

## SOCIAL RESPONSABILITY AND CORPORATE GOVERNANCE IN EVALUATING THE PERFORMANCE OF ECONOMIC ENTITIES

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### **Abstract**

*The evaluation of an entity's economic performance is often perceived by the public as being limited to the analyses carried based on a component of the annual financial statements or on a component of the profit and loss account.*

*We believe, however, that the current financial reporting system no longer offers an informational potential sufficiently high in the process of assessing the performance of an economic entity, and we sustain the large scale introduction of an additional component of reporting (voluntary or required by legal settlements) that must be seen as ethical behavior in reporting.*

*This study aims to bring to light this ethical component of reporting by analyzing the concepts of social responsibility and corporate governance, analyzing specialized literature concerning these concepts, but also how this "ethical behavior" is experienced at the level of the entities that activate in the energy sector. In other words, this approach is not an analysis of the ethics in the research of economic performance of entities, but a research of the ethical side of the performance analysis.*

*However, an important objective of this study is to analyze and assess the extent to which ethical behavior of economic entities (shown here by the application and reporting related to social responsibility and corporate governance) can influence the performance of an economic entity, or they represent a consequence of performance.*

*The results of the study show that at the level of the analyzed entities from the energy sector there are different approaches in terms of both applying the concepts of social responsibility and corporate governance, as well as regarding the way of reporting these issues. If in the application of these concepts, we can assume that each economic entity is free to find its own vision, regarding the manner of reporting the application of these concepts, we believe that this should be done in a more unitary way, in order to ensure comparability between different economic entities.*

**Key words:** *performance, social responsibility, corporate governance, ethics.*

**JEL Code:** *M40, M41*

### **1. Introduction**

Ethics in general, namely all the behavioral norms and values that must be respected in order to achieve different objectives, represents a concept more and more frequently studied in the specialized literature of each research area. The financial activity does not deny these trends. In relation to this, one can speak of ethical behavior of professionals working in the field (there are even codes that describe these aspects), but also of ethical behavior in the business management, which must be adapted to the needs of the management and the external environment and applied by employees from all the levels within the entity [15].

Moreover, authors such as Pup, A., [21] state that a high ethical behavior of the employees of a company lies in an increase of the value of the company, starting with additional remuneration of employees, with consequences on their productivity growth.

In addition to this, we believe that the entity itself must demonstrate ethical behavior, social responsibility and corporate governance being some of the most useful tools for assessing ethical behavior. Given the obligation of financial reporting at the end of each financial year, reporting from which the economic performance of an entity can be analyzed, we consider that it is necessary that simultaneously with the reporting, entities issue a reporting on social responsibility and corporate governance (this report being required by law or voluntarily issued by the entity).

However, social responsibility as a way of expressing ethical behavior by an entity is remembered also by Serban, D., [23], which states that an entity shall correlate its basic objectives with social activities, proposing a specific model through which this can be achieved.

Given these issues, we consider necessary an analysis of how tools such as social responsibility and corporate governance can be useful in maintaining an ethical behavior of economic entities and monitoring how the economic performance of an entity (or the perceived image of the concept of performance) can be influenced by these instruments.

## 2. Literature review

Responsibility as a concept implies the existence of a responsibility, an obligation or a duty. Responsibility as a concept can often be attributed to individuals, without any (relatively recent) references to the existence of a social responsibility of economic entities. Probably, considering that a business is a volunteer creation, with a particular purpose (often the aim being obtaining profit, a key indicator for measuring the performance), it must pursue its goals without taking into account the environment in which it operates.

However, as we can admit that each individual has a moral responsibility, namely showing a behavior adapted to the social environment in which he lives, each economic entity should demonstrate social responsibility (different from legal responsibility), meaning a certain behavior characterized by specific practices that bring an additional benefit or added value (regardless of the value brought) [7]. Also other authors [14] detect a correction of the optics through which a company is managed towards the principles of social responsibility.

Based on this understanding, and accepting the assumption that moral responsibility of individuals is an important factor for the results (performance) obtained by them, we can say that there is a certain extent to which the application of the social responsibility principles by an economic entity may result in an enhancement of the performance of the company. However, defining the relationship of interdependence between these two concepts is quite difficult due to the broad spectrum of variables through which they can be expressed.

In our opinion, the concept of social responsibility is obviously correlated with the performances recorded by an entity, but we believe that the positive influence on performance would be much higher if some limitations such as the following would not exist [10]:

- Medium or long-term manifestation of the results;
- Lack of know-how of many companies;
- Lack of financial resources for the implementation of social responsibility;
- Lack of human resources that assess the opportunity of the implementation of social responsibility

principles.

Besides the positive influence on performance, social responsibility begins to be seen by more and more authors as a basic component of the strategic development strategy [5].

Including globally recognized organizations [8] state that the social responsibility of entrepreneurs may take the form of an increase of the direct economic value and represents a strategic investment in the business strategy.

Moreover, relatively recent studies [26] state that the value of an entity is in fact given by an accumulation of values, based on appropriate social behavior.

If a few years ago there were no studies that discussed issues related to social responsibility of economic entities, business evolution has developed this concept and the society in general has begun to admit that the presence and involvement of the companies in solving social problems from the communities where they operate is appropriate. Moreover, a recent study [6] shows that social responsibility is an important factor influencing the performance of an entity, showing that a company that applies the principles of social responsibility enjoys higher sales and even a large number of customers willing to pay more for goods and services emanating from an organization socially responsible. However, the same study shows that consumers are weakly informed about the social involvement of the organizations, willing to quit buying goods and services of companies that neglect social or environmental issues.

Given these considerations, we can say that an entity's performance can be significantly influenced by the attitude of the entity towards the principles of social responsibility. However, we believe that the achievement of the social responsibility objectives should be a medium and long term concern of any organization, regardless of its size or the sector in which it activates.

Without attempting to define or to take over certain definitions of social responsibility, we can say that it translates into ethical behavior of entities, which must be felt in the perception of customers, employees, society in general, managing issues related to the environment, etc.

Mullerat, R., and Brennan, D., [18] state that corporate social responsibility is a concept through which organizations choose to protect the interests of stakeholders by maintaining a clean environment and a better society and its involvement in this.

Regarding the limits and shortcomings of the principles currently applied in the social responsibility area, we find that a great emphasis is put on corporate social responsibility, without a constant concern for social responsibility at the level of business networks. Given the obvious globalization we are witnessing and the fact that a company, regardless of size and complexity, cannot operate independently, but only by getting in contact with various business partners, it is imperative to have and apply general principles of social responsibility in the business chains that are created this way ([17]; [25]).

From the aspects presented above emerges a sure thing, namely that social responsibility is difficult to assess in terms of quantity, this concept being rather one of a qualitative nature, whose understanding and interpretation can be subjective.

However, theory and practice from the business area have developed certain criteria based on which we can appreciate social responsibility of companies, among them being found [9]:

- Corporate governance (the degree of the decisional transparency, the application of accounting and auditing standards, independence of the managers, etc.);
- Business ethics (the existence of ethics codes, anti-dumping measures, etc.);
- Development of human capital (rules that protect employees, budgets for training and retraining employees, job security, etc.);
- Collaboration with civil society (the degree of transparency of the business, public trust in the business, etc.);
- Environmental policy (compliance with environmental protection laws, implementation of waste management systems, etc.).

Regarding corporate governance in general, we can say that it is represented by the general rules that guide the activity of a company.

According to the opinion presented by Shleifer, A., and Vishny, R., [27], corporate governance is the concept that deals with the means through which capital providers of an economic entity ensure themselves they will obtain a benefit from their investments. Moreover, we believe that the application of corporate governance involves an essential element: the extent to which stakeholders have access to information related to these arrangements. However, the concept of corporate governance should be extended including towards the analysis of how stakeholders are involved in the management processes and also towards the analysis of how the strategic decisions are taken in a company.

As a concept and way of expression, corporate governance is preceded by the genesis of the concept of public governance. Given these issues, specialized studies have been developed [13] which attempt to impose into the corporate governance some principles borrowed from the area of public governance, principles such as: the division of power in the companies, clear rules for accession to management functions and rules regarding competition for the main business areas.

It is important to emphasize this approach in order to make comparisons between the principles of governance applied at the level of the economic entity and those that exist in the global practice, especially in the context of globalization from the business area.

At the same time, globalization itself is a factor that brings changes into corporate governance. A study by Nistor, I., A., [19] shows that together with increasing the share of foreign investors in the economy of Japan, there was a change in the manifestation of corporate governance, but it is difficult to assess whether the principles of corporate governance have changed in order to attract foreign investors.

However, we wonder what happens with the entities in difficulty. Will there be sufficient involvement of the managers in complying the principles of corporate governance? In our opinion, corporate governance is difficult to maintain at a satisfactory level in the case of companies in difficulty, considering that the attention of the managers will be directed towards other areas, and can therefore abandon certain provisions of the corporate governance codes.

Regardless of the manner in which corporate governance can be defined, it highlights the responsibilities that the company has towards some people. Taking into account this essential aspect, we consider unsuitable the existing definitions from the specialized literature that detach themselves from the idea of corporate responsibility towards stakeholders and the public in general.

Since the domestic economy has experienced a continuous transition, being able to consider that we are dealing with an emerging economy, we believe that the application of certain codes of governance would have positive effects on the performance of economic entities. This approach is supported by Bocean, C., B. [4].

Corporate governance can provide a number of indisputable advantages to an entity [2]:

- Can prevent scandals at corporate level;
- Can prevent fraud;
- Can prevent civil and penal liability of organizations;
- Can help improve the image of an organization, making it more attractive for customers, investors, suppliers, etc. .

The same bibliographical source emphasizes the positive effects that corporate governance has on the indicators that measure economic performance (capital retribution, profit margins, the size of dividends, etc.), with examples of studies regarding this aspect made in the United States.

Moreover, this ascertainment is reinforced also by the study conducted by Parnes, D., [20] which shows that a growth of corporate governance causes a decrease of the risk of bankruptcy of an entity.

Furthermore, regarded as a phenomenon manifesting itself in all companies (especially in the multinationals), corporate governance can have significant influence over such phenomena as global strategies and policies, with possible influences on the process of globalization which we are witnessing [24].

Often, the concept of corporate governance is related to the accounting. We believe that even the presentation of the explanatory notes and accounting policies, applied as components of the annual financial statements, represent ways of manifestation of corporate governance. Like any other reports, also these can be altered by the interests of certain categories of stakeholders and thus corporate governance will suffer. For example, the incertitude over the earnings of the shareholders or other unrealistic expectations of them can be regarded as pressure on managers that can result in inappropriate accounting policies and practices.

In the specialized literature, studies related to corporate governance are very actual, especially in terms of theory. Regarding the existence of practical studies, there is a difficulty in relation to the assessment of corporate governance in terms of quantity or in terms of correlations between corporate governance and performance indicators. Methods of analyzing these types of correlations do not exist yet, aspect highlighted in the critical study developed by Axel, B., S., and Jens, K.[1].

### 3. Results and discussions

In order to analyze how these concepts are perceived by the general public, we conducted an individual analysis about the reporting related to social responsibility and corporate governance of the companies from the energy sector operating on the Bucharest Stock Exchange (observations were carried for the financial year 2014).

It should be mentioned that having to do with entities listed on the Bucharest Stock Exchange, they have available a corporate governance code developed by the Bucharest Stock Exchange (which requires the development of a statement of the type "comply or explain"), which even includes items related to the social responsibility of the entities (art. 10 principle XVIII). The results of the observations are shown below.

#### A. OMV Petrom

From the reports issued by OMV Petrom we can appreciate that there is a high degree of social responsibility shown by the entity. The presented reports show that the entity focuses on environmental policies, but often also proposes major education campaigns, particularly for the young people from the social environment in which the entity operates. We also appreciate as appropriate the campaigns initiated by the entity through which it seeks to engage its own employees in volunteer projects.

Moreover, in a study published by Babonea, A. M., and Dumitru, A. P., [3], Petrom is a leader in the top of the companies with the highest social responsibility in 2011, calculated according to various criteria (investment, internal audit, corporate behavior, involvement in environmental issues and public perception of the company). Furthermore, by applying its own code of conduct regarding social responsibility, but also the requirement to apply this code addressed to all those acting on behalf of the company are an example that deserves to be followed by any entity.

Regarding corporate governance, the company adopted its own corporate governance statute from 2012, which contains provisions even more detailed than the corporate governance code of the Bucharest Stock Exchange. The analysis of the "comply or explain" declaration drawn up in accordance with the requirements of the Bucharest Stock Exchange shows that there are still some issues that are not fully respected (related primarily to the

appointment of a remuneration committee), but as they explained, they were met through the functions of the general meeting of shareholders.

At the same time, as a component of corporate governance, we note and appreciate the existence of certain reports that enable stakeholders to take note of the long-term main lines of action and investments planned by the entity (terms of over 5 years).

#### **B. Romgaz**

Like OMV Petrom, Romgaz has a fairly active engagement on the side of social responsibility, taking into account issues such as the environment, education, community, health, culture and sports.

Also Romgaz has its own corporate governance regulation similar to the existing one from Petrom. Like the code of corporate governance of the Bucharest Stock Exchange, also Romgaz includes in its own regulation provisions regarding the basic principles of social responsibility. Also, since the entity is majority-owned by the Romanian state, it takes into account the regulations applicable to public companies.

Regarding the analysis of the "comply or explain" declaration, we observe slight deficiencies in the development of procedures that establish the rules of conducting the general meeting of shareholders, but also in the process of assessing the independence of the non-executive members of the Board of Directors.

#### **C. Electrica**

In terms of regulating the principles of social responsibility within Electrica, we find that they are frequently mentioned in the Code of Business Conduct and Ethics. Regarding the reporting of social responsibility, we find that there are few evidence on this issue, with negative consequences on the company's image, with the possibility of alteration of the performance.

Corporate governance is characterized by the existence of an own code of corporate governance, slightly wider than the ones of OMV Petrom and Romgaz, but the analysis of the "comply or explain" declaration drawn up in accordance with the requirements of the Bucharest Stock Exchange shows that there are deficiencies regarding the procedures that need to be taken into account for the general meeting of shareholders, nomination and remuneration of directors and members of the Board, and even related to the functioning of the Audit Committee.

#### **D. Transgaz**

The principles of social responsibility within Transgaz are not limited strictly to their definition but also to their assumption, and reporting. The Company shall report the actions related to the concept of social responsibility. Even if it is not up to the magnitude of OMV Petrom (in terms of amounts allocated), social actions covered segments such as environment, education, culture, art, health, etc.

Transgaz has an own regulation code of corporate governance. Analysis of "comply or explain" statement revealed a few deficiencies in compliance with the corporate governance rules of the BSE code, but these are explained on account of the existence of legal regulations that are not necessary to develop additional internal procedures.

#### **E. Transelectrica**

Reporting on the application of social responsibility principles is not very detailed on Transelectrica. Reporting provides brief but important information about the amounts that were budgeted for social responsibility and those actually spent in this regard, observing that only 54% of allocated funds were actually spent for this purpose. The funds were allocated to solving health problems of employees and to fund universities for organizing various events.

Corporate governance is regulated internally by its own regulation code in this respect, with a structure similar to that imposed by BSE, and reporting on the implementation of corporate governance principles is achieved in relation to the Executive Board Reporting. Within this section is also detailed the social responsibility as a part of corporate governance. It should be noted that it has not been identified on the company's website the "Comply or Explain" statement for 2014.

As for OMV Petrom, a positive aspect in relation to corporate governance is linked to the existence of long-term forecasts on the evolution of the company.

#### **F. Nuclearelectrica**

Social responsibility is a priority for the company according to those reported on its website. Besides that in the last 4 years there are no reports about the company's social involvement, the information presented for prior years checks as social involvement issues even taxes or wages that the company has paid. We believe that these

issues are not subject to social responsibility; the social responsibility should be regarded as the company's involvement in the community in a voluntary basis outside the legal obligations which are assumed.

Nuclearelectrica has its own regulation on corporate governance in sufficient detail. However, the analysis of the “comply or explain” statement shows that this entity has deficiencies related to the company's remuneration policy.

#### **G. Conpet**

Social responsibility within the company is manifested by issuing presentations stating that the entity is actively involved in supporting some cultural and sporting events, and regular reporting on environmental protection.

This entity also has its own rules regarding the corporate governance. By analyzing the "comply or explain" statement we can notice that the entity does not yet have procedures for conducting the GMS, and there are weaknesses in identifying conflicts of interests.

#### **H. Rompetrol Rafinare**

Social responsibility is manifested by reporting the company's involvement in various social and community projects in areas such as environment, health or culture. These are found within a short section of the directors' report.

Regarding corporate governance, we noted that Rompetrol Rafinare is a company that doesn't have its own code in this respect, the reporting being done on the BSE governance code. Moreover, analysis of the "comply or explain" statement highlights other shortcomings within the company, which are related to the existence and publication of proper regulation of corporate governance, procedures regarding specialized committees, the Board of Directors composition, remuneration policy of the Board members, the lack of an audit committee, etc.

#### **I. Oil Terminal**

Social responsibility within the company is low. Although there is a policy regarding granting donations and sponsorships and the fields that they could be targeted, in a document published on the company's website states that in the year 2014 it was not involved in any such endeavor.

Corporate governance is characterized by the existence of an own regulation code in this regard. By analyzing the "comply or explain" statement, there are appearing shortcomings such as the lack of a regulation on corporate governance (this deficiency is eliminated during 2015) or lack of meetings with financial analysts, brokers, etc.

#### **J. Rompetrol Well Services**

Social responsibility is manifested by reporting the company's involvement in various social and community projects in areas such as environment, health or culture. These are found within a short section of the directors' report.

Rules of corporate governance is lacking in its case. By analyzing the "comply or explain" statement, we notice that there are other shortcomings: problems related to the structure of the Board, lack of Nomination and Remuneration Committee, lack of audit committee, etc.

#### **K. Petrolexportimport**

Regarding the social responsibility, reports were identified showing how it manifests itself.

Corporate governance analyzed through the "comply or explain" statement highlights the numerous existing deficiencies in this respect: the lack of own regulation on corporate governance, non-disclosure on the company's website the articles of incorporation and other important documents, lack of an nomination and remuneration committee, lack of an audit committee, etc.

#### **L. Dafora**

The entity does not have the social responsibility reports. Regarding the corporate governance, the entity has its own rules in this regard, but in the year 2014 on the company's website it is not found the "Comply or Explain" statement.

From the observations on selected entities from energy sector, the idea that emerges regarding how to report social responsibility, it shows that it is quantitative rather than a qualitative, this idea being supported also by Mărăcine, M., S., (2011) in her study. However, we appreciate the manner of reporting applied by Petrom.

In other words, we subscribe to the thesis presented by Iamandi, I., E., [12] which states that since in Romania the concept of social responsibility is introduced in the first phase by the multinational companies operating in our country, social responsibility rather manifests itself through philanthropic initiatives or public relations campaigns, thus reducing the potential of social responsibility to provide a tool for strategic management.

Neither corporate governance principles (established by the Code of Corporate Governance of BSE) are not fully respected; often there are weaknesses in the transparency of procedures for the appointment and remuneration of board members, and other sensitive issues.

#### 4. Conclusions

If we want to see whether there is a link between performance recorded by the analyzed entities and social responsibility we note that it exists at all levels: there are performing companies who demonstrate a high degree of social responsibility (Petrom, Romgaz, Transgaz), but also companies that record a poor performance and demonstrate a poor social responsibility (Petrolexportimport, Dafora).

The above conclusion applies also in the case of interdependence between corporate governance and performance.

In other words, it appears that we are dealing with companies operating in a country with a developing economy, in which the principles of corporate governance are not yet fully in line with trends from developed countries. This mode of expression of corporate governance is not found exclusively in Romania; In a study published by Duman, A., and Postalci, E. [11] it is shown that in companies operating on the Istanbul Stock Exchange, there are evident shortcomings. For example, in 54% of analyzed companies there are leading people who are relatives with major shareholders, only a quarter of the members are independent directorates, directorates members have significant packages of shares in 37.8% of the companies analyzed, or, in 62.2% of the analyzed companies, there remuneration of the Directors is in shares packages.

We believe that the analyzed entities (and not only those) should not be confined to the application and reporting their actions of social responsibility and corporate governance based on a rigid frame (BSE Corporate Governance Code). These are ways of expressing business ethics, and should be expanded by adding a component of voluntary involvement and voluntary reporting. Information such as budgets, forecasts, analyzes and results of activities related to social responsibility (on the model offered by Petrom) should represent basic information that any interested person can have access to.

Thus, we can conclude that most analyzed entities did not fully understand the concept of social responsibility and corporate governance, and not sufficiently informed about the benefits that this concept might have for improving financial performance.

Analyzing the manifestation of corporate governance and social responsibility for the sample in question, it shows that there is limited access to detailed and high quality information, but specialized literature has not yet managed to impose certain methodological approaches devoted to application and analysis of these concepts.

The central question that arises, which should open new directions of analysis is linked to the direction of influence and interdependence of analyzed concepts. It is hard to know whether poor performance is in fact a cause or an effect of a weak social responsibility and corporate governance and a good performance is a cause or an effect of a strong social responsibility and corporate governance.

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