers	Points
Insufficient legislation	42
Cost of implementing and communicating corporate governance policies	41
Lack of information / knowledge	40
Lack of qualified specialists	40
Lack of business understanding on the part of external auditors	23
Information on governance issues of the company harms competition	21
Lack of business understanding on the part of the board	11
Lack of financial understanding on the part of senior executives	3
<b>Total</b>	<b>221</b>

Interestingly, lack of financial understanding on the part of senior executives and the board was not perceived to be a significant barrier, indicating that the board is perceived to have a good level of knowledge about the company's strategic issues.

## 4. Discussion

Law and regulation also can be used to stabilize market and increase investors' confidence by providing a highest level of disclosure. As the literature emphasizes, there are two main types of legal system: common law (associated to Anglo-American countries, and grants higher minority shareholders rights encouraging dispersed ownership through developed financial markets) and civil law (associated to Continental Europe, and offers weak minority shareholder rights and discourages ownership dispersion). Regardless the distinct types of systems law, there is a general consensus they should take into account differences in cultural, historical and legal environment. Following this, international institutions, such as the OECD, have imposed some common principles which supposedly help countries in creating confident legal environments for all stakeholders. In this

sense, this chapter has also analyzed the characteristics of CG in Central and Eastern Europe region. Following this, our essay aimed to: (i) understand the current state of maturity of CG framework in Albania (*i.e.* its evolutionary patterns); and (ii) provide development prospects based on the perceptions of a panel of JSCs CEOs.

Although the importance that represents the enforcement of legislation and regulatory framework in promoting the implementation of advanced standards of governance, especially in countries such as Albania with weak legal environments our results showed that the implementation of legislation isn't at the required levels. Overall, the survey results indicate that there is a substantial gap between the Albanian CG regulatory framework and actual implementation of those rules. Understandably, larger gaps and variations exist in areas where regulations and guidelines are less demanding or enforcement is difficult, such as supporting and evaluating outside directors and the specific functions of the board or of board committees. Furthermore, there is a predisposition for the implementation of international financial reporting standards. This finding may relate to legal requirements (2008 company law) and it is a consolidated practice at financial JSC which are brands of foreign firms. Albanian CEOs believe that company legislation is a significant obstacle to a good level of governance, but some other important obstacles remain, such as the lack of specialists in the field and the low level of awareness and understanding of the real importance of good CG practices.

Given these results, we recommend that the on-going CG reform efforts should be continued to encourage the Albanian companies to pay more attention to "content" rather than "form" (*e.g.* enhancing the effectiveness of boards by selecting better qualified and truly independent directors, assuring adequate and timely information to board members). The introduction of good laws is not a guarantee for the implementation of CG best practices. As such there should perhaps be enforcement mechanisms to ensure that companies truly comply with best practices. It is worth noting that the first and only non-mandatory code of CG was introduced recently in December 2011. A broad perspective should be adopted with regard to future CG reforms in Albania based on the stakeholder approach, which helps the development of sustainable economy.

In looking ahead to future research, it would be important to conduct studies devoted to gauging the opinions of a broader panel, and replicate the experiment and compare the results obtained in different countries. Furthermore, deeper understanding of specific cultural features and the level of institutional development in the country, will allow researchers to identify the model of CG that best suits the Albanian context.

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