CORPORATE GOVERNANCE: RATING OF THE EU MEMBER STATES GUIDELINES

Krambia-Kapardis, M.* Psaros J. and Solomon, J. F.*****

Abstract

This paper presents a synthesis and analysis of corporate governance guidelines of the twenty-five European Union (EU) member states. The paper focuses on observable and quantifiable aspects of corporate governance including key aspects pertaining to the composition and operation of the board of directors, audit committee, remuneration committee, nomination committee, and other corporate governance policies. Using an Australian corporate governance ranking system, contained in the Horwath Report, the Corporate Governance (CG) Guidelines were analysed and rated. Based on the rating system, thirteen of the twenty-five EU countries had guidelines that were considered to be lacking in several key areas. In contrast, Ireland and the United Kingdom have the most detailed and rigorous corporate governance guidelines. Countries with less developed economic frameworks have the least detailed and rigorous corporate governance guidelines. Finally the specificity of corporate governance guidelines varies greatly between the various countries either due to the system used (one or two tier systems) or whether the country's legal system is predominately common or statutory law. The aim of the paper is not to determine the compliance of individual companies on their company's CG Code but to rate the Codes of the countries so as to assess whether there ought to be stricter regulatory measures by the EU on its member states.

Keywords: international corporate governance, ranking of European codes

* *Professor in Accounting, PricewaterhouseCoopers Chair in Applied Accounting Research, Intercollege, Nicosia, Cyprus email: kapardis.m@intercollege.ac.cy*
***Associate Professor, School of Business and Management, The University of Newcastle, Australia. Email: Jim.Psaros@newcastle.edu.au*
*** *Senior Lecturer in Finance, Cardiff Business School, Cardiff University, UK, Email: solomonjf@cardiff.ac.uk*

Introduction

While corporate governance (CG) is anything but a new area of enquiry it has taken on greater international significance since the mid 1990s due to the corporate collapses of Enron, WorldCom, Parmalat etc. An example of a nation waiting to implement CG after a corporate crisis or a stock exchange crash is Cyprus. In the 1990s while there was a boom in the stock exchange and everyone was "winning" there was no discussion of implementing a Corporate Governance Code. Once there was a crash in 1999, the Code was enforced. The United States has responded with the Sarbanes-Oxley Act and the European Union with the publication of the Winter Report of the High Level Group of Company Law Experts (Maasen et al., 2003)

For all countries, but particularly for countries with developing economies, international investment highlights the need to demonstrate the existence, or at least commitment, to the development of quality corporate governance practices. Respective regulatory authorities in most European Union (EU) countries have been pro-active in prescribing "best practice rules or guidelines". As Spanos (2005) states "CG has significant implications for the growth prospects of an economy. Proper CG practices diminish risk for investors, attract investment capital and improve corporate performance" (p.16). Maher and Andersson (1999) have stated that corporate governance affects the industrial competitiveness of countries due to increasing competition and capital mobility. Johnson et al. (2000) and Mitton (1999) have drawn inferences between weak corporate governance and currency crisis. It is important therefore that there is an effective corporate governance code to avoid fluctuations in the market, protect the investors and the overall country's economy.

> "A corporate governance rating could be a powerful indicator of the extent to which a company is currently adding, or has the potential

to add in the future, to shareholder value. This is because a company with good corporate governance is generally perceived as more attractive to investors than one without" (Editorial, *Corporate Governance: An International Review*, 2001, Vol 9, Number 4, p. 257)

Literature Review

As Solomon and Solomon (2004) state the " system of corporate governance presiding in any country is determined by a wide array of internal factors, including corporate ownership structure, the state of the economy, the legal system, government policies, culture and history" (p. 147). In addition, the same authors argue that there are also externalities such as the global economic climate, cross-border institutional investment and the extent of overseas capital inflows which too affect the corporate governance system of a country. As Prowse (1994) notes there are two main corporate governance systems, the Anglo-Saxon model[1] or the institutionally-based model[2]. Solomon et al. (2002), and Solomon, et al. (2003), state that for developing countries to be internationally competitive and attract foreign capital, they need to adopt "commonly accepted standards of corporate governance" (p. 235).

Countries however have unique cultural, legal and economic characteristics and therefore most countries have their own corporate governance guidelines. According to the European Corporate Governance Institute there are more than 107 codes introduced since 1992 in 35 countries and in Europe alone more than 55 codes have been introduced in 19 countries (Gregory, 2002).

Research into corporate governance systems internationally has been carried out. Shleifer and Vishny (1997) focused on the influence of countries' legal systems on corporate governance while La Porta et al. 1997 explored the links between legal systems and corporate governance. Schmidt and Spindler (2002) have compared the German (insider control) to the US (outsider control) system while Charkham (1994) compares the corporate governance systems of five countries, traces their origins, and shows that they all fit national history and political preferences. Conyon and Schwalbach (2001) compare remuneration and compensation practices in different European countries while Witt (2004) compares the US, German and Japanese governance systems.

Solomon et al. (2002) note that both the OECD and CalPERS emphasise the need to recognise the different cultural, legal and economic characteristics and how these have engendered the individual corporate governance systems of each country. However, some other writers are not as sympathetic to the cause of developing economies and their idiosyncrasies. For example Webb, cited in Mertzanis (2001) states:

> People who defend bad corporate governance on the grounds of … some cultural differences are talking nonsense. I think it is a reflection on an ownership structure that gives people the ability to abuse public shareholders and perhaps the mentality that the public is fortunate to be owning shares and providing finance for a company, but not be part-owner of the business. (p.100)

As Solomon and Solomon (2004) state "corporate governance standardization is one way of building confidence in a country's financial markets and of enticing investors to risk funds. (p. 153)" In an attempt to globalise corporate governance the Organization for Economic Co-operation and Development (OECD, 1999 and 2004) issued a set of principles designed :

- *Tto achieve the highest sustainable economic growth and employment and a rising standard of living in member countries, while maintaining financial stability, and thus to contribute to the development of the world economy.*
- *To contribute to sound economic expansion in member as well as non-member countries in the process of economic development; and*
- *To contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations.* (p.2)

The OECD principles have been endorsed by the OECD Ministers in 1999 and were revised in 2004 to take into account recent developments and experiences in OECD member and non-member countries. The guidelines have provided an international benchmark for policy makers, investors, corporations and stakeholders. The Winter Report reviews a number of issues in reference to corporate governance and recommends that listed companies disclose more information on the role of non-executive and supervisory directors, management remuneration and the responsibility of management as far as financial statements and auditing practices. The European Commission on May 2003 presented an Action Plan on corporate governance and as Spanos (2005) and (European Shadow Financial Regulatory Committee, (2002) and Soderstrom et al. (2003) state, this initiative demonstrates the fact that "there is pressure to harmonize the national regulatory frameworks and perhaps ultimately create a single European market for corporate control (p17). Doidger et al. (2004) have found that compliance to governance depends on how developed a country is.

[1] This model is also referred to in the literature as the Anglo-American model, the outsider model, or the market model.
[2] This model is also referred to in the literature as the Bank-based model or the insider model.

There is no uniformity in the EU member States CG Guidelines. As Ugeux (2004) states in the last decade there have been a number of initiatives due to the fact that there is no global regulatory framework. These initiatives were the Lyons G7 meetings which looked at the possible ways to achieve some form of regulatory framework for global financial institutions and capital markets.

To date there has been little attempt to compare and contrast the various corporate governance codes of practice. The main study was carried out by the European Union (Weil, Gotshal & Manges LLP, 2002) and a smaller scale study by Collier and Zaman (2005) who have looked at convergance of audit committees of 20 European countries. The former study presented the findings of a detailed content analysis which examined the Guidelines at the time. However, there has been a proliferation of codes of practice and best practice corporate governance guidelines throughout the European Union, since this study, as well as enlargement of the European Union membership.

The purpose of this paper however is not to compare the European corporate governance guidelines and aim to determine whether they are in line with the OECD principles. The primary aim of the paper is to utilise a corporate governance rating system to rate and rank EU countries according their best practice corporate governance guidelines. This constitutes a significant extension from the more common approach of simply comparing the corporate governance practices of individual corporations and entities (Witt, 2004; Ugeux, 2004; Buck and Shahrim, 2004; OECD survey 2004).

In conjunction with the prominence and increased public reporting and harmonization of corporate governance there has also been a corresponding evolution of corporate governance rating systems in several different Western Countries. By way of example some of the more prominent rating reports in Australia include the Horwath Report[3], RepuTex[4], Governance Metrics International[5] and the Ethical Investor[6]. They all differ in their respective methodologies, but all have the similar goal of trying to measure and rank entities on the basis of their corporate governance.

It needs to be acknowledged that the results of the present study will be indicative rather than conclusive. The key reason for this is that best practice guidelines are not necessarily synonymous with actual practice. To illustrate the tentative nature of the ratings based on the best practice guidelines of the various countries may differ significantly from actual to corporate practice. The secondary aim of the present paper is to provide a rich description and summary of the corporate governance guidelines of the EU countries.

Methodology

The corporate governance rating system that is used in this paper is the rating system that is used in the Australian "Horwath Corporate Governance Report"[7]. There are several rating systems that could have been used, but the decision to use the Horwath Report was based on pragmatic issues to do with cost and availability. Most (possibly all) rating systems sell data bases emanating from their rankings, but do not make their specific research design available. However, one of the authors of this paper is a principal researcher of the Horwath Report. Accordingly, he is able to make use of the research design employed in the Horwath Report to the analysis of this paper.

With the same philosophy and justification as Collier and Zaman (2005) the present authors chose to carry out a comparative analysis of the European countries since there are "countries with varying traditions of corporate governance, and second, the European Commission has been actively addressing the issue with an Action Plan aimed at delivering the integrated and modern company law and corporate governance framework which businesses, markets and the public are calling for" (EU Institutions Press Release, IP/03/716 21 May 2003).

The corporate governance guidelines of each of the EU countries were obtained from the European Corporate Governance Institute web site in July of 2004.[8] The web site as Collier and Zaman (2005) state has an academic integrity and its role is to undertake commission and disseminate research on corporate governance. The full titles and references to the Guidelines are contained in the bibliography.

The Horwath Corporate Governance Model

The specific detail of the model used to derive the ratings is proprietary information.[9] The model has been used annually since 2002 to rank Australia's largest 250 companies on the basis of their corporate

[3]http://www.newcastle.edu.au/school/newc-business/horwath/index.html
[4] http://www.reputex.com.au
[5] http://www.gmiratings.com
[6] http://www.ethicalinvestor.com.au

[7]http://www.newcastle.edu.au/school/newc-business/horwath/index.html
[8] http://www.ecgi.org/codes/all_codes.php
[9] The Horwath Report is copyright by the University of Newcastle (Australia) and is based on research by Jim Psaros (one of the authors of this paper) and Michael Seamer from the University of Newcastle's School of Business and Management.

VIRTUS INTERPRESS ®

governance mechanisms. While no model could claim to cover all aspects of good governance, the Horwath Corporate Governance Model does appear to have reasonable credibility in the Australian financial press and academic community. The report, which is released annually, has been reported in all the major Australian financial press and has been the basis for ongoing academic research. Linden and Matolcsy (2004) described the Horwath Report as the "best-known Australian corporate governance scoring system". One further indication that the Horwath Report is making a useful contribution to the corporate governance debate in Australia is the fact that it forms the basis for research papers from academics from several leading Australian universities. For example, research papers based on Horwath Report data were written by leading accounting and finance academics at several Australian universities (eg West Australia Business School, The University of New South Wales, The University of Technology Sydney, and The Melbourne Business School). Papers include Linden and Matolcsy (2004) and Beekes and Brown (2006). No model would claim to capture all dimensions of corporate governance. Certainly the Horwath Report does not. However, it does provide a quantifiable and objective measure of corporate governance structures.

In short the Horwath model considers objective factors based on publicly disclosed information pertaining to the existence and structure of a company's Board of Directors and associated committees, the level of perceived independence of the company from the external auditors, and disclosures relating to the existence of a code of conduct, risk management and share trading policy. A brief discussion and justification of each of these factors follows.

Components Tested

1. Board of Directors

The Board of Directors is the ultimate decision making body of an organisation and thus plays a crucial role in many areas including corporate governance (Garratt, 1996; Jensen, 1993; Yermack, 1996; Higgs Report 2003). However, an effective board will contain ethical, skilled and critically thinking individuals who contribute special expertise to the company. Solomon (2007) suggests that a whole host of diverse factors are being recognised as influencing board effectiveness and stresses the importance of ethics in the boardroom, as an essential ingredient to 'good' corporate governance. Nicholson and Kiel (2004) conceptualise the board as a 'social phenomenon' with an effective board achieving an appropriate fit between elements of intellectual capital and board functions. They argue that the human dimension, as well as other complex factors, means that board dynamics cannot be analysed purely in an agency theory framework. Garratt (2005) suggests that future boards should be genuinely altruistic, driven by ethics and professionalism.

More specifically the Board is responsible for determining, implementing, maintaining a culture of integrity (ICGN, 2005). The Board will also have an "appropriate" level of independence. For a listed public company there needs to be a balance between internal, non-independent "finger on the pulse" expertise, and external, independent representation (Mace, 1986; Alkhafaji, 1989). While there is no one-size-fits-all formula for all organisations, it seems well established internationally (eg. ASX Corporate Governance Council, Australian Investment and Financial Services Association, New York Stock Exchange Governance Rules, US Blue Ribbon Report, Felton and Watson, 2006), that there needs to be a majority of independent members and including the Chair. In addition a board needs to meet on sufficient occasions to be effective in meeting its oversight role Useem and Zelleke (2006).

For the purposes of the Horwath model the most desirable outcome will be for a company to have:

- a board with the majority of independent directors;
- an independent chairperson; and
- met at least 6 times annually.

The least desirable outcome will be for a company to have:

- a board with <u>no</u> independent directors;
- the CEO as chairperson; and
- met less than 6 times annually.

2. Audit Committee

The importance of the audit committee to effective corporate governance has been well established in the literature for some time now (Cadbury Committee, PricewaterhouseCoopers 2001). Recent research also confirms empirically some of the advantages that result from a properly constituted and independent audit committee. Abbot, Parker and Peters (2004) find that companies that have independent audit committees are less likely to be associated with restated financial statements (i.e. correcting prior year errors) and fraud, than companies that do not have independent audit committees.

An audit committee is also a crucial component of effective corporate governance. It serves to strengthen the auditor's independence by providing an independent forum where issues relating to the audit, can be referred on a timely basis. An audit committee should be in a position to discuss matters with the external and internal auditor in the absence of management and non-independent directors (Collier and Zaman, 2005).

Most authoritative reports recommend that either

the audit committee be comprised *solely of independent* directors [eg. Treadway (1987), MacDonald Commission (1988), Cadbury (1992), Toronto Stock Exchange, New York Stock Exchange, Sarbanes Oxley (2002), Investment and Financial Services Association (2002)], or be comprised of a *majority of independent* directors [eg. Australian Accounting Research Foundation (1997), Bosch (1993, 1995), Ernst & Young (1992), the Blue Ribbon Committee (1999), and the ASX Corporate Governance Council Report (2003)]. The European Commissions Green Paper noted that "audit committees have developed into essential committees of board of directors" (1996, p.5) "with a view to fostering the key role it should play in supervising the audit function" (European Commission, 2003, p.15)

With respect to best practice on the regularity with which audit committees should meet there is less guidance. However, the Blue Ribbon Report (1999) states that "… the (audit) Committee shall meet at least four times annually, or more frequently as circumstances dictate" (p.68). Relevant to this point Abbot, Parker and Peters (2004) find that companies that had audit committees that met frequently were less likely to be associated with restated financial statements (ie. correcting prior year errors) than companies that had audit committees that did not meet frequently.

Therefore for the purposes of the model the most desirable outcome will be for a company to have:

- an audit committee with all the members, including the chair, to be independent;
- a chairperson, who is not the chair of the main board;
- at least one member with professional or educational accounting qualifications;
- at least 3 members; and
- met at least 4 times annually.

Of course, the least desirable outcome will be for a company not to have an audit committee.

3. Remuneration Committee

A remuneration committee is responsible for reviewing the remuneration of the directors and senior management and advising the Board whether the amounts are reasonable in comparison with industry and corporate yardsticks. A remuneration committee can be a more efficient mechanism than the full board for focusing the company on appropriate remuneration policies to enhance corporate and individual performance. The Higgs Report (2003) recommends that the Board should establish a remuneration committee; however the Australian Stock Exchange (ASX) Corporate Governance Council extends this and states that this committee should consist of a majority of independent directors, have an independent chairperson, and have at least three members. Whilst, Cadbury Report (1992) suggested that the Composition of the Remuneration Committee be wholly or mainly of Non- Executive Directors, Greenbury (1995) suggested that the members of the set committee be exclusively Independent Non-Executive Directors.

Consequently, for the purposes of the model the most desirable outcome will be for a company to have a remuneration committee with:

- all the members, including the chairperson, independent;
- At least 3 members.

The least desirable outcome will be for a company not to have a remuneration committee.

4. Nomination Committee

As was the case with a remuneration committee, the Cadbury Committee, Higgs Report as well as the ASX Corporate Governance Council recommends that the Board of Directors appoint a nomination committee. A nomination committee is responsible for proposing new nominees to the Board and advising the Board on the core competencies required of new directors. An independent director should chair the nomination committee and at least a majority of the committee should be independent. Further, the nomination committee should contain at least three members. Therefore for the purposes of the model the most desirable outcome will be for a company to have a nomination committee with:

- all the members, including the chairperson, independent;
- at least 3 members.

The least desirable outcome will be for a company not to have a nomination committee.

5. External Auditor Independence

While the empirical evidence remains mixed with respect to whether non-audit fees impact on audit judgements, there is little doubt that when the proportion of non-audit fees dwarfs the audit fee, the *perception* of audit independence is questioned. Whether this leads to sub-optimal judgements by the auditor is a vexed question.

Internationally, most regulators and accounting professional bodies have tread cautiously in terms of prohibiting the provision of non-audit services. In the USA the Sarbanes-Oxley Act (2002) greatly restricts the ability of the auditor to provide non-audit services. In Australia, the Corporations Act contains some provisions which give some prominence to the need for audit independence. Notwithstanding the above arguments, it is irrefutable that the auditor needs to be beyond reproach with respect to both the reality *and perception* of independence. Against this backdrop, it is likely that at least the perception of independence is clouded by an audit firm providing substantial

amounts of non-audit services to their client. Consequently, for the purposes of this study a weighting is placed on a limit on the proportion of non-audit fees (relative to audit fees) paid by a client to their auditor.

6.Code of Conduct and Other Policy Disclosures

A weighting is also included for disclosures relating to the existence and substance of a company's code of conduct, policy on risk management and policy on share trading. Brief discussion on each of these issues follows.

6.1 Code of Conduct – It is interesting that Cadbury (1992) "said virtually nothing about the application of ethics and responsibility in the boardroom…despite events…such as Zeebrugge ferry disaster" which had been affected by Board decisions (Keasey et al. 2005, p. 29). Intuitively it is to be expected that a quality organisation would engage in proper ethical behaviour at all levels of their operation. Consistent with this approach, it would also be expected that the organisation would document its policies on appropriate behaviour. Accordingly, a code of conduct is an effective way to guide the behaviour of directors and key executives and demonstrate the commitment of the company to ethical practices. Obviously the existence of a code of conduct does not guarantee ethical behaviour, but it is a start.

6.2 Policy on risk management – Up until recent times, the general theme was that risk (and risk management) was an issue that, *in an ad hoc manner*, floated onto the agenda of the audit committee, the internal audit function, the external auditor function, and the main board. In essence, while all parties had a concern for risk, there wasn't always a clear understanding, in specific circumstances, of where responsibility lay. A small, but concrete way of helping to eliminate duplication and/or over-looking of risk management responsibilities is to have clear policies on risk management.

A recommendation of the ASX Corporate Governance Council requires that the board, or appropriate committee, should establish policies on risk oversight and management. Implied within this recommendation is the possibility that a specific committee (eg. Audit committee or risk management committee) may oversee the risk function of an organisation. Even if the task is not delegated to a specific committee, the minimum is that a company should clearly document their policies on risk management. This should comprise more than a blanket statement of the kind that "the board has policies in place to consider risk management".

6.3 Policy on share trading – While in most countries the law prohibits insider trading per se, there is clearly a greater moral obligation for company directors and executives when trading in company shares. Simply they should only trade in their own company's shares in specific circumstances and during specific periods. Public confidence in a company can be eroded if there is insufficient understanding about a company's policies governing trading by "potential insiders". As a minimum, companies should disclose of the trading in company securities by directors, officers and employees. While disclosure is important, it is equally important that the policy on share trading has some rigour, and ideally restricts the trading of shares to selected limited time periods when the "potential insider" is less likely (or perceived to be less likely) to have privileged information.

6.4 "Soft" Governance Measures

There are other issues that impact on corporate governance that are not included in the Horwath model. Of course corporate governance is much more than independence levels, committee structures, and other policies. In addition to the above factors there are other issues that impact on corporate governance, including the ethical and corporate culture of the organisation and the skills and characteristics of the senior management and directors (i.e. "soft measures"). These "soft" difficult to measure attributes are clearly important.

No doubt soft governance measures are an important part of the overall corporate governance framework. However, by definition there is a significant measurement problem. As it is not possible to objectively measure these factors, they are not included in the model. No model, including that used in the Horwath Report, is absent of all subjectivity. However, the authors of the Horwath Report believe that the inclusion of other softer characteristics of governance into the model would overly water down the objectivity of the model and its findings. Without discounting the importance of "soft" governance measures, it seems hard to believe that the "hard" measures as examined in the Horwath model don't add *some* value to good governance. If that is not the case, then all the international best practice guidelines have got it completely wrong. Furthermore, it seems reasonable to presume that *in the majority of occasions*, quality "hard" measures of governance will facilitate quality "soft" measures of governance. Therefore, the Horwath model used in the research only considers objective, quantifiable and publicly available information.

Findings

Based on the model described previously, an overall corporate governance assessment and ranking was

performed for each of the 25 EU countries on the basis of their corporate governance guidelines. As noted previously in this paper, this constitutes a significant extension from the more common approach of analysing the corporate governance practices of individual corporations and entities. Quite possibly national best practice guidelines are not necessarily synonymous with individual corporate practice. In any event the results of the ranking are contained in Table 1.

INSERT TABLE 1 HERE

In aggregate the results are quite disappointing. Of the 25 EU countries, it is felt that the corporate governance guidelines of at least 13 of them are seriously lacking. In essence a one or two star rating meant that corporate governance guidelines were seriously lacking in most key areas. In particular, there appeared to be few (if any) requirements for an independent Board of Directors or any associated committees. In aggregate the corporate governance requirements were scanty in most if not all areas.

In contrast five countries (Ireland, the United Kingdom, Finland, Sweden and Slovakia) had corporate governance guidelines that could be described as “good or better”. Their corporate governance guidelines were rigorous, and met best practice standards. These countries recommended independence in all key areas including the Board of Directors, audit committees, remuneration committees and nomination committees, as well as prescribing other important corporate governance policies.

Star Ratings Explanations

5 stars (0 countries, 0%)

Corporate governance guidelines were rigorous and incorporated all best practice standards. There were requirements for unequivocal independence in all key areas including the Board of Directors, audit committees, remuneration committees, and nomination committees. The Board and related committees were required to meet regularly. There was a requirement for policies with respect to the provision of non-audit services by the external auditor, risk management, share trading, and a code of conduct.

4.5 stars (2 countries, 8%)

Corporate governance guidelines were rigorous and met all best practice standards other than in relatively minor circumstances.

4 stars (3 countries, 12%)

Corporate governance guidelines were very good and met the vast majority of best practice standards.

3.5 stars (4 countries, 16%)

Corporate governance structures were generally good and met most of the best practice standards.

3 stars (3 countries, 12%)

Corporate governance guidelines were adequate and met some of the best practice standards. Most of the trimmings of good corporate governance were present but usually there was no requirement that the Board and associated committees had a majority of independent members. There were also non-trivial short-falls in some other areas.

2 stars (10 countries, 40%)

Corporate governance guidelines were lacking in some key areas. There was no requirement that the Board and associated committees had a majority of independent members and there were significant corporate governance short-falls in several other areas.

1 star (3 countries, 12%)

Corporate governance guidelines structures were either totally lacking or inadequate in most key areas.

Descriptive Statistics

As mentioned in the methodology above the second purpose of the paper is to provide a rich description and summary of the corporate governance guidelines of the EU countries

INSERT TABLE 2

Using the SPSS package the details of each legislation were coded so as to determine a general overview of Corporate Governance Code’s expectations. As stated in Table 2 the majority of the CG’s in the member states are one-tier and 24% of the Guidelines state that the maximum number of board members should be sufficient whilst 28% do not make any mention of that. The number of CG Guidelines that do not mention the proportion of non-executive directors (NED) and executive directors (ED) is also alarming at 72% and 92% respectively. Regarding the number of independent non-executive directors (INED) on the Board 32% of the Guidelines state that the majority should be independent whist 92% do not state if the Chair should be INED or if he/she can be the CEO.

Regarding Audit Committees (AC) 76% of the Guidelines state that an AC should exist and 24% go as far as to state that the majority of the AC members should be INED, while only 12% of the Guidelines state that the AC Chair should be independent. A further issue regarding AC is that only 28% of the Guidelines state that AC member(s) should have some formal accounting experience.

Another issue that was looked at was the Remuneration Committee (RC), its composition and

its independence. 68% of the Guidelines stated that there should be an RC, whilst only 12% stated that it should comprise 100% of INED and only 8% stated that it should be chaired by an INED.

Another limb of Corporate Governance is of course the Nomination Committee, whereby 72% of the Guidelines specifically stated that there should a NC, and 16% had gone as far as to state the majority of the members of the NC should be independent.

Other issues that were looked at were: (a) as to whether risk management committee and written policies exist (0%); written policies but not formal committee existed (16%); (b) whether the code specifies the requirement for a Code of Conduct (8%); (c) whether the Code provides a restriction on the length of director tenure (40%) and (d) whether there was a policy on share trading requirements (no requirements were found in any of the EU Guidelines).

Regarding the issue of who qualifies to be considered as an independent non-executive director there is no uniformity in the Guidelines. The UK Code is the most exhaustive in its list but the rest of the other country Guidelines need further clarification. An example is the definition of independence provided in the Combined Code[10] to that in the Greek Code[11].

Concluding Comments and Caveats of the Research

The importance of corporate governance for all countries, but particularly for countries with an emerging economy has been well established in the literature (Doidger et al. 2004). While it might not appear "fair" or appropriate, many will be judged against traditional Anglo Saxon principles of corporate governance. Based on an Australian corporate governance ranking system (i.e. the Horwath Report) this paper ranks and rates EU country on the strength of their corporate governance guidelines.

In aggregate the results were disappointing, 13 of the EU countries provided corporate governance guidelines that were lacking in some key areas. Further, based on the ranking system, not one country achieved a 5 star rating for its corporate governance guidance. While the findings are interesting, care needs to be taken with their interpretation. Therefore the following caveats are noted.

First, the rating is based on the *guidelines* that apply in each country. In some circumstances the guidelines may exceed the practices of most (or all) entities in a particular country. As such they are held to be the "ideal" and entities will do well to follow some of the guidelines. Alternatively, in other circumstances the guidelines may be seen to be the "minimum" and actual practice will exceed it on a regular basis. Second, the legal framework or financial markets of some countries might not be not well geared to enforcement of some key governance principles. Consequently having rigorous, but not enforceable guidelines may not be that useful. Third, the rating system only considers observable and quantifiable aspects of corporate governance such as independence levels, committee structures, and other policies. In addition to the above factors there are other issues that impact on corporate governance, including the ethical and corporate culture of the organisation and the skills and characteristics of the senior management and directors (i.e. "soft measures"). These "soft" difficult to measure attributes are clearly important but are not factored into the model. Fourth, the model is based primarily on Australian measures and indices of good governance. Notwithstanding the reasonably non-contentious nature of them there is the prospect that some of them may not be suitable or appropriate for some EU countries.

It is obvious however, that the EU must either move towards harmonizing the CG Guidelines like it has done with the IFRs and is in the process of doing with the auditing standards or it should implement a regulatory body to enforce and ensure better CG Guidelines are in place in emerging economies. As demonstrated in this paper some countries have major deficiencies in their CG Guidelines which in turn could jeopardise investor confidence.

[10] Which is defined as a) not employee of the company, b) has or has had last 3yrs relationship with company, c) receives or received additional remuneration from company, d) has close families ties with any advisers or directors or employee or shareholders of the company, e) holds cross-directorships or links other directors through involvement in other companies or bodies, f) served on the board more than 9 years, g) represents a significant shareholders, h) independent to character and judgment .

11 Which is a) not employee of the company, b) has close families ties with any advisers or directors or employee or shareholders of the company

Bibliography

1. Australian Accounting Research Foundation, Australian Institute of Company Directors and the Institute of Internal Auditors, (1997), *Audit Committees: Best Practice Guide*, Melbourne.
2. Abbot L.J., S Parker & Peters G.F. (2004), " Audit Committee Characteristics and Restatements", *Auditing: A Journal of Practice and Theory*, Vol 23, No. 1, pp.69-87
3. Alkhafaji, A. F. (1989), *A Stakeholder Approach to Corporate Governance: Managing in a Dynamic Environment*, Quorum Books, USA.
4. Australian Stock Exchange (ASX) (2003), *Corporate*

Governance Principles and Guidelines, viewed 13 April 2004, www.asx.com.au

5. Austrian Working Group on Corporate Governance (2002), *Austrian Code of Corporate Governance, Vienna:* Office of the special Government Representative for the Capital Market.
6. Beekes W. and Brown, P (2006) “'Do better-governed Australian firms make more informative disclosures?', *Journal of Business Finance and Accounting*, Vol. 33. No. (3/4), p.422
7. Belgium Commission for Corporate Governance (1998) *Corporate Governance for Belgium Listed Companies.* Brussels: Brussels Stock Exchange
8. Blue Ribbon Committee (1999), *Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees. New York: New York Stock Exchange.*
9. Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees, (1999), “Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Audit Committees”, New York, NY: NYSE and NASD.
10. Bosch, H., (1993), Working Group of the Australian Institute of Company Directors, *Corporate Practices and Conduct*, 2nd edition, Information Australia, Melbourne.
11. Bosch Committee, (1995), Working Party of the Australian Institute of Company Directors, *Corporate Practices and Conduct*, 3rd edition, FT Pitman Publishing, Melbourne.
12. Buck T. and Shahrim A (2004), “The translation of corporate governance changes across national cultures: the case of Germany” *Journal of International Business Studies* Vol. 36, No. 1, pp.42-61
13. Cadbury (1992), *Report of the Committee on the Financial Aspects of CG: The code of Best Practice*, Gee Professional Publishing London.
14. Charkham (1994), *Keeping Good Company: A study of Corporate Governance in Five Countries,* Clarendon Press, Oxford.
15. Collier, P. and Zaman M. (2005), “Convergence in European Corporate Governance: the audit committee concept”, *Corporate Governance: An International Review*, Vol. 13, No. 6, pp.753-768
16. Conyon, M.J. & Schwalbach, J. (2001), *European Differences in Executive Pay and CG,* Zeitschrift fur Betriebswirtschaft, Special Issue 1 2001 .,pp.649-666
17. Cyprus Stock Exchange (2002), *Corporate Governance Code,* Nicosia: Cyprus Stock Exchange
18. Czech Republic Securities Commission (2001)**,** *Revised Corporate Governance Code Based on the OECD Principles,*Prague: Czech Securities Commission.
19. Denmark, Copenhagen Stock Exchange Committee on Corporate Governance (2003), *Report on Corporate Governance in Denmark,* Copenhagen: Copenhagen Stock Exchange
20. *Doidger C., Karolyi G.A., and Stulz R.M. (2004) Why do countries matter so much for corporate governance? Finance working paper no 50/2004 (www.ecgi.org/wp)*
21. Editorial (2001) *Corporate Governance: An International Review*, Vol 9, No. 4, p. 257
22. Ernst and Young, (1992), “*Audit Committees: Functioning in the 1990s*”.
23. Estonia*, Corporate Governance in Estonia*
24. European Commission (1996), Green Paper- The Role, Position and Liability of the Statutory Auditor in the European Union. Brussels: European Commission
25. European Commission (2003), *Modernising company Law and Enhancing Corporate Governance in the European Union- A Plan to Move Forward*. Com (2003) 284. Brussels :European Commission.
26. European Shadow Financial Regulatory Committee (2002) *Corporate Governance in Europe, Statement No. 15.* ESFRC. London
27. Felton, R.F. and Watson M. (2002) Inside the Board-room*, McKinsey Quarterly*, No. 4
28. Finland*, Corporate Governance Recommendation for Listed Companies, December 2003*
29. France*, The Corporate Governance of Listed Companies, October 2003*
30. Garratt, B (1996), *The Fish Rots from the Head,* HarperCollins Business, London.
31. Garratt, B. (2005) "A Portrait of Professional Directors: UK Corporate Governance in 2015", *Corporate Governance: An International Review*, Vol.13, No.2, March, pp.122-126.
32. German Panel on Corporate Governance (2000), *Corporate Governance Rules for German Quoted Companies,* Berlin: German Panel on Corporate Governance
33. Greece, Committee on Corporate Governance in Greece (1999, *Principles of Corporate Governance in Greece*. Athens: Capital Markets Commission
34. *Greenbury, R. (1995) Directors' Remuneration: Report of a Study Group Chaired by Sir Richard Greenbury,* Gee: London
35. Gregory, H. (2002). Comparative Study of Corporate Governance Codes Relevant to the European Union and its Member States, available at www.europa.eu.int.comm/internal_market.
36. Higgs (January, 2003) *Review of the Role and Effectiveness of Non-Executive Directors.*
37. Holland, *The Dutch Corporate Governance Code, 9 December 2003*
38. Hungary*, Corporate Governance Guidelines*
39. ICGN (2005), *ICGN statement on Global Corporate Governance Principles,* International Corporate Governance Network, London, UK
40. Investment and Financial Services Association, (2002), *Corporate Governance: a Guide for Fund Managers and Corporations* – Blue Book:, December. www.ifsa.com.au
41. Ireland*, Irish Association of Investment Managers Corporate Governance, Share Option and other Incentive Scheme Guidelines, March 1999 (incorporating the UK Combined Code on Corporate Governance July 2003)*
42. Italy, Committee for Corporate Governance of Listed Companies *(2002), Corporate Governance Code,* Rome: Italian Stock Exchange.
43. Jensen M.C. (1993), “The modern industrial revolution, exit and the failure of internal control systems” *Journal of Finance 48, 831-880.*
44. Johnson, S., A.P. Boone, A.Breach, and Friedman E. (2000), “Corporate Governance in the Asian crisis” *Journal of Financial Economics,* No. 58, pp.141-86.
45. Keasey, K., S Thompson,. and Wright M. (2005),

Corporate Governance: Accountability, Enterprise and International Comparisons, John Wiley Chichester, West Sussex, England.
46. La Porta, R., F.Lopez-de-Silanes, and Shleifer A. (1999), "Corporate Ownership Around the World", *Journal of Finance*, Vol.54, pp.471-518.
47. La Porta, R., F. Lopez-de-Silanes, , A. Shleifer, and Vishny R. (1998), "Law and Finance", *Journal of Political Economy,* Vol.106, pp.1113-1155.
48. La Porta, R., F.Lopez-de-Silanes, A.Shleifer, and. Vishny R. W (1997) "Legal Determinants of External Finance", *Journal of Finance*, Vol.52, No.3, pp.1131-1150.
49. *Latvia*, Corporate Governance in Latvia
50. Linden, P & Matolcsy, Z P. (2004), "Corporate Governance Scoring Systems: What Do They Tell Us?', *Australian Accounting Review*, Vol. 14, No. 1 pp. 9-16.
51. Lithuania*, Corporate Governance in Lithuania*
52. Maasen, G.F., F.A. J. Van den Bosch, and Volberda H. (2003), *"The importance of Disclosure in corporate governance self-regulation across Europe: A review of the Winter Report and the EU Action Plan" International Journal of Disclosure and Governance, Volume 1, No. 2.*
53. MacDonalds Commission (1988), *Report of the Commission to Study the Public's Expectation of Audits.* Toronto: Canadian Institute of Chartered Accountants.
54. Mace, M. L. (1986) *Directors: Myth and Reality*, Harvard Business School Press, Boston, MA, USA.
55. Maher, M. and Anderson, T. (1999), "corporate governance: effects on firm performance and economic growth", paper presented at the Tilburg University Conference on Convergence and Diversity in Corporate Governance Regimes and Capital Markets. Eindhoven, November 4-5
56. Malta Stock Exchange (2001)*, The Code of Principles of Good Corporate Governance,*Valletta: Malta Stock Exchange.
57. Mertzanis, H.V. (2001), "Principles of Corporate Governance in Greece", *Corporate Governance: An International Review*, 9, pp.89-100.
58. Mitton, T (1999), *A cross-firm analysis of the impact of corporate governance on the East Asian financial crisis" mimeo Massachusetts Institute of Technology, Cambridge, MA*
59. Nicholson, G. J. and G. C. Kiel (2004) "A Framework for Diagnosing Board Effectiveness", *Corporate Governance: An International Review*, Vol.12, No.4, October, pp.442-460.
60. Organisation for Economic Co-operation and Development (OECD) (1999) *OECD Principles of Corporate Governance*, OECD.
61. Organisation for Economic Co-operation and Development (OECD) (2004) *OECD Principles of Corporate Governance*, OECD.
62. Polish Corporate Governance Forum (2002), *The Corporate Governance Code for Polish Listed Companies (final proposal).* Gadansk: The Gdansk Institute for Market Economics.
63. Portugal Commission of the Stock Exchange (1999)*, Recommendations on Corporate Governance,*Lisbon: Portuguese Stock Exchange.
64. PricewaterhouseCoopers (2001), *The Board Agenda, Good Practices for Meeting Market Expectations.*
65. Prowse, S. (1994), "Corporate Governance in an International Perspective: A survey of Corporate Governance Mechanisms among Large firms in USA,UK, Japan, and Germany", *BIS Economic Papers,* No.41, May
66. Sarbanes Oxley ACT (2002) *US House of Representatives*
67. Schmidt R.H. & Spindler, E.T (2002), *Path Dependence, Complementarity and Corporate Governance – A Comment on Bebchuk and Roe, International Finance 5, 2002, pp311-333*
68. Shleifer A. & Vishny R.W(1997) " A survey of CG"*, Journal of Finance, Vol. 5 , No. 2, pp.737-84.*
69. Slovakia*, Stock Exchange (2002) Corporate Governance Code based on OECD principles.*
70. Slovenia*, Stock Exchange (2004) Corporate Governance Code.*
71. Soderstrom, H.T. , Berglof, E. Holmstrom, B. Hofgeldt P. and Meyersson-Milgrom E. (2003), *Corporate Governance and Structural Change: European Challenges,* SNS Economic Policy Group Report, Center for Business and Policy Studies, Stockholm
72. Solomon J.F , A Solomon, and Park, C. (2002), "A conceptual framework for the corporate governance reform in South Korea", *Corporate Governance : An International Review,* Vol. 10, No. 1, pp. 29-46.
73. Solomon J.F.& Solomon A.(2004), *Corporate Governance and Accountability.* John Wiley, west Sussex: England
74. Solomon, A. (2000), "Could corporate environmental reporting shadow financial reporting*?" Accounting Forum,* Vol 24, No. 1, pp. 35-61.
75. Solomon J.F, Lin S.W, Norton S.D& Solomon A. (2003) "Corporate Governance reform in Taiwan: Empirical evidence from Taiwanese company directors", *Corporate Governance: An International Review*. Vol.11, No.3, pp.235-248.
76. Spain, Madrid Stock Exchange (1998) *The Governance of Listed Companies*, Madrid: Madrid Stock Exchange.
77. Spanos, L. (2005), "Corporate Governance in Greece: developments and policy implications" Corporate Governance, Vol.5, No. 1, pp.15-30
78. Sweden*, Swedish Code of Corporate Governance – A Proposal By the Code Group 2004*
79. Treadway Commission (1987), *Report of the National Commission on Fraudulent Financial Reporting, New York.*
80. Ugeux, G. (2004) "Towards global convergence in corporate governance: An assessment of the current situation" *International Journal of Disclosure and Governance,* Volume 1, No 4., pp-339-354.
81. United Kingdom, *The Combined Code on Corporate Governance July 2003*
82. Useem M. and Zelleke A (2006), "Oversight and Delegation in Corporate Governance:deciding what the board should decide", *Corporate Governance: an International Review Vol 14, no 1, pp.2-12*
83. Weil, Gotshal & Manges LLP (2002), *Comparative Study of Corporate Governance Codes Relevant to the European Union and its Member States*, prepared on behalf of the European Commission Internal Market

Directorate General, January, Tab le K, 73, citing Company Reporting (2000) “Issue of the Month”.
84. Winter Jaap (2002), *“Winter Report*”, Consultative document of the High Level group of Company Law Experts.
85. Witt, P. (2004), “The competition of International Corporate Governance Systems- A German Perspective”, Management International Review, Vol. 44, No. 3,pp.309-333
86. Yermack, D. (1996) “Higher market valuation for firms with a small board of Directors” *Journal of Financial Economics 40, 185-211.*

Appendices

Table 1. Corporate governance guideline rank

COUNTRY	RANK	NUMBER STARS
Ireland	= 1st	4.5 stars
United Kingdom	= 1st	4.5 stars
Finland	= 3rd	4 stars
Sweden	= 3rd	4 stars
Slovakia	5th	4 stars
Belgium	6th	3.5 stars
Hungary	7th	3.5 stars
Holland	8th	3.5 stars
Slovenia	9th	3.5 stars
France	10th	3 stars
Czech Republic	11th	3 stars
Cyprus	12th	3 stars
Italy	13th	2 stars
Denmark	= 14th	2 stars
Spain	= 14th	2 stars
Malta	16th	2 stars
Poland	17th	2 stars
Lithuania	18th	2 stars
Austria	19th	2 stars
Germany	20th	2 stars
Greece	21st	2 stars
Portugal	22nd	2 stars
Estonia	= 23rd	1 star
Latvia	= 23rd	1 star
Luxemburg *	25th	1 star

* Luxemburg at the time of the research did not appear to have a Corporate Governance Code.

Table 2. Corporate governance – calculation of scores

TYPE OF BOARD	One-Tier Two-Tier	56% 44%
Min or Max Number of directors	- 1-7 - 7-10 - 11-15 - +15 - sufficient - not mention	20% 12% 12% 4% 24% 28%
Proportion of ED	- 1/3 - majority -at least 1/2 - not mention	8% 92%
Proportion of NED	- 1/3 - majority - at least ½ - all NED - sufficient - not mention	4% 16% 8% 72%
BOARD OF DIRECTORS		
Independence	- majority - at least 25% independent - at least one independent - no independence requirement - no mention	32% 32% 4% 32%
Board Chair	- must be independent - need not be independent but cannot be CEO - can be CEO - no mention	8% 12% 80%
Board Meetings	- less than 6 - 6 or more - regularly -no mention	8% 12% 36% 40%
AUDIT COMMITTEE		
AC Exists	- yes must have - need not have one - no mention	76% 12% 12%
AC Independence	– 100% independent - majority independent - no majority independence - no mention	16% 24% 8% 52%
AC Chair	- must be independent - need not be independent but cannot be CEO - independent but also board chair - CEO - not mention	12% 88%
AC Number Meetings	- less than 4 – 4 or more - no mention	24% 76%
AC Size	- less than 3 – 3 or greater - no mention	16% 36% 48%
AC Financial Expertise	– yes at least some formal accounting experience required - no - no mention	28% 72%
REMUNERATION COMMITTEE		
RC Exists	- yes must have - no	68% 12%

	- no mention	20%
RC Independence	– 100% independent - majority independent - no majority independence no mention	12% 20% 12% 56%
RC Chair	- independent - not independent but not CEO - CEO - no mention	8% 92%
RC Size	- less than 3 – 3 or greater - no mention	20% 8% 72%
NOMINATION COMMITTEE		
NC Exists	- yes must have - no - no mention	72% 4% 24%
NC Independence	– 100% independent - majority independent - no majority independence - no mention	4% 16% 16% 64%
NC Chair	- independent - not independent but not CEO - CEO - no mention	8% 8% 84%
NC Size	- less than 3 – 3 or greater - no mention	16% 12% 72%
EXTERNAL AUDIT		
Non-audit Fees	*- less than 10% audit fees* - between 10 – 100% - more than 100% - no mention	 8% 92%
OTHER		
Risk management committee (separate from main board) and written policies Written policies but no formal committee to consider no mention		16% 84%
Requirement for Code of Conduct No requirement for Code of Conduct		8% 92%
Restriction of length director tenure (eg. > 10 or 20 years) No restriction of length director tenure		40% 60%
Requirement for Share Trading policy No requirement for Share Trading policy		100%