The Regulation of Self-Dealing in Europe, among convergence and path-dependency opportunities. A comparison between disciplines of some Eastern and Western Countries.

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Abstract

Self-dealing refers to all kinds of transactions and operations whose aim is to divert value from a company to corporate controllers. In order to tackle self-dealing, scholars and regulators have emphasised the importance of legal tools. However, although the pro-regulatory approach prevails on a wide scale in the academic arena, there still exists a marked divergence between theoretical positions supporting the existence of a benchmark model towards which to converge (convergence hypothesis) and those that underscore the importance of socio-economic factors on the efficacy of governance rules (path dependency view).

The aim of this paper is to join in the convergence vs. path dependency debate by adding some considerations on the efficiency of mandatory rules to the well-known investigations on the effectiveness of legal frameworks. Specifically, considering the current market integration and associated opportunities and threats, the traditional cost-benefit analysis has been extended in order to embrace direct and indirect costs specifically associated to the issue of domestic rules in a global scenario. Such an economic analysis on self-dealing introduces new variables that may support the convergence view and encourage at least a partial and gradual adjustment of national legislations towards the Anglo-Saxon model.

To test our hypothesis, an examination of the self-dealing rules adopted in some Western European Countries (Germany, Italy and UK) and Eastern European Countries (Czech-Republic, Hungary and Poland) has been conducted. In particular, spatial and temporal comparisons of conflict of interests and self-dealing legislations have been carried out in order to appreciate trends, differences and similarities of some of the most important European legal frameworks.

Keywords: legal framework, Europe, corporate governance

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1. Introduction

One of the most important corporate governance issues caused by the separation between ownership and control concerns the risk of asset diversion by the corporate controller (manager or dominant shareholder). The label of self-dealing has been introduced to underline the threat stemming from business choices adopted by the agent in a situation of potential conflict of interests, and both researchers and regulators have focused their attention on legal tools able to constrain or punish wealth expropriation. In actual fact, the role played by governance mechanisms in explaining the development of stock markets is intuitively understandable and empirically demonstrable (SHLEIFER, VISHNY, 1997; LA PORTA et al., 1997; SHLEIFER, WOLFENZON, 2002). Legal frameworks and monitoring systems able to detect outright theft or to appreciate the economic soundness of equity operations and transactions with related parties enhance the opportunities of an efficient resource allocation and have a positive impact on social welfare (COOTER, ULEN, 2004).

As “law matters”, all jurisdictions provide stakeholders with a set of rules aiming to protect outside investors. Shareholders and board approval, independent director ratification, disclosure or periodic releases, legal instruments, planned to ease shareholder litigation or even to ban self-dealing transactions, are often required by regulators and overseers where a conflict of interests exists. The academic literature has long since focused its attention on their effectiveness, questioning in particular the existence of a benchmark model to implement. Nonetheless, a unique answer to this problem is still far from being reached.

According to the seminal papers referable to the Law & Finance approach, the legal frameworks adopted by Common Law countries offer better shareholder protection than those governed by Civil Law and, as such, a convergence process towards an Anglo-Saxon approach should be encouraged (LA PORTA et al., 1998; 1999; DJANKOV et al., 2008). A path dependency view, instead, disproves the above conclusions, stressing the peculiarities of the different socio-economic environments and the ownership structure of firms operating there. Governance protections working effectively in one case might fail in another one (COFFEE, 2005) and the implementation of a common set of rules could be loose and ineffective (GOSHEN, 2003b).

This paper aims to contribute to the convergence vs. path dependency debate by introducing some considerations on the mobility opportunities offered by the current globalization process and the consequent impact on the efficiency of domestic self- dealing rules.

In fact, while an assessment of corporate laws’ effectiveness in preventing opportunistic behaviour of local insiders is quite common, their actual efficiency in a global market is rarely examined and this assessment neglects the overall effects on the shareholders’ wealth.

As is known, the introduction of stricter rules on self-dealing – although justifiable in the light of narrowing the corporate controller’s actions whenever a conflict of interests condition is detected – may reduce the net present value of non-controlling shareholders’ investment. Such a circumstance has been firstly ascribed to the costs directly associated to the actual implementation of a new rule, and then indirectly connected to the loss of profitable opportunities due to the consequent managerial discretion constraint (ENRIQUES, 1998; PACCES, 2009). However, with increasingly integrated markets for capital, products and human resources, a cost-benefit analysis cannot neglect the direct and indirect costs deriving from the responses that global economic players would give to domestic conflict of interests legislations (MILHAUPT, 2003). First of all, differences among national legislations introduce substantial expenses, forcing globalized firms to become acquainted with several governance systems and also affect firms’ hiring policy of foreign managerial talents and their internationalization plans. Moreover, the option to choose self-dealing rules to comply to by selecting quoting markets or countries where to incorporate, could be opportunistically exploited by corporate controllers to the detriment of outside investors. The agent’s personal benefits deriving from the adoption of less demanding corporate governance systems might lead to carry out sub-optimal internationalization strategies whose costs would finally affect minorities and creditors’ wealth. We label such a particular category of indirect costs as induced costs.

A deeper investigation on the above-mentioned costs allows us to point out the potential benefits associated to more intense cooperation between domestic institutions and to support a convergence process. In particular, we hypothesize and suggest, at least, a gradual and partial adjustment away from national conflict of interests rules towards the Anglo-Saxon model. Indeed, either the mandatory adoption of financial reporting standards (IAS/IFRS), whose theoretical framework clearly originates from an Anglo-Saxon perspective (MARKS, 2004), or the existing voluntary global convergence of codes of best practices towards the Anglo-Saxon system

(MARKARIAN et al., 2007) provide clear evidence of an already widespread awareness by market participants and as such an implicit approval of Anglo-Saxon rules. Therefore, the need to minimize the switching costs associated to new conflict of interests rules appears to favour the necessary adoption of legislation consistent with the Anglo-Saxon model.

To test this assumption, the paper provides a picture of the legal frameworks of some of the most important West and Eastern European Countries by examining doctrines and remedies on self-dealing adopted by Germany, Italy, UK, Poland, Czeck Republic and Hungary. Spatial and temporal comparisons of the conflict of interests legislations will then be carried out in order to increase understanding of the issue and appreciate trends, differences and similarities among the European regulations.

The article proceeds as follows. The next part briefly summarizes the current debate on the topic, comparing the proposed solutions referable to the Law & Finance approach with the theoretical outcomes of the path-dependency thought. The third part carefully describes the economic consequences associated to a self-dealing legislation, focusing in particular on direct and indirect costs due to a lack of convergence among national rules in a global market. A detailed examination of self-dealing legislations adopted in each of the above-mentioned European countries is then developed in the fourth part. Some concluding remarks are finally put forward.

2. Convergence vs. Path-Dependency: a brief review of the current debate on self- dealing

Since the publication of the seminal article by Bearle and Means (1932), the need for regulatory intervention to protect outside investors has been highlighted. The risk that corporate controllers (director or dominant shareholder) might maximize their own benefits to the detriment of the other stakeholders (JENSEN, MECKLING, 1976; PRATT, ZECKHAUSER, 1985) and the inability of the minority shareholders to monitor the agent are frequently described as the main factors justifying the issue of mandatory rules (RIBSTEIN, 2002).

In actual fact, although in theory shareholders might incorporate the perceived risk of expropriation in the securities price, the high information and transaction costs due to the inefficiency of the market make such a hypothesis hardly verifiable (GORDON, 1989; GOSHEN, 2003a) ([1]). Moreover, corporate contracts are affected by an inevitable contractual incompleteness. In order to leave the corporate controller his managerial discretion, the contracts between the agent and the principal are characterized by an unavoidable partial vagueness, allowing the former to renegotiate, for his/her own benefits, the terms previously arranged with the latter (BRATTON, MCCAHERY, 2001).

On the other hand, strong empirical evidence supports the pro-regulatory approach about self-dealing. Countries with weaker investor protection and ineffective legal enforcement show less developed financial markets (LA PORTA et al., 1997, 2006), while a higher cost of capital is frequently associated with poorer legislation on insider trading and conflict of interests (BHATTACHARYA, DAOUK, 2002). Since efficient debt and equity markets are a fundamental factor for economic growth (KING, LEVINE, 1993; LEVINE, ZERVOS, 1997; RAJAN, ZINGALES, 1998), a positive correlation between the strength of the legal system and economic development is expected.

Several strategies can be pursued to tackle self- dealing. Traditionally, the possible regulation tools are classified into two broad categories: "property protection rule" and "liability protection rule" (CALABRESI, MELAMED, 1972; GOSHEN, 2003a, 2003b). The former requires operations potentially detrimental to the outside investors" claims to be directly or indirectly approved by the disinterested party. A "liability protection rule", on the other hand, allows corporate controllers to impose conflict of interests transactions on minorities, requiring different instruments though, in order to reassure the disinterested party about their fairness ([2]).

Both the existence of the best mix of the above-mentioned legislation tools and the need for domestic institutions to converge towards such an ideal set of rules have always been important topics in the corporate governance literature.

By developing quantitative indexes in order to measure the strength of different self-dealing legislations ([3]), Law & Finance scholars have collected empirical evidence supporting the convergence hypothesis. In fact, according to such a research stream, legal frameworks characterizing Common Law countries apparently show greater concern on minorities and creditors' claims, embodying more effective instruments to manage conflict of interests (LA PORTA et al., 1998; JOHNSON et al., 2000). Specifically, a combination of ex-ante disclosure and disinterested shareholder approval is described as the proper strategy in managing conflict of interests (DJANKOV et al., 2008). For this reason, the implementation of such a protection system is implicitly suggested, and underscores the need for convergence towards the Anglo-Saxon legislation.

Although they are key contributions in the self-dealing discussion, Law & Finance papers have been strongly criticized, because of the normative considerations following their empirical outcomes (BRAENDLE, 2006).

First of all, evaluation of the quality of shareholder protection by using numerical indexes leads to excessively crude conclusions, and gives way to misrepresentation of the relative effectiveness of the different legal frameworks (SIEMS, 2005; BAUMS, SCOTT, 2005). Moreover, the comparative law methodology developed by La Porta et al. seems to be seriously invalidated by the "home bias problem" (SIEMS, 2005). In drawing up their indexes, Law & Finance scholars have been indirectly influenced by their knowledge of the US legal system. The Anglo-Saxon rules on self-dealing represent the yardstick for assessing other countries and no effort is made to appreciate the actual effectiveness of alternative solutions (COOLS, 2004; CONAC et al., 2008) ([4]). Finally, these researchers seem to undervalue the impact of the cultural, social and economic features of each country (COFFEE, 2005; ENRIQUES, VOLPIN, 2007). In particular, differences in share ownership might shape the nature of self-dealing. In a dispersed ownership system, concerns on self-dealing operations could rise because of a conflict of interests between powerful controlling managers and small shareholders (managerial self-dealing) (BERLE, MEANS, 1932; JENSEN, MECKLING, 1976). In concentrated ownership structures, however, an agency relation has to be identified between the controlling shareholders and the outside investors (dominant shareholders' self-dealing) (DEMSETZ, LEHN, 1985; SHLEIFER, VISHNY, 1997). Although managerial and dominant shareholders' self-dealing partially overlap, legal tools able to tackle opportunistic behaviour could differ (CONAC et al., 2008). For this reason, identical rules might have different effects on the conflict of interests issue as influenced by the context which they are implemented in (GOSHEN, 2003b). A "one-best-way" is an unsuitable solution and a path-dependency view could be the only effective strategy in ruling self-dealing (BEBCHUCK, ROE, 1999).

These founded criticisms on the research methodology adopted by Law & Finance scholars and the deductive considerations on the impact of socio-economic factors on the efficacy of conflict of interests legislations have strongly weakened the "convergence thesis" and neglected any deeper examination of the benefits associated to more intense cooperation among national institutions. However, as the globalisation process proceeds, a reassessment of the conclusions reached so far is required. Indeed, because of market integration, the negative effects on shareholders' wealth due to the imposition of domestic legislations on global actors become greater and greater and oblige the effectiveness analysis on self-dealing regulations to be joined to an investigation of their efficiency.

For this reason, in the next part an examination of self-dealing regulation costs is undertaken, thereby widening the traditional cost figures with those directly and indirectly provoked by the lack of cooperation in the actual globalized world. Such an economic analysis enables us to take an important step forward in the convergence vs. path-dependency dispute and highlights some of the reasons supporting the convergence hypothesis.

3. The Efficiency of Self-Dealing Regulations in a Global Market

3.1 Direct and indirect costs

Issuing a new rule on self-dealing should always be subject to a cost-benefit analysis where direct and indirect costs are assessed and compared with the expected benefits in order to appreciate the overall economic effects of the legislation.

"Out-of-pocket compliance costs" (direct costs) is the first figure traditionally considered in a cost-benefit analysis. In fact, a new rule on conflict of interests requires changes in internal control systems, whose design and implementation costs are directly borne by shareholders (ZHANG, 2007). Given the current global dimension of many companies, differences among the various jurisdictions clearly increases compliance costs. Firms with several administrative and production units settled in different countries are forced to invest a substantial amount of money in obtaining, translating and analyzing national legal frameworks (GEIGER, 1997) and in adopting internal administrative and control procedures. For this reason, the greater the degree of internationalization of a firm, the higher the costs directly incurred by shareholders to meet self-dealing rules and to adapt internal control and governance systems to domestic requirements.

Poor cooperation among national institutions also increases the burden of indirect costs. These usually refer to the negative effects indirectly associated to the loss of profitable business opportunities. Indeed, a corporate controller's attention could be diverted from doing business to ensuring full compliance with the imposed governance legislation (SOLOMON, BRYAN-LAW, 2004). Moreover, a stricter rule would probably expose managers and controlling shareholders to greater litigation risks and heavier penalties, narrowing the managerial discretion and consequently reducing the firm's value (RIBSTEIN, 2002; PACCES, 2009).

However, in the current global scenario, issuing a domestic self-dealing rule, when not consistent with internationally prevailing ones, could negatively impact on firms' value also by discouraging foreign directors from accepting company board appointments. It is reasonable to expect that greater litigation risks and penalties following stiffer self-dealing legislation will not only limit the managerial discretion of existing directors, but will also hinder the implementation of strategies whose purpose is to raise the degree of internationalization towards a higher top management team (TMT) diversity (ONADO, 2009), and this assumption may still be kept regardless of how rigorous the rules may be, when further differences are introduced. Because of cultural differences and a negligible awareness of the political and legal framework, the costs borne by a foreign manager when applying local governance rules will be higher than those supported by native directors. Consequently, stricter and different self-dealing rules might decrease the percentage of foreign board members and negatively affect the correlated firms' international propensity. At the same time, they might limit the positive consequences - in terms of higher transparency and stronger investor protection - generally associated to a top management team diversity (RUIGROK et al., 2007; RANDOY, OXELHEIM, 2001) ([5]).

An important category of indirect costs lies in the negative impact on the principal's wealth which is provoked by the ability of the agent to take advantage from differences among national legislations (induced costs). The existence of several domestic regulations and the inability of outside investors to immediately assess corporate controllers' incorporation or quoting choices allow the latter to orientate these internationalization plans towards less demanding governance systems and, in so doing, maximize their own benefits by pursuing sub-optimal strategies whose costs are finally borne by minorities and creditors.

A deeper analysis of the induced costs is carried out in the next section.

3.2 A special category of indirect costs: induced costs

The current globalization process offers new advantageous opportunities to companies. Legal deregulation on incorporation decisions and market for capital integration do affect the firms' equity value.

A deregulated environment, for example, favours countries' competition for attracting businesses through the issue of effective legal rules (FISCHEL, 1982; WINTER, 1989). The choice of the State of incorporation can be exploited by corporate controllers in order to introduce governance mechanisms that are able to minimize agency costs and, consequently, increase shareholders' wealth. For example, when observing the US market – where investors' protection system differs across the States – it has been demonstrated that firms incorporated in the Delaware State are worth more than firms incorporated elsewhere, thereby showing a positive and significant association between the quality of governance rules and the equity value (ROMANO, 1985; DAINES, 2001; SUBRAMANIAN, 2004) ([6]).

A different internationalisation strategy is also represented by a cross-listing choice. Firms listed in foreign countries experience lower cost of capital and increase their ability to fund their business operations and make their stocks more visible and liquid (MITTOO, 1992; FANTO, KARMEL, 1997; KAROLY, STULZ, 2001; LICHT, 2004; KAROLY, 2006). Indeed, a "cross-listing premium" is generally granted to foreign companies whose stocks are quoted on the major U.S. Stock Exchanges (DOIDGE et al., 2004). This positive financial effect is attributed to a lower liquidity-risk (FOERSTER, KAROLYI, 1999; LOMBARDO, PAGANO, 1999), a more detailed disclosure (FUERST 1998; MOEL, 1999) and an enhanced investor protection system (COFFEE, 2002; REESE, WEISBACH, 2002). More generally, a cross-listing choice is probably also perceived as a signal of strong commitment by the corporate controllers to limit their expropriation activity and to use the raised capital in order to exploit growth opportunities (CANTALE, 1998) ([7]).

The positive effects on firm value and investor protection systems associated with the globalization process help to explain the nature of induced costs potentially caused by a self-dealing regulation.

In the current economic scenario, where a more and more intense market integration, deregulation and international competition for equity capital prevail (KAMAR, 2006), every normative intervention carried out by a domestic institution may influence business decisions, inducing corporate controllers to carry out potentially sub-optimal strategies (GEIGER, 1997).

For example, stricter local legal rules on self-dealing could lead corporate managers and blockholders to change the State of incorporation, moving it towards countries with less demanding governance systems (CARY, 1974), and/or move some business or transactions to countries with more lax systems or with more legal loopholes. High information costs prevent outside investors from carrying out an intense examination on the reasons behind incorporation choices, and increase the probability of opportunistic behaviour by corporate controllers (GEIGER, 1997). On the other hand, it has been empirically proved that countries whose legislation seems to shelter the private benefits of managers and controllers show great attractiveness, while no particular penalization – in terms of a firms "emigration" – has been discovered for States adopting governance rules widely viewed as harmful to minorities and creditors (BEBCHUK, FERREL, 1999; BEBCHUK, COHEN, 2003). For this reason, a lack of coordination among national institutions could cause a "race to the bottom" phenomenon, neutralizing the theoretical effectiveness of a self-dealing rule and imposing higher costs on outside investors (BAR- GILL, 2006).

By affecting a firm's cross-listing strategy, unilateral intervention by a national securities commission on the conflict of interests topic can be considered a further source of induced costs. An analysis of the economic consequences associated to the Sarbanes-Oxley Act puts forward some evidence supporting this opinion (ZHANG, 2007). In 2002 the passage of SOX Act has reduced the number of foreign firms quoted on the NYSE (MARKS, 2004; BERGER et al., 2005; ZINGALES, 2007), causing the loss of previously examined financial and corporate governance opportunities associated to a cross-listing decision. The higher compliance costs presumably introduced by the new SEC regulation have often been pointed out as one of the main reasons for the observed firms' emigration. However, the agent's effort to maximize its own wealth by exploiting the freedom offered by the globalization of choosing the desired level of mandatory disclosure could be an equally important factor (COFFEE, 1984; EASTERBROOK, FISCHEL, 1984). In actual fact, market inefficiencies cause a mismatch between private and social costs/benefits of disclosure. In particular, because of "proprietary" or "inter-firm" costs associated to a more detailed disclosure ([8]), the marginal costs of additional disclosure borne by the corporate controller will be higher than the relative social costs. At the same time, information asymmetry and transaction costs will prevent the potential social benefits associated to higher transparency from being fully reflected in the share price (FOX, 1999). Therefore, the financial and corporate governance information that the corporate controller is willing to deliver will probably not be as significant as the optimal social disclosure level. The corporate controller is likely to emigrate towards less demanding countries, imposing on outside investors the associated negative effects (MARKS, 2004).

These considerations lead to the conclusion that the same reasons justifying the pro-regulatory approach to discipline conflict of interests conditions legitimise the issue of mandatory rules, thus boosting the need for convergence among national legislations. Because of high transaction and information costs, differences among self-dealing regulations are a source of private benefits for corporate controllers. For this reason, public intervention that encourages more effective cooperation among domestic institutions could replace market inefficiencies and decrease the probability of opportunistic behaviour.

However, suggesting a convergence process among national legislations is only part of the story. In order to complete our economic analysis on self-dealing, an examination of the model to be adopted by domestic legislations has to be carried out, selecting the governance system whose adoption is able to curtail the costs referable to the convergence process (switching costs).

3.3 The efficiency of self-dealing: which model to converge towards?

An examination of the direct, indirect and especially induced costs driven by domestic self-dealing rules in a global market points out the role that international cooperation could play in order to achieve the most efficient and protective solution.

However, the process of convergence, justified to decrease costs introduced by the different national legislations, is itself a costly activity. This is why in an economic analysis on self-dealing, the type of governance model that reduces the inevitable switching costs has to be privileged.

The Anglo-Saxon legal framework might well represent such a model.

The instruments and knowledge deemed useful to implement this governance system are already widely known by market participants. A constant and voluntary convergence of disclosure and governance practices towards the Anglo-Saxon model has been empirically demonstrated (MARKARIAN et al., 2007). Because of the active role played by US and UK institutional investors (GILLAN, STARKS, 2000; NESTOR, THOMPSON, 2000; CARLETON et al., 1998; KARPOFF et al., 1996), non Anglo-Saxon organizations have partially shaped their governance and corporate communication according to the Common Law system (CHANDLER, 1990) ([9]). Moreover, some earlier evidence about a convergence of European firms' corporate governance towards regulatory regimes associated with an Anglo-Saxon system has already been gathered (MILLMAN et al., 1999; BRANDLE, NOLL, 2005). In addition, the mandatory accounting harmonization recently instituted in the EU zone with the adoption of the IAS/IFRS has introduced a common body of disclosure standards whose origins are clearly referable to the Anglo-Saxon financial reporting tradition (MARKS, 2004).

In such a scenario, the introduction of European conflict of interests regulations would imply an important step towards a significant convergence in corporate governance systems, and would also take advantage of the possible synergy between accounting standards and self-dealing guidelines.

The next part focuses on the rules adopted in Germany, Italy, UK, Czeck Republic, Hungary and Poland. By carrying out a temporal and spatial comparison of their national legislations, the strength of the convergence process in Europe is evaluated and our hypothesis of a gradual and partial approach of Western European Countries (Germany, Italy and UK) and Eastern European Countries (Czech-Republic, Hungary and Poland) towards the Anglo-Saxon legal framework is tested.

4. A Comparative Overview and Analysis of European Self-Dealing Regulations

4. A Comparison between West-Eastern European Countries' Self-Dealing Regulations

This section investigates how self-dealing is tackled in some Western European Countries (Italy, UK and Germany) and Eastern European Countries (Czech Republic, Hungary and Poland) in order to highlights differences and similarities in governance codes and legal rules addressed to listed companies.

If the efficiency considerations put forward in the previous paragraphs really play a role in shaping domestic legislations, such a renewal process should have led to higher harmonization among self-dealing rules. In an attempt to minimize the unavoidable switching costs, we hypothesize at least a partial and gradual approach of European countries self-dealing disciplines towards the Anglo-Saxon systems.

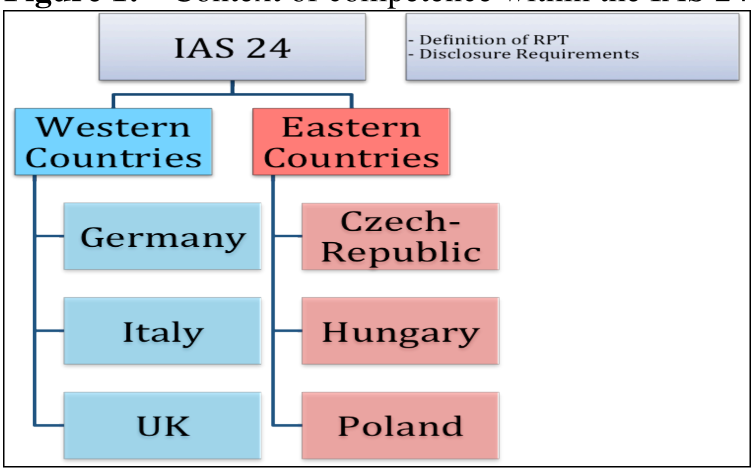
In order to test our hypothesis and to assess the degree of convergence, a detailed examination of the *scope* of national legislations is firstly carried out, followed by a comparison among the designed disclosure requirements and *authorization/monitoring* mechanisms ([10]). Some concluding remarks are finally developed.

4.1 Discipline scope

Since 2005 listed companies in States member of the European Community have been adopting IFRS; thus the IAS 24, *Related Party Disclosures*, has been applied too. This process of accounting harmonization has clearly introduced a common definition of *related party*, pointing out persons or organizations whose relation of control/significant influence towards the reporting entity might lead to unfair transactions ([11]).

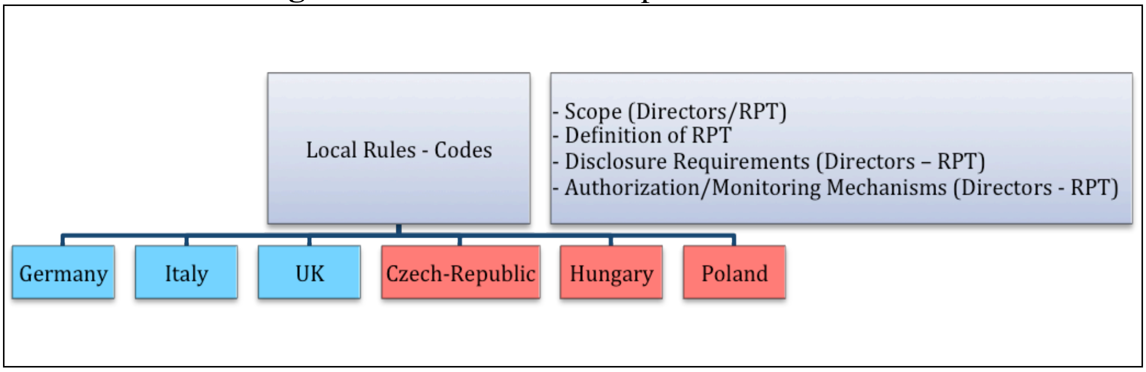
However, as will be discussed further, the aim of the IAS 24 focuses only on the disclosure that has to be periodically delivered whenever a *related party transaction* (RPT) occurs.

Figure 1. – Context of competence within the IAS 24



Moreover, the IASB documents are only a specific source of financial reporting rules, as several domestic legislations concerning self-dealing and conflict of interests are still operative. For these reasons, besides the common framework represented by IAS/IFRS, listed companies also have to comply with local rules and codes, where some differences may be found in terms of discipline' scope.

Figure 2. – Context of competence within local rules



The paper will proceed with a description of relevant areas of regulation of each of the selected Countries of the sample, in order to verify (if any) their level of convergence-superposition.

It will describe first the discipline' scope of the Countries of the West Europe and then those from the East part.

With regard to the former, the discipline seems more definite. In particular:

- in **Germany**, the current Corporate Governance Code focuses only on the "conflicts of interest" issue: members of the Management Board (*Vorstand*) and of the Supervisory Board (*Aufsichstrat*) are bound by the enterprise's best interests; they may not pursue personal interests in their decisions or use business opportunities intended for the enterprise for themselves. Conflict of interests between a corporation and its controlling shareholders and the fairness problem concerning intra-group transactions are dealt with only in a specialized area of German corporation law (*Actiengesetz*) ([12]);
- **Italy**, unlike Germany, explicitly points to the question both in terms of "interests of directors" and RPT ([13]). The local framework has its own extensive and detailed definition of RPT, that basically is aligned with that proposed by the IAS 24 ([14]);
- in **UK**, the rules on self-dealing transactions handles the issue either in terms of "interest of directors" ([15]) and in terms of RPT, providing an autonomous definition of the latter in the Listing Rules.

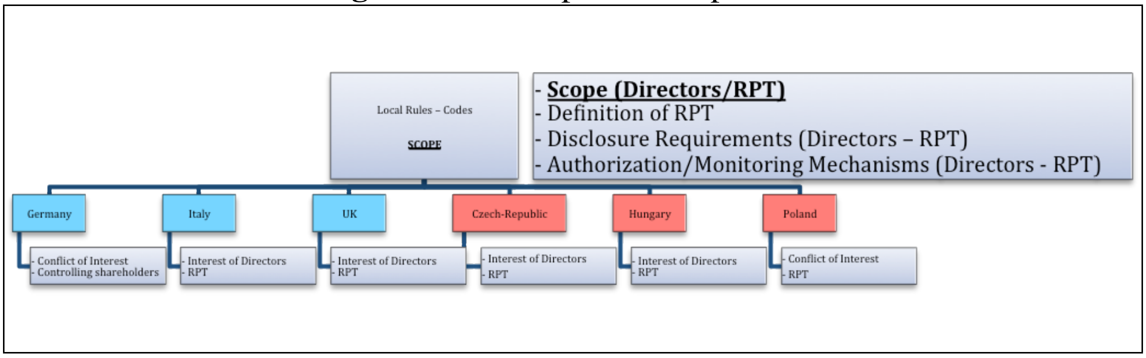
For what concern the Countries of Eastern Europe, a common thread of their disciplines is a weaker attention paid to the RPT concept, if compared with the regulations from UK and Italy. Even when the notion is invoked, the rules do not provide always an explicit definition, as in UK and in Italy. Indeed:

- in **Hungary** ([16]), for example, the discipline centers attention just on "interest of directors" and on relations between members of the Managing Body and a third party which may result in a conflict of interest, but a definition of third party is missing ([17]) ;
- in **Poland** the Corporate Governance Code for Listed Companies points out the question in terms of "conflicts of interest" for both members of the Management Board and of the Supervisory Board and also in terms of RPT; however, there is not an explicit definition of the latter, that can be just inferred from the examples proposed in the comments to the principles of the Corporate Governance Code.

Interestingly, the Commercial Company Code does not mention the RPT case and regulates only conflicts of interest between the company and a Management Board Member ([18]), not also between the company and the Supervisory Board Members;
- in **Czech-Republic**, finally, Corporate Governance Code draws attention both on "interest of directors" and on RPT, referring for the latter to the "*controlling person*" and to the "*concerted conduct*" concepts, as defined in the Commercial Code ([19]).

Therefore, while Germany pays attention only on directors and controlling shareholders, Hungary, Italy, UK, Czech Republic and Poland concentrate on a wider category of *related parties* (RP).

Figure 3. – Discipline's scope of local rules



However, whereas the meaning attributed to the word "directors" is common to all countries, no convergence may be found for the term RP. Indeed, with regard to the latter, Italy assumed a definition very close to that from the IAS 24, while UK, Czech Republic and Poland assumed autonomous meanings of it.

Below it will be proposed a description of the RP concept in each of the different Countries of the sample, starting from the Poland, that has the strictest definition.

The Gdansk **Polish** Code does not mention explicitly the RP concept, while refers to transactions and agreements between the firm and entities or individuals related to, or having direct or indirect influence on the company itself, as ([20]):
- the controlling shareholder or its affiliates;
- the company subsidiaries or affiliates, as well as significant clients or suppliers;
- members of the Management Board and of the Supervisory Board, as well as entities related thereto.

In **Czech Republic** the Corporate Governance Code relates clearly to RPT, that are those involving the:
- "*controlling person*" (company), as a person (parent company) who (which) de facto or legally exercises, directly or indirectly, a decisive influence on the control or operation of another person's (party's) enterprise, the controlled person (subsidiary); however, this influence has not to be based on a mandate or on a management/commercial contract ([21]) ([22]);
- *"concerted conduct*", that means conduct by two or more persons ([23]) undertaken in mutual agreement with a view to acquiring or conveying or exercising voting rights in a specific person (entity), or utilising voting rights to exert joint influence on the management or operation of such person's enterprise or to elect that person's (entity's) statutory organ (or most of its members) or supervisory organ (or most of its members), or otherwise influence that person's (entity's) conduct ([24]) ([25]).

The **UK** definition appears little wider than the previous one. The Listing Rules consider a *related party* as ([26]):

- a person (a company ([27])) who (which) is the *substantial shareholder* or someone exercising a significant influence;
- a person who is *director* or *shadow director* of the listed company or of any other related company;
- an *associate* of the above mentioned related parties.

Moreover, according to the UK discipline, a transaction involving these subjects is considered an RPT even if it is carried out by persons who were *related party* within the 12 months before the date of the transaction or arrangement (*former* director/substantial shareholder).

Notwithstanding this broad definition of *related party*, the scope of the UK Listing Rules appears to be narrower than the **IAS 24** and the **Italian** ones, which result to be the largest among all.

Indeed, in the latest versions of the International Accounting Standard, as in the definition adopted in Italy, the category of the *directors* has been replaced with the wider definition of *member of the key management personnel*; moreover the categories of *joint ventures* or *post-employment defined benefit* are not explicitly considered neither by the UK Listing Rules, nor by the Polish discipline and by the Czech Republic Civil Code, whereas they constitute important *parties* according to the IAS 24 and to the Italian Regulation.

Finally, by introducing the category of the "*shadow director*" and extending the focus of attention to *former* directors/substantial shareholders, the UK discipline - devised to emphasize the importance of the economic substance of relations – is characterized by a higher degree of vagueness than the international one.

This brief examination of the scope of national legislations, though highlighted differences among national rules, pointed out a convergence pattern mainly driven by the International Accounting Standards. In actual fact, compliance with IAS n. 24 has narrowed Continental and Eastern European legislations to the Anglo-Saxon one, introducing a common framework that will probably influence the domestic regulator' acts. The adoption by the Italian CONSOB of a definition of RPT very close to that of the IASB can be interpreted as a clue to this process which involves, as will be shown in the next section, not only the discipline scope, but also some control mechanisms.

Having framed the discipline's scope of the selected Countries, the paper will proceed below describing the tools adopted by each of these Countries in order to regulate self-dealing transactions.

4.2 Regulatory frameworks: disclosure requirements and authorization/monitoring procedures.

The presence of one of the above-mentioned situations (potential interest, conflict of interest, *related party transaction*) implies that the entity must comply with specific rules designed to avoid any possible asset diversion achievable trough unfair self-dealing operations.

In this part of the paper, these tools will be described in terms of "*disclosure requirements*" and *authorization-monitoring procedures*".

DISCLOSURE REQUIREMENTS

As is well-known, whenever an RPT occurs separately for each category of related parties, all listed companies in EU Countries must comply with the IASB discipline. According to the IAS 24, they have to disclose the nature of the related party relationship as well as information about the transactions and outstanding balances ([28]). Then, as already suggested before, the process of accounting harmonization has considerably boosted convergence among self-dealing rules, forcing entities to deliver a common disclosure through periodic financial statements.

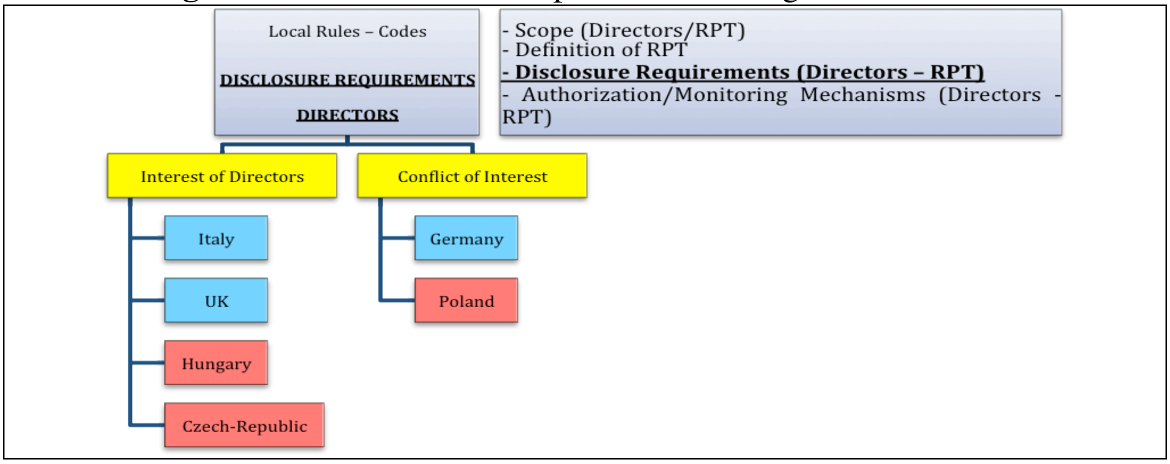
However, entities also have to provide *further disclosure* in order to meet the requirements of their local codes, both with regard to directors and other categories of related parties.

For what concern the *information to be provided with regard to directors*, **Italy** and UK have a more detailed discipline, when compared to the **German** ones. Indeed, the Italian ([29]) and the

English (30) listed companies have to convey disclosure in all circumstances in which a director has an interest of his/her own or on behalf of a third party, even though this operation is not in conflict with the interests of the company.

Among the Countries of Eastern Europe, **Hungary** and **Czech Republic** have a discipline similar to the Italian and English ones, requiring that disclosure must be provided when a director has an interest in the transaction, regardless of whether this is in contrast with that of the company. While the **Polish** listed companies, like the German ones, have to give information only when the directors have an interest in conflict with those of the company.

Figure 4. – Disclosure to be provided with regard to Directors



Even with regard to *disclosure concerning RPT*, as a consequence of the latest CONSOB regulation and reform of the Civil Code, Italy has acquired a very detailed discipline, the most articulated between the West Countries composing our sample.

Indeed, as already mentioned in the previous section, the Italian framework addresses a broad category of RPT, close to that suggested by the IAS 24. Moreover, in focusing the attention on the disclosure required when parties other than directors are involved, some differences among the disciplines of the West Countries of our sample concern *type*, *detail* and *timing* of information. With regard to these aspects, **Italian** companies:

- have to prepare a release ("*documento informativo*") with general information regarding the transactions (31);
- for *relevant transactions* (32), in the interim financial report, have to disclose information concerning transactions that have occurred in the first six months, show their impact on the periodic performance, and describe the consequent risks and uncertainties with regard to the second half of the year. In addition, they also have to disclose: any weaknesses reported by experts, the evaluation methods adopted, and the sources used by the experts to assess the adequacy of the amount due. Finally, they also have to certify the consistency of the delivered information with the experts' opinion;
- for *transactions not considered relevant* , they have to provide: full disclosure to the Board of Directors, at least on a quarterly basis; external disclosure, at least quarterly, of the operations approved against the advice of the independent directors.

UK discipline also distinguishes between relevant and non-relevant transactions, specifying that Chapter 11 of the Listing Rules does not apply to "small transactions" (33) and "transactions that do not have any unusual features". When a relevant RPT occurs, according to the UK Listing Rules, companies must:

- provide notification to the Regulatory Information Service (RIS), showing the name of the related party and the details of the nature and extent of the related party's interest;
- send a circular to its shareholders describing in detail the major aspects of the transaction; if the transaction involves an acquisition or a disposal of a social asset, where any percentage ratio is 25% or more and appropriate financial information is not available, the circular will also include a statement through which disinterested directors certify that the transaction is consistent with the social interest as verified by a qualified and independent consultant.

In **Germany**, listed companies have principally to perform the obligations required by the IAS n. 24, as local codes only discipline the case partially. Indeed, according to German corporate law, the management board of a controlled company has to prepare a report (the "dependency report") describing all intra-group transactions, within the first three months of the year. However, it is important to note that such a report is disclosed to the supervisory board only and not directly to the shareholders or to the market ([34]).

The regulations in force in the East European Countries of the sample are less detailed than the previous ones. Indeed:

- **Polish** listed companies do not have to provide any additional information than those required by the IAS 24;
- **Hungarian** listed companies must disclose, in the annual report and on the company's website, any relationship between members of the Managing Body and a third party which might have an influence on the operation of the company ([35]);
- in **Czech Republic** listed companies must disclose information on RPT ([36]) and on companies acting in concert ([37]). Where no controlling agreement has been concluded, the statutory organ of the controlled person shall draw up a written report (part of the annual one), on relations between the controlling person and the controlled person and on relations between the latter and other persons controlled by the same controlling person. This report shall state what agreements were concluded between related persons, what other legal transactions were made in the interest of these persons, and all the other measures which were adopted or effected by the controlling person in the interest, or at the initiative, of the controlled persons. If a performance was supplied by the controlling person, the report shall also mention what counter performance was effected and the advantages and disadvantages of the measures taken, and whether any detriment arose to the controlled person from the said agreements or measures, and whether such detriment was settled in the accounting period or whether an agreement on its settlement was concluded ([38]).
  Moreover, shareholders shall have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes as extraordinary transactions, including the transfer of all or substantially all assets, that in effect result in the sale of the company ([39]).

AUTHORIZATION/MONITORING PROCEDURES

The entity is then obliged to comply with the authorization/monitoring mechanisms specifically considered by domestic legislations. Also with regard to this aspect, there are rules governing behavior of directors and of related parties.

With regard to authorization/monitor mechanisms, the German discipline is the most demanding of the three West Countries of our sample, although it applies only to directors and controlling shareholders; while Italy and UK rules provide a stricter framework regulating the wider category of RPT.

Indeed, insofar as the *interests of directors* are concerned, the **Italian** framework only obliges the Managing Director to refrain from transactions in which he has an interest, entrusting it to the Board ([40]). Moreover, in order to avoid a situation of conflict, a director also may not:

- be an unlimited partner in another company carrying out competitive activities;
- carry out competitive activities for himself or on behalf of third parties; or
- hold office as director or chief executive in another company carrying out competitive activities ([41]).

Also in **UK** the **Companies Ac**t imposes some duties in order to avoid conflict of interests ([42]), moreover companies may not enter into the following transactions with their directors or with their holding company's director unless they have been approved by a resolution of the company's members: employment contract longer than two years; transaction concerning "substantial non-cash assets"; loan, quasi-loan transactions or give a guarantee or provide security in connection with such operations made by any person to the director; credit transaction as creditor for the benefit of a director of the company or of its holding company.

In **Germany**, *Management Board Members,* as well as persons they are close to or companies they have a personal association with, cannot undertake transactions with the company unless made at conditions consistent with current industry standard; they cannot hold other positions (especially Supervisory Boards' mandates outside the enterprise) and cannot receive loans from the company, unless approval has been given from the Supervisory Board. During their employment, *Management Board Members* are subject to a comprehensive non-competition obligation. Specifically, they may not, in connection with their work, demand nor accept from third parties payments or other advantages for themselves or for any other person, nor grant third parties unlawful advantages. *Supervisory Board Members,* now required to consist of an adequate number of independent directors, need the Supervisory Board's approval to take on advisory and other service agreements and contracts for the company. They, as well as their relatives, cannot receive loans from the company unless there has been prior approval from the Supervisory Board and they have to resign when conflicts are of a material nature or are not merely temporary. As Supervisory Board Members, *employees* ([43]) may not, in connection with their work, demand nor accept from third parties payments or other advantages for themselves or for any other person nor grant third parties unlawful advantages. German laws also deal with self-dealing between controlling shareholders and their company by qualifying such transactions as "concealed distributions" whenever carried out at unfair conditions ([44]). In other terms, operations carried out with a shareholder on unfavourable terms are automatically regarded as "substantial distribution" to that shareholder and, as such, considered illegal since they are not conducted according to the rules for dividend distribution.

The attention paid to regulate the activity of administrators is strong also in Eastern Europe, especially in the Czech Republic.

According to the **Czech Republic'**s discipline Directors must not take personal advantage of the company's opportunities, allow their personal interests to conflict with those of the company or misapply the company's assets; they are also subjected to certain duties in order to avoid situations of conflict of interest ([45]).

Moreover, Members of the Board of Directors/Supervisory Board, as individual authorized to act in the name of the company, or persons close to them, cannot conclude with the company a credit/loan contract, or a contract on securing the debts of these persons, or a contract for free-of-charge transfer of property from the company, or enjoy from the company an assumption of suretyship, unless the prior approval of the general meeting and only under the terms customary in business transactions. In the case these persons are authorized to act in the name of another person, the previous provisions shall apply, as appropriate, to any performance stipulated therein in favour of such persons ([46]).

Additionally, the company (or a person controlled by the latter) cannot acquire property for a consideration from its founders or persons involved in concerted conduct with the former, from members of the Board of Directors/Supervisory Board, individual authorized to act in the name of the company, persons close to them, or controlled by the former, or from the same holding-type group, unless:

- the value of such property is determined on the basis of a court-appointed expert's report;
- the property is acquired within the framework of customary business transactions;
- the acquisition is initiated or supervised by a state authority;
- the property is acquired on a stock exchange or similar public market.

The same rule applies if the company transfers its property to any such person for a counter performance in an amount equal to at least one-tenth of the company's subscribed registered capital at the day of acquisition; and if this acquisition occurs within three years of incorporation of the company, it must be approved by the general meeting ([47]).

Moreover, the consent of the Supervisory Board shall be required for acquire/alienate assets the value of which exceeds, in a single accounting period, one third of the shareholders' equity according to the last ordinary financial statements (or consolidated financial statements) ([48]).

Also in **Hungary**, to prevent situations of conflict an executive officer:

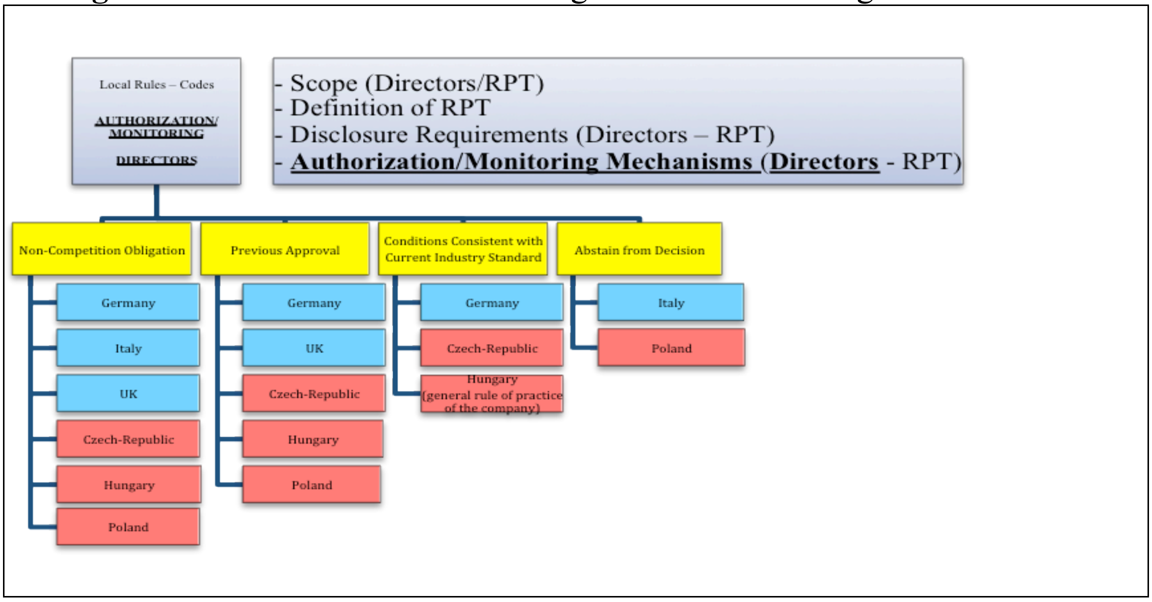
- may not acquire any share (except than in public limited companies), or accept an executive office (unless permitted by the memorandum of association or granted by the supreme body of the business association affected) in any economic operator whose main business activity is similar to that of the business association ([49]);
- and his close relatives or domestic partner may not (unless specifically permitted in the memorandum of association) conclude any transactions falling within the scope of the main activities of the business association in his own name and on his own account ([50]).

Moreover, any transactions and commissions between members of the Board and executive management (or persons close to them) and the company (or the company's subsidiaries) should be conducted according to the general rules of practice of the company. If these rules are not respected, the transaction and its terms should be approved by the Supervisory Board (or by the Audit Committee) ([51]).

Similar in **Poland**, Directors have a duty to do not to compete with the company. In fact, they cannot, without the consent of the company: involve himself in any competitive business; participate as a partner in a competitive partnership; sit on a management board or supervisory board of a competitive limited liability company or a competitive joint stock company; own 10% or more shares in such competitive companies; be authorized to appoint one or more management board members in such competitive companies ([52]). If a conflict between the company and the inside director (his spouse, relatives or those related up to the second degree, and persons with whom he has personal relations) occurs, the inside director must abstain from making any decisions and may request the recording of this fact in the minutes ([53]).

Finally, the consent of the shareholders' meeting is required for the conclusion of a loan agreement, a credit agreement, a surety agreement, or other similar agreements between the company and its director, or for the director's benefit. Rather, the consent of the supervisory board of the dependent company (or in its absence of the shareholders' meeting of the dominant company) is required for the conclusion of these agreements between the director of the dominant company and a dependent company ([54]).

Figure 5. – Authorization/Monitoring Procedures with regard to Directors



Looking at RPT, the Italian and UK disciplines are the most articulated throughout the reference sample; while German and East European Countries are less attentive.

Indeed, according to the **UK** Listing Rules, listed companies have to comply with the following procedures to be launched *ex-ante*:

- they must obtain the shareholders' approval before entering into the transaction/arrangement; or, if the transaction or the arrangement is expressly conditioned by this approval, before it is completed;
- they must ensure that the related party does not vote on the relevant resolution and that it takes all reasonable steps to ensure that not even the related party's associates vote on the relevant resolution.

In **Italy** the regulation is much more detailed. In accordance with the Audit Committee (*Comitato Controllo Interno*) the Board of Directors, has to ensure that transactions carried out with related parties are performed in a transparent manner, observing the criteria of substantial and procedural fairness. ([55])

Moreover, the CONSOB Regulation requires the following procedures to be applied, differentiating between RPT and "relevant RPT" in order to prevent unnecessary costs and guarantee an adequate level of managerial discretion:

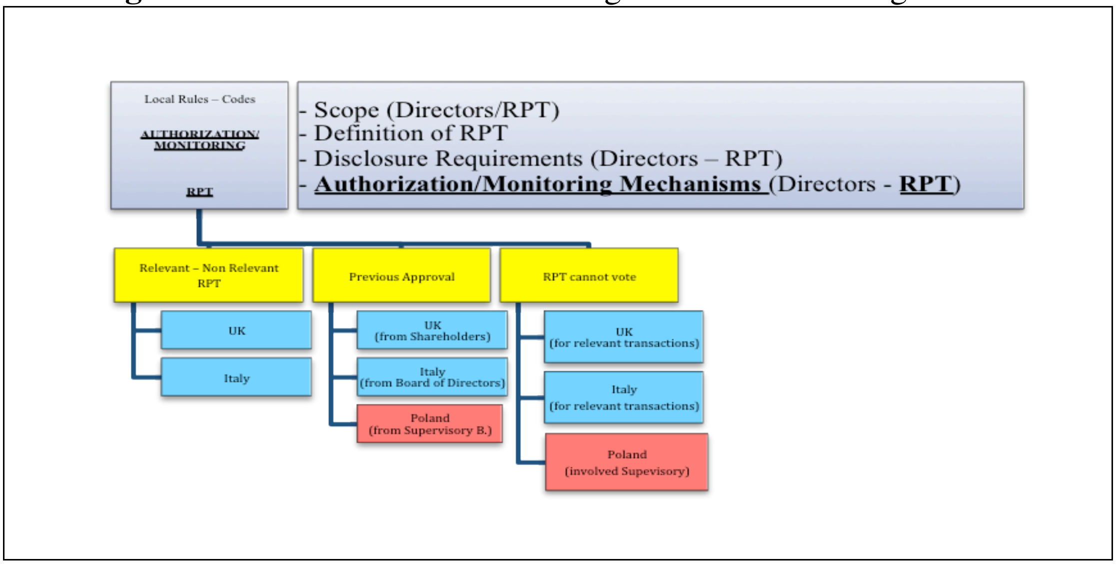
- for transactions not defined relevant: non-binding opinion from a committee of independent directors who are entitled to receive timely, ex-ante, adequate information; the possibility for independent directors to apply for independent advice at the company's expense; a thorough and documented examination, both in the preliminary investigation and in the deliberation phase, of the reasons behind the transaction and of the adequacy and accuracy of its material conditions; if the terms of transaction are defined equivalent to those of the market (or standard), elements of confirmation have to be attached to the prepared documents ([56]);
- for relevant transactions, the draft suggests providing more monitoring/authorization mechanisms: exclusive competence of the Board of Directors in the approval phase (after a favorable opinion from a committee of independent directors); involvement in negotiations and in the preliminary investigation of independent directors; in the event of unfavorable opinions from independent directors, the possibility (where provided by the company's statute and upon justification of the choice) that the transaction is fulfilled through shareholders approval ([57]).

In **Poland** transactions and agreements between the company and entities or individuals related to (or having direct or indirect influence on) the company, should be on arm's length basis and be subject to supervisory board approval. Any supervisory board members involved therein should not participate in the decision-making and relevant resolutions of the board should require a “yes” vote from at least two independent board members ([58]) .

Moreover, at least two members of the supervisory board should be independent. If they account for less than a half of the supervisory board, resolutions concerning issues that are crucial for the interests of minority shareholders (as transactions between the company and its parent entities or subsidiaries; setting the terms of share issues under the authorized capital; selection and appointment of the auditor) should require a “yes” vote from at least two independent board members ([59]) .

Finally the **Czech Republic** discipline, simply impose to the Board of Directors and to the Supervisory Board to monitor misuse of corporate assets and abuse in related party transactions ([60]).

Figure 6. – Authorization/Monitoring Procedures with regard to RPT



The overlapping area among the disclosure requirements and the authorization/monitoring mechanisms provided by national legislations becomes broader and broader.

However, this overview of the European self-dealing rules supports the convergence hypothesis even through differences between countries whose legal and economic frameworks, according to the path dependency view, should have lead to a common legislation on self-dealing.

In actual fact, although the ownership structure of most German entities is not distant from that of Italian firms, and although both countries are characterized by a strong Civil Law tradition, the ‘conflict of interests’ discipline adopted in Italy diverges considerably from the German one. Moreover, the analysis on local rules figured out some steps towards the Anglo-Saxon discipline also from Eastern European Countries, although they are have a Civil Law tradition too.

If these findings are interpreted as a clue to a weak relationship between self-dealing legislations and the economic and legal conditions of the countries in which they operate, it is reasonable to assume that the efficiency reasons described in the previous sections (decreasing *direct* and *indirect* costs and minimizing *switching* costs) will be strong enough to encourage a convergence process towards the Anglo-Saxon model.

5. Discussion and Conclusions

The European legal scenario concerning self-dealing and conflict of interests is still fragmented. The previous sections have stressed differences either in the discipline scope or in the authorization/monitoring mechanisms. However, notwithstanding these documented divergences, the brief analysis developed above has also highlighted several variables supporting the existence of a gradual convergence process of domestic self-dealing legislations towards the Anglo-Saxon model.

Indeed, the endorsement by the European Commission of the International Financial Reporting Standards obliges listed companies in all six countries to draw up their financial statements according to the IAS/IFRS, adopting accounting standards whose theoretical foundations are closer to the UK GAAP than the local ones. With regard to self-dealing and conflict of interests, this accounting harmonization process has implied the implementation of IAS n. 24, with the introduction of a common definition of related party and the requirement of a periodic and detailed related party disclosure.

Moreover, according to local rules, the first aspect common to all of the Countries composing the sample is the requirements, for Directors, to avoid situations of conflict of interest. Also the increasing attention given to the role played by "independent directors" in preventing corporate controllers' opportunistic behaviour is an important factor signalling a gradual approach of local self-dealing rules towards the Anglo-Saxon's discipline.

Additionally, in almost all Countries composing the sample (UK, Italy, Czech-Republic, Hungary), Directors have to provide disclosure in all circumstances in which they have an interest; while German and Polish Directors are obliged to disclosure their interest just if these are conflicting with the company's ones.

With reference to disclosure to be provided about RPT, beyond the common reference represented by the IAS 24, Italy, as UK, differentiates between relevant and not relevnat RPT; in addition, unlike Germany and Poland, Czech Republic and Hungarian national rules also ask to provide some information about transactions undertaken with related parties.

Finally, there are also some common points in the national rules, from Countires making up the sample, with regard to the authorization/monitoring procedures both regarding:

- transactions involving Directors; indeed, in all selected Countries (except than Italy), the latters need to be previously approved by uninterested party;
- RPT, with regard to which the strongest similarities are between the Italian and the UK discipline. On this point, it is relevant to note that also Poland and Czech-Republic implemented some procedures, even if less demanding than the previous ones.

In practice, with regard to the *Western European Countries*, the Italian discipline is clearly moving towards that of the UK with concern to either the required disclosure or the implemented control systems; on the other hand, although the German legislation shows a slower pace in that direction, the increasing role played by the independent directors in carrying out the *Supervisory Board* functions also testifies to the strong influence of the Anglo-Saxon system over the Rhine one.

Also with regard to *Eastern European Countries* we can find fewer, but still not negligible, significant changes towards the Anglo-Saxon's discipline.

For these reasons, it is possible to conclude that the differences concerning a firm's ownership structure together whit the socio-economic conditions of the Countries examined do not seem to prevent more and more intense cooperation between national regulatory agencies. In other words, our hypothesis of the centripetal effects exercised by the positive economic consequences (in terms of lower direct and indirect costs) associated to the rise of a common legal framework in a global market is at least partially verified. And this provides encouragement for further analysis of the factors leading to the development of European self-dealing regulations.

In particular, a deeper investigation into the nature of direct and indirect costs borne by the market participants, as a consequence of poor cooperation among national regulators, has to be carried out. Above all, a more detailed assessment of induced costs is required in order to better appreciate the corporate controller's behaviour and his ability to take advantage of market imperfections and legal divergences. Obviously, the wider the sample of European countries involved in any future analysis, the more robust will be the outcomes achieved.

([1]) In actual fact, the *non-intervention approach* assumes that outside investors are able to price securities according to the effectiveness of the protections offered by firms whose stakes they hold. However, the high costs associated to the process of gathering and evaluating all relevant information useful in an appreciation of the quality of governance systems could discourage market participants from carrying out such a deep examination and eventually lead to a market failure situation.

([2]) Shareholder approval (the "majority of the minority vote") and independent directors/external appraisal ratification fall within a property-type protection. On-going disclosure and the enforcement of supervisory agencies and criminal sanctions are a direct expression of such a liability-protection rule.

([3]) We specifically refer to the well known "anti- director rights" (La Porta *et al.,* 1997, 1998) and "anti-self dealing" indexes (Djankov *et al.,* 2008).

([4]) On the other hand, recent scandals involving companies subject to Anglo-Saxon legislation offer some anecdotal evidence contrasting such a position and encourage a more careful examination of the rules rooted in Civil Law systems.

([5]) Previous researches have pointed out a positive association between the top management team (TMT) diversity and the firm"s internationalisation process (Ruigrok *et al.,* 2007; Barkema, Shvyrkov, 2007; Lee, Park, 2006). A significant impact of foreign board membership on the firm"s value has also been proved, ascribing such a correlation either to a stronger international posture or to a more demanding corporate governance mechanism that generally characterizes firms with a high TMT diversity (Randoy, Oxelheim, 2001).

([6]) An increasing corporate mobility is also expected in the European Union. Indeed, since the end of the 20th century, the European Court of Justice (ECJ) has repealed the so-called "real-seat rule", allowing companies to incorporate in countries different from those which they operate in (Ryan, 2005; Becht et al., 2008). Firms can now freely choose where to incorporate, balancing between the quality of the proposed governance rules and the costs associated to similar legal systems (Kamar, 2006; Becht et al., 2008).

([7]) Although U.S. markets are the main target for dual-listing firms (Pagano et al., 1999), European ones have also widely increased their attractiveness for cross-listing activity. As a consequence of Stock Exchange mergers and the adoption of a common body of accounting standards, the implementation of cross-listing strategy into EU borders has become more feasible, and have positively affected shareholders" wealth and minorities" protection.

([8]) The "proprietary" or "inter-firm" costs concern the negative effects of a more detailed disclosure that the corporate controller has to bear because of the consequent disadvantages relative to its competitors, major suppliers or major customers. Outside investors will not be affected by similar costs because the "inter-firm" disadvantages to the issuer are counterbalanced by the advantages it confers on the other firms.

([9]) In particular, with respect to the governance mechanisms adopted in the last few years, non Anglo-Saxon firms show stronger independent mechanisms of control as testified by smaller boards, more independent directors, more independent audit, nominating and remuneration committees. Moreover, a more detailed disclosure on governance matters is delivered.

([10]) The survey refers only to regulations affecting the directors and related parties, focusing on the information that must be provided and the mechanisms of control/authorization to which they are subjected.

The analysis does not take into account the mechanisms for remuneration of the boards of the corporation.

There is also no analysis of the role of the audit and of the enforcement, that also deserves attention.

([11]) According to the paragraph 9 of the IAS n. 24, a related party is:

a) a person or a close member of that person's family if that person:

- has control or joint control over the reporting entity;
- has significant influence over the reporting entity; or
- is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.

(b) an entity if any of the following conditions applies:

- the entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others);
- one entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member);
- both entities are joint ventures of the same third party;
- one entity is a joint venture of a third entity and the other entity is an associate of the third entity;
- the entity is a post-employment defined benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity;
- the entity is controlled or jointly controlled by a person identified in (a);

– a person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel (11) of the entity (or of a parent of the entity).

([12]) See German Corporation Law, § 311 Aktiengesetz, that prohibits the controlling enterprise from using its influence to induce a subordinate enterprise to enter into a transaction that is disadvantageous to the subordinate enterprise without being given compensation.

([13]) See Italian Civil Code, Art. 2391 and 2391-bis and the Regulations containing provisions relating to transactions with related parties, CONSOB 2010.

([14]) According to the Annex 1 (Definitions of related parties and related party transactions and functional definitions thereof) of the Regulations containing provisions relating to transactions with related parties (CONSOB 2010), an entity is a related party to a company if:

(a) directly or indirectly related, through subsidiaries, trustees or an intermediary:

(i) controls the company, is controlled by, or is under common control;

(ii) holds a stake in the company to exert significant influence over the entity;

(iii) exercises control over the company jointly with others;

(b) is an associate of the company;

(c) is a joint venture in which the company is a participant;

(d) is one of the key management personnel of the company or its parent;

(e) is a close relative of a person referred to in paragraphs (a) or (d);

(f) is an entity in which a person referred to in paragraphs (d) or (e) exercises control, joint control or significant influence or owns, directly or indirectly, a significant portion, but not less than 20 % of voting rights;

(g) is a supplementary pension fund, collective or individual, Italian or foreign, established for the employees of the company, or any other entity associated with it.

([15]) See Companies Act 2006, Art. 177.

([16]) There is also a very articulated regulation, which deserves an independent analysis, which covers the field of insider dealing and market manipulation, see “Act CXX 2001 on the Capital Market”; and a discipline that deals specifically the investment firms, see “Act CXXXVIII 2007 on Investment Firms and Commodity Dealers, and on the Regulations Governing their Activities”.

([17]) See Corporate Governance Recommendations, Principle 4.1.14.

([18]) See Commercial Companies Code, Art. 209 and Art. 377.

([19]) See Corporate Governance Code, Commentary on Chapter V.

([20]) See Gdansk Corporate Governance Code, Comments on the Principle 3.1.

([21]) See Commercial Code - Act No. 513/1991 "Obchodní zákoník" -, Section 66a(2).

([22]) According to the Commercial Code - Act No. 513/1991 "Obchodní zákoník" -, in particular a controlling person is a person who:

- is a majority member (shareholder) (Section, 66a(3));
- has at its disposal a majority of voting rights based on an agreement with another member (shareholder) or members (shareholders) (a "pooling agreement") (Section, 66a(3));
- can force through the appointment or election or recall of the majority of persons who form the statutory organ or are members of such, or the majority of persons who are members of the supervisory organ (supervisory board) of the legal entity of which he is a member (shareholder) (Section, 66a(3));
- has at its disposal at least 40% of the voting rights in a legal entity, unless it is proved that another person has at its disposal the same or a higher percentage of the voting rights, (Section 66a(5)).

([23]) The concerted conduct shall mean conduct undertaken in particular by:

a) a legal entity and its statutory organ or a member of such, or persons directly managed by such;
b) a member of the supervisory organ, a liquidator, a bankruptcy trustee, a composition trustee (settlement administrator) or an administrator concerned with enforced administration, or mutually between these persons;
c) the controlling person and persons controlled by it;
d) persons (entities) controlled by the same controlling person; or
e) persons (entities) forming a holding-type group.

See Commercial Code, Section 66b(2) – Concerted Conduct.

([24]) See Commercial Code - Act No. 513/1991 "Obchodní zákoník" -, Section 66b(1).

([25]) Moreover, according to the Commercial Code, Section 66b(3), unless the contrary is proved, it is assumed that concerted conduct is conduct undertaken by:

- a limited liability company and its members or mutually between its members;
- a general commercial partnership (i.e. an unlimited partnership) and its partners or mutually between its partners;
- a limited partnership and its general partners or mutually between its partners;
- close persons;

- an investment company and an investment fund, or a pension fund, managed by such investment company, or between an investment company and investments funds which it manages; or
- a brokerage house and a person whose securities the brokerage house manages, if the former can make use of voting rights attached to such securities.

([26]) See Listing Rules, Chapter 11 – Related party transactions: Premium listing, updated at July 2012.

([27]) In accordance with the Interpretation Act 1978, the concept of person measn any person, including a body of persons corporate or unincorporate (that is, a natural person, a legal person and, for example, a partnership).

([28]) According to the par. 16 of the IAS 24, regardless of whether there have been transactions between a parent and a subsidiary, an entity must disclose the name of its parent and, if different, the ultimate controlling party. If neither the entity's parent nor the ultimate controlling party produces financial statements available for public use, the name of the next most senior parent that does so must also be disclosed.

According to the pars. 18 – 19, the following information has to be disclosed, separately for each category or related parties, when an RPT occurs:

a) the amount of the transactions;
b) the amount of outstanding balances, including terms and conditions and guarantees;
c) provisions for doubtful debts related to the amount of outstanding balances;
d) expense recognized during the period in respect of bad or doubtful debts due from related parties.

([29]) "L'amministratore deve dare notizia agli altri amministratori e al collegio sindacale di ogni interesse che, per conto proprio o di terzi, abbia in una determinata operazione della società, precisandone la natura, i termini, l'origine e la portata […].

See Italian Civil Code, Art. 2391.

([30]) "If a director of a company is in any way, directly or indirectly, interested in a proposed transaction or arrangement with the company, he must declare the nature and extent of that interest to the other directors."

See Companies Act 2006, Art. 177.

([31]) This information concerns: risks related to potential conflicts of interest of related parties involved in the transaction; characteristics, rules, terms and conditions of the transaction; nature of the related party relationship and of their interests in the transaction; economic opinion of the company for the implementation of the transaction; methods for determining the transaction price and assessments regarding its adequacy compared to market values of similar transactions (indicating any assessments conducted by professionals in support of the fairness of that price, whether such assessments have been specially commissioned by the issuer); economic and financial effects of the transaction; reward of the board"s members of the company and/or of its subsidiaries whether the amount of the reward is likely to vary as a result of the transaction.

See Regulations containing provisions relating to transactions with related parties, CONSOB 2010, Annex 4.

([32]) According to the CONSOB Regulation, a transaction is considered to be relevant whenever at least one of the following ratios is higher than 5%:

- price ratio: price exchanged / average market capitalisation over the last 6 months;
- assets ratio: net asset value of the exchanged good / total asset value of the involved company;
- earnings ratio: gross earning referable to the exchanged good / company"s gross earning;
- liabilities ratio: total liabilities referable to the exchanged good / company"s total assets;
- sales ratio: price exchanged / company"s revenues.

See Regulations containing provisions relating to transactions with related parties, CONSOB 2010, Annex 3.

([33]) According to the Listing Rule n. 11 Annex, par. 1.1., a small transaction is defined as a transaction or arrangement where each of the applicable percentage ratios is equal to or less than 0.25%.

([34]) See German Corporation Law, § 311 Aktiengesetz.

([35]) See Corporate Governance Reccomendations of Budapest Stock Exchange, May 2008, Principle IV.

([36]) See Commercial Code, Section 66a(9).

([37]) See Commercial Code, Section 66b(1)(2).

([38]) See Commercial Code, Section 66a(9).

([39]) See Corporate Governance Code, Chapter II.

([40]) See Italian Civil Code, Art. 2391.

([41]) See Italian Civil Code, Art. 2390.

([42]) See Companies Act 2006, Art. 175.

([43]) In companies with more than 2,000 employees, the supervisory board must consist of equal numbers of shareholder-elected and employee-chosen members (so- called "co-determination). To break ties, the shareholder- selected chairman has a second vote.

([44]) Stock Corporation Act (Aktiengesetz), art. 57.

([45]) In, order to prevent conflict of interests' situations, Directors may not:

- carry on, either on his/her own behalf or on behalf of a person connected with, any business activity that is of the same kind as, or is connected to, a business activity of the company, or enter into business relationships with the company;

- mediate business activities of the company for other persons;
- take part in the business activities of another company as an associate with unlimited liability, or hold a controlling interest in another company with the same or similar scope of business; and/or
- perform the office of a director or other statutory or other body, or its member, of another legal entity which carries on the same or similar business, unless the companies are members of the same holding group.

Those rules are imposed by the Commercial Code, Section 196. Moreover, the articles of association may stipulate additional limitations.

([46]) See Commercial Code, Section 196a.

The tie is stressed also by the Corporate Governance Code, according to which all contracts for the sale of assets or products between the company and the management, key executives, board members, shareholders, or persons connected with them, should be undertaken at arms' length and approved by a general meeting of the company prior to their execution.

See Corporate Governance Code, Chapter III.

([47]) See Commercial Code, Section 196a.

([48]) See Commercial Code, Section 193(2).

([49]) See Company Law Act CXLIX-2006, Section 25.

([50]) See Company Law Act CXLIX-2006, Section 25.

([51]) See Corporate Governance Recommendations, Principle II.

([52]) See Commercial Companies Code, Artt. 211-380.

([53]) See Commercial Companies Code, Artt. 209-377 and Gdansk Corporate Governance Code, Principle 3.

([54]) See Commercial Companies Code, Art. 15. About the consent, it may be granted before or after the conclusion of the contract, but not later than within two months of the date on which the company makes the relevant declaration.

([55]) See Regulations containing provisions relating to transactions with related parties, CONSOB 2010, Article 4.

([56]) See Regulations containing provisions relating to transactions with related parties, CONSOB 2010, Article 7.

([57]) In this case, the deliberation mechanisms have to be devised in order to prevent the vote being determined by shareholders who are a related party in the transaction (whitewash, though conditional on the presence of a minimum share capital owned by minorities).

See Regulations containing provisions relating to transactions with related parties, CONSOB 2010, Article 8.

([58]) See Gdansk Corporate Governance Code, Principle 3.

([59]) See Gdansk Corporate Governance Code, Principle 2.

([60]) See Corporate Governance Code, Chapter VI.

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