

CORPORATE GOVERNANCE PRACTICES IN EUROPE: A DESCRIPTIVE STUDY

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Abstract

Our study examines corporate governance practices in Europe according to the best practice guidelines of 17 countries. We particularly focus on the independence criteria of Board members. Doing so, we wish to understand how these best practices are enforced in the actual corporate governance guidelines in each country. To better define the independence criteria, which is very different among European countries, we develop our own measure of independence, taking into account the strictest criteria of independence recommended in the corporate governance codes of the studied countries. Then, we gather firm-level statistics on a sample of 463 European firms to understand whether the best practice guidelines are actually enforced by these firms. Hence, we contribute to the existent literature by presenting descriptive statistics on the compliance of European firms to their national guidelines. Our findings show that most European firms tend to comply with their local best practice guidelines of corporate governance. We also document a high compliance of our European sample-firm with the Anglo-Saxon best practices of corporate governance.

Keywords: Corporate Governance, Board Independence, Ownership Concentration, Audit Committee Independence

1. INTRODUCTION

In the last decade, corporate scandals such as Enron, WorldCom and Parmalat, caused many changes and reforms in corporate governance practices around the world. Since then, standard setters have made remarkable efforts to improve corporate governance mechanisms. Moreover, in the recent years, the pressure of international investors and the globalization of capital markets are also leading towards the development of new governance mechanisms. After the Sarbanes-Oxley act (SOX, hereafter), the independence criteria of board members and, more specifically audit committee members, became an important issue for determining good corporate governance. In fact, independent directors play an important role on the decision making process of the board. Many studies address the importance of having independent members in the board of directors and audit committees (Daily et al, 2003; Gordon, 2007; Kim et al, 2007; Zattoni & Cuomo, 2008).

Having independent directors is known to be an important governance criteria, whether a firm has a controlling shareholder or a widely-held ownership structure (Bebchuk and Hamdani, 2009). In widely-held firms, where the main agency conflict resides between the managers and the dispersed shareholders (Jensen and Meckling, 1976), the presence of independent board members is

important in preventing managerial opportunisms. On the other hand, for closely-held firms, where the agency conflict is mainly between the controlling and the minority shareholders, the presence of independent members is important in ensuring the protection of minority shareholders (Fama & Jensen, 1983). The risk of expropriation of minority shareholders' wealth can be even greater for closely-held firms in which minority shareholders do not have representatives on the board. In such cases, having more independent members on the board may alleviate the conflict of interest between controlling and minority shareholders.

In this study, we report European countries' best practices in defining the "independence" criteria. We then examine the application of the independence criteria by identifying the proportion of independent directors in boards and audit committees on a sample of 463 European listed firms. We also identify whether there is a separation between the CEO and the Chairman of the Board, as an additional measure of independence. The objective is to measure how these companies comply with their respective country codes recommendations in regard to the proportion of independent directors in the board of directors and the audit committee. The definition of "independence" for boards and audit committees is different from one European country to another. Hence, in order to compare the level of

independence of European boards, we develop a new measure of independence taking into account the definitions of independence, as specified in the corporate governance codes of 17 EU countries, the EU Commission report (2005) and the SEC rules of corporate governance. This allows us to use the same criteria when assessing the independence of the members of the board of directors and the audit committee.

Most of the literature up until now has been focusing on the role that independent directors have in improving companies' performance (Coles et al., 2012; Renders et al., 2010; Bhagat and Bolton, 2008; McConnell et al., 2008) or companies' financial reporting quality (Chalevas and Tzovas, 2010; Peasnell et al., 2005; Xie et al., 2003; Klein, 2002). However, as suggested by Crespi and Fuster (2013), and Santella et al., (2006) there is a misrepresentation of the proportion of independent directors as disclosed by the companies' annual reports. The authors suggest that in most cases, the real proportion of independent directors in the company is lower than what the companies' disclose in their annual reports. We believe that these interesting results could explain why some of the studies have been contradictory on the role that independent directors may have in improving corporate performance and financial reporting quality. Also, since many firms have shares listed in more than one stock exchange and have international investors as shareholders, the "independence" criteria should satisfy the prerequisites of independence as required by different countries.

Analyzing the proportions of independent directors in boards and audit committees by using the "independence criteria" developed in this study, we find that most of our European sample-firms tend to comply with their respective country codes, even though our "independence" criteria is stricter than their countries' best practices. These results are different from the findings of Crespi and Fuster (2013), and Santella et al., (2006) in that even with a stricter "independence" criteria, we find that firms still tend to have a high proportion of independent directors in both, the board and the audit committee. We next try to understand the determinants that lead companies to adopt stricter governance rules than what is required locally.

Finally, it is argued in the literature that the tendency of corporate governance practices is moving towards a more shareholder-oriented framework, such as that of Anglo-Saxon countries (Hansmann and Kraakman, 2001). We aim to measure this by analyzing the structure and the functioning of the board of directors and the audit committee. To see if corporate governance practices are converging with the Anglo - Saxon practices, we specifically measure the proportion of independent directors in boards and audit committees and analyze the level of compliance of European countries with the Anglo - Saxon best practices of corporate governance. We also perform mean comparisons on the level of independence of the BOD, the audit committee and also the CEO/Chair duality (which is widely-known as a breach to the independence of boards) according to the legal regime (Common versus Civil law) as well as to La Porta et al.'s (1999) ranking of countries with high

and low anti-director rights, to see if our results are in line with those of these authors.

This paper is structured as follows. The first section presents a literature review on corporate governance studies, a description of the evolution of corporate governance in Europe and a descriptive analysis of corporate governance practices of the 17 countries in our study. In the second section, we discuss the data collection process and present our developed measure of independence. In the third section, we present our findings on firm-level empirical analysis. In the last section, we conclude our study and propose avenues for future research.

2. LITERATURE REVIEW

There is a common idea that stronger corporate governance mitigates agency problems and a large number of studies have analyzed this relationship. In this area of research, many studies focus on the impact of independent directors in mitigating agency problems. In the US, studies have shown that the presence of independent directors is associated with less earnings management (Xie et al., 2003; Klein, 2002). Klein (2002) using a sample from S&P 500 for the years 1992-1993 finds a negative relation between board independence and earnings management as measured by the abnormal accruals. She finds the same results for the audit committee independence. Xie et al., (2003), using the same data sample as Klein, (2002) for the years 1992, 1994 and 1996 finds that earnings management is less likely to occur only when boards are independent and directors have corporate experience.

Empirical evidence has been controversial regarding the role that independent directors have in improving firms' performance and there is not a clear idea on the impact that independent directors have on corporate performance. Block (1999) suggests that the market reacts positively on the announcements of the appointments of outside directors. Dahya et al., (2008) in a cross-country analysis, find that the corporate performance increases with the presence of independent members on the board. On the other hand, Bhagat and Bolton (2008) do not find significant relation between outside members and firm performance on a sample of US firms.

The role of independent directors in mitigating agency problems has also been widely studied in Europe. In the UK, Peasnell et al., (2005) find that firms with higher outside independent directors are associated with less income-increasing earnings management. On the other hand, the authors do not find any relationship between the presence of an audit committee and earnings management. Benkraiem (2011) finds that the presence of independent directors moderates earnings management in the case of French listed firms. The authors suggest that the role of independent directors becomes more effective when they represent one third of the board. However, these conclusions are not the same for all the European countries. In fact, Chalevas and Tzovas (2010) find no statistical evidence linking independent directors to earnings manipulation on a sample of Greek firms.

We believe that the mitigated results may be due to considerable differences that exist in how

each European country defines the “independence” criteria. In fact, Zattoni and Cuomo (2010) analyze the corporate governance codes for 60 countries and argue that the concept of “independence” is commonly accepted by all the best practices of European countries but the defining criteria for “independence” differs significantly in most of the countries. Same results, as mentioned before, from the studies of Crespi and Pascal Fuster (2013) and Santella et al., (2006) when analyzing the proportion of independent directors in the board of directors.

Crespi and Pascal Fuster (2013) develop a stricter definition of independence that takes into account the best practices of UK code of corporate governance, NYSE and EU Commission recommendations and by applying this definition to a sample of Spanish firms, report a misclassification of the independent director in the companies’ annual reports. In fact, the authors find that the proportion of independent directors as disclosed by the Spanish firms is higher than it would be when applying the stricter criteria they developed to measure independence. Moreover, the authors find that this misclassification is particularly higher for audit committee members and for firms controlled by managers.

Santella et al., (2006) analyze the degree of independent directors on a sample of Italian companies by using the independence requirements of the EU Recommendation (2005)⁴. The authors find that the proportion of independent directors on the board is very low when using the EU Recommendation criteria to determine the independence of the board members. The authors find that one particular requirement that is not respected by the companies is the one that requires directors not to have a direct or indirect business relationship with the company where they are actually part of the board of directors.

The literature analyzing the convergence of the corporate governance mechanisms is divided in two streams of research. One stream of research focuses in studying the convergence of governance mechanisms on a country level analysis, comparing corporate governance practices guidelines of different countries (Cicon et al., 2012; Collier and Zaman, 2005; Gregory and Simmelkjaer II, 2002, etc.) and the other, on a firm-level analyses of applied governance practices.

Gregory and Simmelkjaer II (2002) undertake a comparative analysis on the corporate governance recommendations for fifteen EU member states to understand differences and similarities among the countries of the union. According to the authors, the European countries present important similarities with regard to the best practices of corporate governance. They suggest that the differences found between the recommendations are due to different company laws and securities regulations rather than in the best practices recommendations. Collier and Zaman (2005) analyze the recommendations of the codes of corporate governance related to the structure and the functioning of the audit committee. The objective is to demonstrate any degree of convergence from the European codes of

corporate governance and the Anglo-Saxon model of corporate governance (which requires an audit committee). The authors find that European countries are converging to the Anglo-Saxon model as the audit committee is now widely recommended in the codes of governance of many European countries. On the other hand, Cicon et al., (2012), as opposed to the previous studies, fail to find strong evidence of convergence between the corporate governance codes of 23 EU nations, as only a few seem to be converging towards the Anglo-Saxon models, while other are mostly diverging.

The firm-level research studies use data on corporate governance of listed companies to measure the degree of convergence based on the similarities or differences among the practices of corporate governance that these companies adopt.

The first empirical paper to provide a firm-level evidence of convergence is the study of Markarian et al., (2007). On a sample of 75 large firms from different countries all over the world for the years 1995-2002, the authors examine the governance practices of each firm. They find that the governance practices are moving towards mechanisms that are similar to those of Anglo-Saxon countries. The authors also conclude that both Anglo-Saxon and non-Anglo-Saxon firms are improving their disclosure practices but there is no convergence of these practices towards an Anglo-Saxon model.

Using a recent sample of European listed companies for the years 2000 and 2004, Wojcik (2006) finds that the companies have improved their corporate governance rating during the years. By using corporate governance ratings developed by a professional rating agency such as Deminor Rating SA, the author measures the governance ratings for Anglo-Saxon and non-Anglo-Saxon firms. He suggests that a convergence is in process by finding that non-Anglo - Saxon firms have similar corporate governance ratings with Anglo - Saxon firms over the years. The governance mechanisms that have significantly improved are the structure and functioning of boards and the disclosure practices of firms. Wojcik (2006) is the first study to use a sample of European firms to measure the convergence between two types of cultures, Anglo-Saxon and non-Anglo-Saxon firms. However, the author uses a governance rating developed by a professional agency, which can constitute a limitation when compared to governance indexes developed using a more scientific approach. As Daines et al., (2010) suggests, professional governance ratings may not provide useful information to the shareholders and they also have limits in predicting companies’ performance or other outcomes.

2.1. Description and evolution of best practices in Europe

In the recent years the number of new codes issued by countries all over the world has increased significantly. Aguilera and Cuervo-Cazurra (2009) suggest that the country-level adoption of guidelines for governance practices has improved corporate governance. International organizations such as the World Bank and the Organization for Economic Co-operation and Development (OECD) have played an important role on the development of new practices

⁴ Recommendation on the role of non - executive or supervisory directors of listed companies and on the committees of the (supervisory) board, Brussels 2005.

of corporate governance. The OECD principles of corporate governance (1999) served as guidelines for OECD and non-OECD countries in developing new codes. Considering the number and magnitude of corporate scandals that followed, the OECD (2004) published a revised version of these principles with the main objective “to strengthen the fabric of corporate governance around the world in the years ahead”⁵. As a response to the globalization, the integration of capital markets and the increasing competitiveness of businesses, the EU Commission developed new principles in line with the best practices commonly accepted all over the world. The Action Plan was a first move in modernizing corporate governance practices for European companies (EU, 2003). These codes of best practices are related to enhancing the governance disclosure requirements, strengthening the shareholder’s rights and the protection of creditors, and increasing the proportion of independent non-executive directors. The Commission suggests that promoting a unique corporate governance code for all the countries of the union is not necessary and there is no need to do so. Instead, reducing the barriers that determine divergences of corporate governance practices among the European countries allows companies to operate cross-border and integrate in the European market. In the Action Plan there is a commonly shared idea that the “comply or explain principle” of the United Kingdom’s Cadbury Report (MacNeil and Li, 2006) is better than the enforced law of the Sarbanes-Oxley act. Another important development was the creation of the European Corporate Governance Forum with the main objectives to promote the co-ordination and convergence of national codes. However, as suggested in the Global Corporate Governance Forum report of 2008, the actual work of the forum is to promote and develop new best practices of corporate governance rather than account for differences in the laws, the cultures and the market structures of European countries.

Hence, there seems to be a global trend in improving corporate governance practices, especially after the Sarbanes-Oxley act. Another debate among the scholars is now on whether or not the new governance practices in Europe are converging or not towards the Anglo-Saxon model. In this perspective, Aguilera and Cuervo-Cazurra (2004), when analyzing the codes of governance for 49 countries worldwide, suggest that there is some convergence towards the Anglo-Saxon model of corporate governance from most of the countries’ corporate governance mechanisms. Similarly, Bauer et al. (2008) suggest that large European listed firms are moving towards more shareholder - oriented practices to be found in the United States (US) and the United Kingdom (UK) models of corporate governance. In fact, the adoption of these practices are inevitable due the increasing governance quality needed to cross-list in international exchanges or to adopt practices that are more likely to gain the trust of international investors. Moreover, the actions taken by the Commission to strengthen the internal corporate governance mechanisms such as the

recommendation (2005/162/EC)⁶ and the directive (2006/43/EC)⁷ seem a progress towards adopting Anglo-Saxon best practices.

However, the corporate governance of European countries faces many concerns. As Enriques and Volpin (2007) point out, the ownership structure of the European companies is quite different from that of US and UK firms. In Europe, only a few companies are widely held as opposed to the Anglo-Saxon countries. In this sense the conflict of interests in the European companies is between the large shareholders and the minority shareholders with the risk for the minority shareholders to be expropriated of their wealth by the controlling shareholders. Hence, applying Anglo-Saxon governance practices may not be entirely effective for a large number of European firms,

In this study, we analyze the compliance to corporate governance code recommendations of European firms. We specifically focus on the level of the “independence” of board and audit members. As noted by Zattoni and Cuomo (2010), the corporate governance codes are a set of best practice recommendations related to the structure and the functioning of governance mechanisms. For Europe, the best practices are not rigid rules but are based on the “*comply or explain*” principle by which the companies that do not comply with the recommendations of the code should explain the reasons of non-compliance. For reasons related to the diversities that still exist between the European countries, the choice of the regulators is not to enforce the companies in adopting the best practices. However the market pressure for compliance and the fact that these best practices are also recommended by the listing rules, increases the degree of adoption from the companies (Aguilera and Cuervo-Cazurra 2004). It could be of interest to see how European companies have responded to the regulations and the market pressure to adopt new governance rules even though European companies present different ownership structures when compared to other companies, especially US companies.

After having documented the literature and reviewed the evolution of corporate governance codes, in the next section we present an in depth descriptive analyses of the best practices guidelines regarding the independence of boards and audit committees on a sample of firms from 17 European countries.

2.2 Descriptive analyses of best practices in European countries

Best practices in Europe differ among countries in their recommendations for the board of directors and audit committee structures. Countries such as Germany, Austria or Netherland have the two-tier model predominant for their board structure. In the two-tier model, the supervisory board is responsible for the supervision while the executive board is

⁵ OECD (2004) *OECD principles of corporate governance*, page 4.

⁶ European Commission (2005), *Recommendation on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board*, Brussels 2005

⁷ European Parliament and Council (2006), *Directive 2006/ 43/ EC on statutory audits of annual accounts*, Brussels 2006

responsible for the management of the company. In other countries, the dominant structure is the unitary model that derives from the UK corporate governance code. For Italy, the best practices recommend three different structures for the board. According to the Italian Corporate Governance Code (2006), alternatively to the traditional corporate governance system based on the Board of Directors and the board of statutory auditors, companies may also choose between the unitary and the two-tier model.

Gregory and Simmelkjaer II (2002) suggest that the role of the board of directors in the unitary system and that of the supervisory board in the two-tier are very similar because of the considerable influence of international corporate governance best practices. They point out that both boards are elected by the shareholders, and that the board members have the right to appoint management and ensure the compliance with the law. Moreover, the authors report that in some countries, the presence of employee representatives in the board of directors is enforced by law. In Austria, Germany, Denmark, Luxembourg and Sweden, companies of a certain size must include employee representatives in their supervisory boards. In France, when the employees' shareholdings exceed the 3% threshold, they have the right to appoint representatives in the board of directors.

Differences in the structure and recommendations also exist for audit committees. With the 8th EU Company Law Directive on Statutory Audit (2006), the EU recommended that all the required entities establish an audit committee. In countries such as Austria and Spain, the constitution of an audit committee is mandatory by law. Böhm et al. (2013) indicate that audit committees have evolved in becoming a mandatory component in the European governance system and the main concern is how to design an audit committee rather than establishing one. However, the authors find that differences still exist in the recommendations of the codes related to the responsibilities of the audit committee, the competencies of its members, and the proportion of independent members in the committee.

Table 1 details the best practices for European countries with regard to the composition of the board of directors, audit committees and also the separation of duties between the CEO and Chairman of the board. We believe that a board's independence can be jeopardized when the Chairman of the board is also the CEO of the corporation. Hence, we include this measure in our analysis of the independence of European Boards. The corporate governance codes analyzed are the most recent codes released by the Stock Exchanges of each country by the end of the year 2011.

We focus on the level of independence in the board of directors and the audit committee. The number of countries in the table is 16 because we combine our subsample of Irish listed companies, (which are required to use the UK corporate governance code for their governance mechanisms) with our subsample of UK listed firms. We observe that the recommendations are different in almost all the countries. Netherlands recommends a high proportion of independent members suggesting that only one member of the board of directors may be

dependent. For England the best practices recommend that half of the members of the board should be independent. The chairman, according to the UK Corporate Governance Code (2010), should be independent on the appointment as chairman of the board. Denmark's best practices recommend that the majority of the members elected by the shareholders be independent while in France, there is a clear distinction between widely held and controlled companies. According to the French Corporate Governance code, only widely held companies⁸ are recommended to have a majority of independent members in the board of directors.

We note that almost all the best practices recommend a minimal number of independent members except for Portugal, Luxembourg and Germany, in which the presence of independent members in the board is only mentioned with no indications about their number. Italy and Switzerland have no recommendations whatsoever on the number of independent members in the board.

When examining the best practices in regards to the independence of audit committees, we find that the minimal requirement of all the codes is to establish at least one independent member. However, most of the countries' best practices recommend that the majority of the members of the audit committee be independent. Nevertheless, differences in the recommendations and the composition of audit committees still exist in line with Collier and Zaman (2005) study. When comparing our findings for the audit committee recommendations with the recommendations of Sarbanes-Oxley act and the SEC rules for listed companies, we notice that none of the countries in our study recommend a fully independent audit committee. Even the UK which is an Anglo-Saxon country does not recommend a fully independent audit committee but a minimum number of at least three independent members. It seems that European standard setters do not consider important having a high proportion of independent directors in the audit committees.

When analyzing the recommendations regarding the separation of duties between the CEO and Chairman we see that the results are more consistent. Most of the best practices recommend the division of responsibilities between the CEO and chairman and only five countries' best practices allow the dual position. In the case of Denmark, there are no recommendations for the separation of duties between CEO and Chairman.

In Table 1, countries are classified based on the proportion of independent directors they recommend starting from Netherlands which recommends the highest proportion to Italy which recommends the lowest. Based on the findings of other studies (Klein, 2002; Xie et al., 2003; Peasnell et al., 2005; Ramzi Benkraiem, 2011) suggesting that the presence of independent members improves financial reporting quality, if we define as strong governance practices, those that recommend at least a majority of independent members on the board of directors as well as on the audit committee we may

⁸ The French corporate governance code of 2010 indicates as widely held those companies in which no shareholder owns more than 20% of the shares of the companies.

observe interesting results. The country who recommends the highest proportion of independent members in the board of directors and so having the strongest governance practices is Netherland a non-Anglo - Saxon country. This result is interesting taking into account the different ownership structure of the non-Anglo - Saxon companies. As observed in Table 1 only Netherland and UK are the

only countries of the sample recommending a majority of board independence. Denmark recommends a majority of independence in the board of directors but according to the Danish corporate governance code employee representatives should be also part of the board of directors, and in this study we count them as independent.

Table 1. Corporate governance recommendations for the Board of directors and Audit committee by country

Country	Board (BOD) independence		Audit committee (AC) independence		CEO/Chairman	Size
Netherlands	All except one	All - 1	Mentioned but with no specifications	0	No	Mentioned but with no specifications
Uk	At least half of the board excluding the chairman	50%+1	At least three independent non-executive directors	3	No	Mentioned but with no specifications
Denmark	At least half of the members elected by the shareholders	50%+1	The majority	50%+1	Not mentioned	Mentioned but with no specifications
France	In widely-held firms: half of the members;	50%+1	At least equal to two thirds	66.7%	Allowed	No indications
	In controlled firms: at least a third	1/3				
Spain	At least one third	33.3%	The committee should be formed exclusively of external directors and have a minimum of three members. Should be chaired by an independent directors	1	Allowed	5-15
Greece	At least one third	33.3%	The majority	50%+1	Allowed	More than 7 and less than 15
Belgium	At least 3 independent non-executive members	33.3%	The majority	50%+1	No	Mentioned but with no specifications
Finland	At least two	2	At least one member	1	No	Mentioned but with no specifications
Sweden	At least two	2	At least one member	1	No	No indications
Norway	At least two	2	The majority should be independent of the company	0	No	Mentioned but with no specifications
Austria	Ownership concentration less than 80%: at least one independent member;	1	The majority	50%+1	No	Not more than 10 without the employees
	Ownership concentration less than 50%: at least two independent members	2				
Portugal	Adequate number of independent members	0	The majority	50%+1	No	Mentioned but with no specifications
Luxembourg	Mentioned but with no specifications	0	The majority	50%+1	No	Not to exceed 16 members
Germany	Mentioned but with no specifications	0	The chairman should be independent and not be a member of the Management Board of the company whose appointment ended less than two years ago.	1	No	No indications
Switzerland	The majority of non-executive members	0	The committee should consist of non-executive members preferably independent	0	Allowed	Mentioned but with no specifications
Italy	no indications	0	The majority	50%+1	Allowed	No indications

If we analyze the countries based on the origin of their codes, as in La Porta et al.,(1998), for the French-origin countries the results are contradictory. The country which has the strongest corporate governance recommendations, Netherlands, and that having the weakest corporate governance recommendations, Italy, are both French-origin countries. In general from Table 1 we observe no significant similarities between French-origin countries with regard their recommendations on the

proportion of independent directors in the board of directors and audit committees.

However, for the Scandinavian-origin countries, the observations are different. With the exclusion of Denmark, for the other three Scandinavian-origin countries, Finland, Sweden and Norway, there are some similarities in their best practices. Table 1 shows that they recommend the same number of independent members in the board and, according to their best practices, the CEO should not also be Chairman of the board.

Same results for the German-origin countries. According to our table, with the exclusion of Portugal which is a French-origin country, the entire four country group, Austria, Luxembourg, Germany and Switzerland, is in the lowest level of the table and also these countries present similarities in term of proportion of independent members in the board of directors, audit committee and CEO duality.

Considering La Porta et al.'s (1999) study, Spain and Norway are classified as countries having strong corporate governance mechanisms but as we mentioned, according to our results these countries are classified as having weak corporate governance mechanisms as measured by the proportion of independent directors in the board. For the other countries, our classification is in line with La Porta et al.'s (1999) study, classifying these countries as having weak corporate governance.

3. METHODOLOGY

In the previous section, when analyzing the European corporate governance codes, we observed that the recommendations on the number of independent members differ significantly among countries. For different reasons we noted that the best practices are significantly related to the country specific characteristics and there is not a unique degree of independence recommended by most of the corporate governance codes. In the empirical part, we will measure the degree of independent members in boards and to what level, our sample firms comply with the governance guidelines of their country. We then will compare these results with the Anglo - Saxon practices of corporate governance to see how the companies of the sample comply with these practices to contribute to the debate on the convergence of corporate governance practices. To do so, we collect firm-level data on the level of independent board members and audit committees and on the independence status of the Chairman of the board.

3.1. Data collection

Our final sample consists of 463 companies from seventeen European countries. The companies are part of the STOXX Europe 600 Index, a subset of STOXX Global 1800 Index and represent 600 European listed companies with large, medium and small capitalization across seventeen countries. We excluded from this index financial companies, due to their different structures and accounting regulations and companies for which corporate governance information in regards to the independence criteria of boards and audit committee are unavailable or unclear. To collect the data on governance, we analyzed the corporate governance reports and the annual reports of the companies of each sample firm for the year 2011. Having the three types of companies in our sample (small, medium and large capitalization) allows us to generalize the results for all the listed companies since one can expect that the large corporations are more predisposed to adopt international corporate governance principles, due to their widely held ownership structure. In this analysis also we included the Irish companies present in the index. According to the Irish Stock Exchange, Irish listed

companies are required to apply on a “comply or explain” basis with UK corporate governance code (June 2010),

3.2. Measurement of the independence criteria

The objective of the empirical part of our study is to understand how the best practices in regards to “independence” are applied by European firms. To do so, we first define the independence criteria necessary to measure the degree of independence on boards. We examine the independence criteria used in the codes of corporate governance for the countries of our sample and observe that the definition of independence is significantly different among countries. Countries adopt different measures with regard to whom the director should be independent from. The major difference observed concerns the “independence” from the major shareholders. In most of the countries studied, one of the independence criteria states that a board member is considered independent if he or she does not have significant shareholdings in the company (and of related companies), However no clear indication is provided for the required level of shareholdings it takes to be considered as significant. Furthermore, in countries such as Germany, Swiss and Austria, there are no specific guidelines requiring members' independence from any major shareholders of the firm to qualify them as independent. Other countries such as UK, Italy, Denmark and Norway require the independence from the major shareholders but do not specify the degree of major shareholding. For many countries in our sample, this degree is 10% or more of the shares (voting rights) of the company which is in line with the SEC (OECD 2004),

To measure the degree of independent members in the boards, we developed a unique measure of independence taking into account the recommendations provided by the SEC rules, corporate governance codes of European countries, the OECD and the EU commission recommendations. This allows us to use the same criteria in assessing the degree of independence in all the companies of our sample.

To begin with, we refer to independent director as the director who is a non-executive and independent member of the board. In this case, neither an employee nor a member of the management may be qualified as an independent director. Our definition is in line with most of the codes of governance of Europe that use the definition of “independent non-executive directors” as the independent members on the board. In different studies the independent members are also defined as outsiders, or non-executives or independent members.

According to our definition a director is not independent if he or she:

- a) is or has been an employee of the company or its group or an executive member of the board within the past three years;
- b) is an external auditor of the company or has a relationship with the external auditor of the company;
- c) receives directly or as a partner a significant remuneration from the company or any other related company or person for services or advices not connected with his duties as director of the board;

d) has significant business relationship with the company or a related company, directly or as a partner, shareholder, member of the board of directors or management of another company who has such relationship;

e) holds cross-directorship or has relationships with other directors of other companies that have links with the company;

f) is a major shareholder⁹ of the company or represents a major shareholder of the company;

g) holds more than 10 % of the company shares, either directly and/or indirectly, through the control he or she exercises in other companies;

h) has close family ties with persons that fulfill any of the points above.

The source we used for the corporate governance codes is the European Corporate Governance Institute (ECGI) an international scientific non-profit association seeking to improve corporate governance in Europe and elsewhere. We only analyzed the English translations of the codes and in the case that for some countries we didn't find the corporate governance code in the ECGI, we made a web research to obtain it.

4. RESULTS

4.1. Firm-level analysis of applied Corporate Governance practices in Europe.

We start the analysis by identifying the degree of independent members in the board of directors, audit committee and the separation of duties between the CEO and Chairman. More specifically the variables used in our analysis are: the proportion and the number of independent members on the board of directors, the proportion and the number of independent members in the audit committee, audit committee fully independence, the size of the board of directors and the audit committee and the division of roles between the CEO and the Chairman of the board of directors. We constructed dummy variables to identify the CEO/ Chairman duality, the majority of independent members in the board of director and audit committee.

Table 2 presents descriptive statistics on the level of independence of the Board, audit committee and the independence of the Chairman, for all the firms in the study, classified by country.

We divided the sample of companies by country and measured the value for all the variables identified. The number of companies varies across countries and, for countries such as Luxembourg, Portugal, Austria and Greece, this number is significantly low. The major number of companies is from UK, France and Germany. As shown in Table 2, there is a variation in the value of the proportion of independence across countries, consistent with the prior section's descriptive analyses of the best practices. We observe that companies from UK, Ireland, Netherland, Norway and Switzerland show a high proportion of independence. For these countries, we also find that the average size of the audit committee is very similar. Finland and Netherlands present the highest proportion of independent members. It seems that for the Netherlands, the best practices are widely respected

by the companies. However, Finish companies tend to follow the international best practices by adopting a higher degree of independence in respect to their national corporate governance recommendations. Listed companies of Denmark, Germany, Italy, Portugal, Spain, Belgium and Greece tend to have less independent boards compared to the firms in other countries.

For the audit committees, we find a high degree of independence in the European companies showing that the EU recommendations and the international best practices are being widely accepted. For the Italian listed companies, we analyzed the Internal risk and control committee which according to Melis (2004) has a similar role as the UK audit committee. In fact, for some Italian listed companies of our sample, we found that they named the internal risk and control committee, "audit committee".

The audit committees of our German sample firms do not seem to present, on average, a majority of independent members. A possible explanation for these findings is that in German audit committees, half of the members excluding the chairman should be employee representatives qualified as non-independent.

When examining whether audit committees are entirely independent, our findings show that the Anglo-Saxon countries such as UK and Ireland tend to have a high proportion of firms with entirely independent audit committees. However what seems interesting to note is that a relevant number of companies from Italy, Finland, Netherlands, Luxembourg, Portugal and Norway tend to also adopt a fully independent audit committee following the Anglo - Saxon best practices recommendations. For the German and Austrian companies, the proportion of fully independent audit committees is lower than the other countries.

Table 3 reports the independence criteria compliance level in respect to the independence criteria of boards, audit committees and the chairman's independence of our sample firms. The first section of the table presents statistics on the compliance level of our sample firms according to their respective corporate governance codes. The second section of Table 3 presents the level of compliance of our sample-firms with the Anglo - Saxon practices of corporate governance. According to the SEC rules of corporate governance as well as the UK code of corporate governance, we define Anglo-Saxon practices are requiring: majority of independent directors in the board of directors; fully independent audit committee and the CEO not being the Chairman of the Board.

Our findings show that the level of compliance of our sample-firms with the respective country codes of corporate governance is higher than their level of compliance with the Anglo - Saxon best practices. This may be due to the fact that the definition and the degree of independence that we used in our study is very strict compared to many of our studied countries' best practices. However, we note that for Netherlands, the degree of compliance with the respective country code regarding the proportion of independent directors in the board of directors is lower than the compliance with Anglo-Saxon best practices. This can be explained by the fact that the corporate governance code (2008) of the Netherlands is very strict in regards to board independence, requiring that, all members, except one, be independent.

⁹ A major shareholder is a shareholder who holds more than 10% of the shares or voting rights of the company.

Table 2. Descriptive statistics of Board of Directors (BOD), Audit committee (AC), and Chairman Independence

Country	N	% BOD INDEP	% AC INDEP	BOD SIZE	N. BOD INDEP	AC SIZE	N. AC INDEP	AC FULL IND	CEO = CHAIR
		Average	Average	Average	Average	Average	Average	Average	Average
Netherland	26	,8347	,9071	7,54	6,15	3,46	3,12	,77	,00
Uk	143	,6427	,9866	9,63	6,15	3,79	3,74	,96	,03
Ireland	10	,6861	,9714	11,60	8,00	3,70	3,50	,90	,00
Denmark	12	,4812	,7321	,1017	4,83	3,42	2,33	,33	,08
France	68	,5350	,6978	12,97	6,82	4,03	2,79	,26	,62
Spain	21	,4512	,6587	12,90	5,67	3,95	2,57	,24	,43
Greece	2	,3447	,6667	11,50	4,00	3,00	2,00	,50	,50
Belgium	10	,4947	,7600	11,60	5,60	3,70	2,80	,40	,10
Finland	17	,8553	,9635	7,47	6,35	3,31	3,19	,93	,00
Sweden	28	,5159	,7048	11,00	5,46	3,68	2,50	,36	,04
Norway	10	,6526	,8750	9,10	5,70	3,20	2,80	,60	,10
Austria	6	,6537	,5556	11,67	7,33	5,17	2,83	0	,00
Portugal	4	,3284	,8889	16,75	5,50	3,33	3,00	,67	,00
Luxembourg	3	,5852	,8889	12,67	7,33	4,33	3,67	,67	,67
Germany	59	,4296	,4879	13,78	5,61	4,57	2,22	,05	,00
Switzerland	27	,7120	,7340	9,26	6,59	3,48	2,67	,48	,15
Italy	18	,4534	,9995	11,67	5,17	3,61	3,05	,61	,22

For the two Anglo - Saxon countries in the list, the results are different with regard the audit committee fully independence measure. While for UK the compliance with the audit committee measure does not change in both sections of Table 3 for Ireland the compliance is lower in the second section suggesting that even though Irish firms have at least three independent directors in the audit committee not all the companies present a fully independent audit committee.

As seen in Table 3, our subsample of firms from France, Spain, Sweden, Portugal, Germany and Italy exhibit significant differences between their level of compliance to their local country codes and their level of compliance to Anglo - Saxon best practices. One explanation is that the degree of independence required by the respective country

codes is lower compared to the Anglo - Saxon best practices of corporate governance.

We also observe differences in regards to the compliance with the guidelines concerning the separation of CEO/Chairman positions. These differences are specifically related to the countries' recommendations. Indeed, in many of our sample countries, having the CEO serve as Chairman of the board is not prescribed. In fact, the lowest level of separation between CEO and Chairman position is observed in firms operating in countries where there is no specific recommendation on the duality of the two positions.

Denmark and Netherlands have the lowest rate of compliance to their respective country codes. As for Germany, Spain, Portugal and Italy, they have the lowest rate of independence according to the Anglo - Saxon best practices.

Table 3. Descriptive statistics on the level of compliance to the corporate governance guidelines of independence of our European sample firms

Country	N	% of Compliance with local country codes of best practices			% of Compliance according to Anglo - Saxon best practices		
		% BOD INDEP	% AC INDEP	CEO NOT CHAIR	% BOD INDEP	% AC INDEP	CEO NOT CHAIR
Netherlands	26	58	100	100	92	77	100
Uk	143	94	96	97	94	96	97
Ireland	10	100	100	100	100	90	100
Denmark	12	50	92	100	50	33	92
France	68	77 ¹⁰	68	100	60	26	38
Spain	21	71	100	100	48	24	57
Greece	2	50	50	100	0	50	50
Belgium	10	90	90	90	70	40	90
Finland	17	100	100	100	100	93	100
Sweden	28	100	100	96	61	36	96
Norway	10	100	100	90	80	60	90
Austria	6	100	100	100	100	0	100
Portugal	4	100	100	100	25	67	100
Luxembourg	3	100	100	67	100	67	67
Germany	59	100	100	100	41	5	100
Switzerland	31	100	100	100	90	48	87
Italy	18	100	100	100	50	61	78

¹⁰ widely held= 79; controlled= 77

Overall, the level of compliance of all our sample firms of all countries combined is 69 % for BOD independence, 56% for the audit committee fully independence and 85 % for the Chairman's independence as measured by the distinction (non-duality) of BOD Chair and CEO. These latter results are not reported in tables.

Our last analysis consists in verifying whether our developed measure of independence criteria is consistent enough to capture corporate governance quality. To do this we use two different measures of classification to identify firms qualified as having strong or weak corporate governance systems; the legal regime and the level of anti-director rights (La Porta et al. 1999) of the country in which they operate. Numerous empirical studies have shown that an economy's legal regime has a significant impact on its corporate governance practices and that Common Law countries have better corporate governance systems than Civil Law countries (La Porta et al., 1998; La Porta et al. 1999; etc.). Hence to validate our independence model, we classify our sample according to the countries' legal regime and level of anti-director rights. We then perform T-tests on each of our three corporate governance measures (BOD independence, audit committee independence, and Chairman independence) according to these classifications to verify if there are significant differences found in the independence levels of the BOD, audit committee and the Chairman's status. Table 4 reports the results of these tests.

Table 4. Mean Comparison (T-test) analysis of the proportion of BOD, audit committee and chairman's independence according to the legal regime and anti-director rights

<i>Legal Regime</i>	<i>Civil Law</i>	<i>Common Law</i>	<i>T</i>	<i>Sig</i>
% BOD INDEPENDENCE	,58	,93	-8,094	,000
% AC INDEPENDENCE	,87	,99	-4,542	,000
% CEO ≠ CHAIR	,79	,97	-6,928	,000
<i>La Porta et al.'s (1999) ranking of anti-director rights</i>	<i>High</i>	<i>Low</i>	<i>t</i>	<i>Sig</i>
% BOD INDEPENDENCE	0,59	0,85	-6,014	0
% AC INDEPENDENCE	0,86	0,97	-4,017	0
% CEO ≠ CHAIR	0,81	0,92	-3,502	0

As seen in Table 4, the level of compliance to our independence measure is significantly higher for Common Law and High anti-director rights endowed firms for all three of our corporate governance variables. Hence our developed measure of independence criteria is robust and corroborates with other metrics to capture the quality of corporate governance systems.

5. CONCLUSION

In this study, we explore and review the corporate governance practices of European countries. We focus our attention on the recommendations of the European corporate governance codes for the independence criteria. Using a definition of independence we developed by analyzing several national and international best practices in the most recent post SOX corporate governance codes in European countries, we find useful results with regard to the country best practices recommendations and the company compliance.

We find major differences in the degree of independent members in the boards recommended by the national codes. The definition of independence differs from one country to another, most particularly when defining the threshold regarding the independence of the majority shareholders.

Our findings also show a high level of compliance of our sample firms to their respective corporate governance codes. When we measure the compliance with the Anglo - Saxon best practices, we note different results and the degree of compliance decreases significantly for some countries of our sample. Nevertheless, in general, our sample firms exhibit a high level of compliance to the Anglo - Saxon best practices, suggesting that companies tend to comply also with the international commonly accepted principles of governance.

Classifying our sample between Common and civil Law countries and with La Porta et al.'s (1999) ranking of countries according to the level of anti-director rights, we find that firms operating in common law countries and having high anti-director rights exhibit a significantly higher degree of independence compared to firms in civil law countries and with low anti-director rights.

Our research contributes to the literature in many ways. It documents corporate governance practices in Europe, but also gathers firm level statistics on the independence of boards, audit committees and the chairman's independence from management, on a large sample of European firms from 17 different countries to understand how the firms comply with governance guidelines. Moreover, because many differences are observed in the definition of independence from one country to another, we develop our own definition of independence inspired by the strictest criteria found in the governance code of the countries studies as well as by the SEC and European commission recommendations. The independence criteria developed in this study allows us to contribute to the existing studies by proposing a new set of standardized guidelines in defining the independence criteria for board members and audit committees. In this study we also contribute to the long debate on the convergence of corporate governance practices. We actually find a high compliance of the firms of our sample to the Anglo - Saxon best practices of corporate governance, suggesting that a firm-level convergence towards the Anglo - Saxon practices of corporate governance does exist. The most interesting results relate to the measure of "full audit committee independence". Even though none of the countries in our sample require a fully independent audit committee, we find that more than half of the companies of the sample do comply with this measure.

Our study shows that the level of compliance of firms in terms of board of directors and audit committee independence as well as Chairman's independence, is higher in Common Law countries with stronger enforced corporate governance systems. Corporate governance standards and codes setters of Civil Law countries can be inspired by our research to enforce their actual guidelines in regards to the independence criteria, and therefore attract more international investors. We found a firm-level convergence with the Anglo - Saxon practices of

corporate governance. However, many questions are still left unanswered. It would be interesting to identify the determinants that lead companies to comply with local and Anglo-Saxon standards. Future studies could address this issue. Finally, we hope our study inspires future research in corporate governance to further develop corporate governance quality measures.

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