

**Edited by:**

Alexander Kostyuk  
Maria João Coelho Guedes  
Dmytro Govorun

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**CORPORATE GOVERNANCE:  
EXAMINING KEY CHALLENGES AND  
PERSPECTIVES**

*Conference proceedings*

**2020**

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**Proceedings**  
of the  
International Online Conference  
**“Corporate Governance: Examining Key  
Challenges and Perspectives”**

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名誉

*Meiyo*

*Honor*

良心

*Ryoushin*

*Conscience*

高貴

*Kouki*

*Nobility*

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## CONTENTS

INTELLECTUAL ILLUMINATION OF ISOLATED SCHOLARS: AN ONLINE SCHOLARLY CONFERENCE IN THE EPOCH OF PANDEMIC

*Alex Kostyuk, Maria João Coelho Guedes, Dmytro Govorun* ..... 7

### SESSION 1: BOARD OF DIRECTORS: THEORY AND PRACTICE

1.1. THE JOINT EFFECT OF BOARD INDEPENDENCE AND CSR COMMITTEE ON CSR DISCLOSURE: EVIDENCE FROM ITALIAN LISTED COMPANIES

*Alfredo Celentano, Luigi Lepore, Sabrina Pisano, Gabriella D'Amore, Federico Alvino* ..... 13

1.2. THE EFFECT OF BOARD STRUCTURE ON DIVIDENDS POLICY: A COMPARATIVE STUDY BETWEEN BRAZILIAN AND CHILEAN FAMILY FIRMS

*Guadalupe del Carmen Briano-Turrent* ..... 22

1.3. BOARD LEADERSHIP LEGITIMACY AND DIRECTOR TURNOVER IN FAMILY FIRMS

*Jung-Eung Park, Brian Bolton* ..... 29

1.4. CEO DUALITY: NEWSPAPERS AND INVESTORS' OPINIONS

*Marco Caiffa, Vincenzo Farina, Lucrezia Fattobene* ..... 41

1.5. A CONFIGURATIONAL APPROACH TO THE DETERMINANTS OF WOMEN ON BOARDS

*Maria João Coelho Guedes, Alice Galamba Monteiro* ..... 43

1.6. THE HOLISTIC FRAMEWORK FOR THE ECONOMICALLY AND SOCIALLY FAIR CEO COMPENSATION

*Mehtap Aldogan Eklund* ..... 48

1.7. WOMEN IN THE BOARDROOM AND THEIR IMPACT ON FINANCIAL PERFORMANCE AND RISK-TAKING: A BIBLIOMETRIC ANALYSIS

*Michalis Bekiaris, Pantelis Papanastasiou* ..... 57

1.8. THE IMPACT OF CAPITAL STRUCTURE AND BOARD OF DIRECTORS CHARACTERISTICS ON INVESTMENT DECISIONS AND PERFORMANCE OF NORDIC FIRMS

*Shab Hundal, Elmira Sarbassova, Nikita Staroshvetchii* ..... 66

1.9. DOES CEO TURNOVER INFLUENCE THE DIVIDEND POLICY?

*Victor Barros, Maria João Coelho Guedes, Pedro Santos, Joaquim Miranda Sarmento* ..... 74

1.10. HAS THE TRADITIONAL BOARD GOVERNANCE MODEL PASSED ITS USE-BY-DATE?

*Dean Blomson* ..... 79

### SESSION 2: CORPORATE GOVERNANCE AND OWNERSHIP STRUCTURES

2.1. THE INFLUENCE OF CHINA'S INTELLECTUAL PROPERTY POLICIES SINCE ITS ACCESSION TO WTO ON THE FOREIGN OWNED PHARMACEUTICAL R&D

*Alina Bari* ..... 82

2.2. CORPORATE GOVERNANCE, FAMILY FIRMS AND INNOVATION

*Brian Bolton, Jung-Eung Park* ..... 90

2.3. CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES: CARRIS COMPANY CASE STUDY

*Joana Andrade Vicente* ..... 101

2.4. RUNNING A SUSTAINABLE STATE-OWNED FINANCIAL INSTITUTION

*Mbako Mbo* ..... 113

## 2.5. FROM NON-PROFIT ORGANIZATIONS TO MULTI-STAKEHOLDER SOCIAL ENTERPRISES

*Ermanno Celeste Tortia* ..... 121

## 2.6. THE IMPACT OF CORPORATE GOVERNANCE MECHANISMS ON THE FINANCIAL DISTRESS: THE EGYPTIAN CASE

*Ghada Gaballa, Bahaaeldin Samir Allam, Mohamed Antar* ..... 130

## SESSION 3: ACCOUNTING, AUDITING AND TAXATION

### 3.1. CORPORATE TAX BEHAVIORS AND FIRM VALUE: THE MODERATING ROLE OF AUDIT CHARACTERISTICS

*Andrea Vacca, Antonio Iazzi, Amedeo Maizza* ..... 134

### 3.2. THE INTERNAL AUDIT FUNCTIONS IN UAE LAW

*Bashar H. Malkawi* ..... 142

### 3.3. COMPETITION BETWEEN ACCOUNTING STANDARDS IN NATIONAL CONTEXTS: DOES FAMILY MATTER?

*Mario Daniele* ..... 145

## SESSION 4: CORPORATE GOVERNANCE: GENERAL ISSUES

### 4.1. IMPACT OF THE POLITICAL AND ECONOMIC CSFS ON OTHER CSFS IN THE PPP PROJECTS LIFE CYCLE

*Ahmad Almeile, Maxwell Chipulu, Ramesh Vahidi* ..... 155

### 4.2. CORPORATE GOVERNANCE IN AGILE ORGANIZATIONS: A PATH DEPENDENCY SCHEME OR A SOURCE FOR GROWTH

*Iliana Evangelina Haro Leon* ..... 161

### 4.3. HUMAN CAPITAL'S IMPORTANCE IN ICOS SUCCESS

*José Campino, Ana Brochado, Álvaro Rosa* ..... 170

### 4.4. A MULTI-COUNTRY ANALYSIS OF THE SHAREHOLDER EFFECTS OF CYBER BREACHES

*Karen M. Hogan* ..... 178

### 4.5. TERRITORIAL FOOD HERITAGE. IS IT POSSIBLE TO VALORIZE AND TO REPORT IT TO LOCAL STAKEHOLDERS?

*Nadia Cipullo* ..... 188

### 4.6. ENABLING FACTORS IN INNOVATION GOVERNANCE: A BUSINESS POLICY APPROACH

*Pedro B. Águia, Anacleto Correia* ..... 194

### 4.7. CHARACTERISTICS OF FIRMS ELIGIBLE TO GO INTO “EXTRAORDINARY ADMINISTRATION” IN ITALY

*Pierluigi Santosuosso* ..... 206

### 4.8. DIFFERENCES IN CULTURAL-REFERENCED AND SELF-REFERENCED VALUES AND THEIR ROLE IN CULTURE IDENTIFICATION

*Salman Saleem* ..... 210

### 4.9. ENVIRONMENTAL DISCLOSURE IN EUROPEAN BANKS: THE ROLE OF RELIGIOUS SOCIAL NORMS

*Simone Terzani, Teresa Turzo* ..... 216

### 4.10. RISK AND RETURN PROFILE OF INVESTMENTS IN THE PROTECTED TECH-INDUSTRY IN CHINA: A STOCK MARKET'S PERSPECTIVE ON VARIABLE INTEREST ENTITIES (VIE)

*Philipp Prigge, Marc Schroedter, Mark Mietzner* ..... 220

---

4.11. A NEW PERSPECTIVE IN CREDIT RATIONING FOR EUROPEAN SMES	
<i>Christos Kallandranis, Petros Kalantonis</i> .....	222
4.12. CORPORATE GOVERNANCE PRACTICES IN MOROCCAN LISTED COMPANIES: STATE OF PLAY AND INTERNATIONAL COMPARISON	
<i>Oumaima Sadqi</i> .....	225
4.13. UNDERSTANDING THE RELATIONSHIP BETWEEN CORPORATE GOVERNANCE PERFORMANCE AND CORPORATE SUSTAINABILITY	
<i>H A R P Madushanka, Ajantha S. Dharmasiri</i> .....	233
4.14. CORPORATE GOVERNANCE: HOW SOCIAL NORMS AND CULTURAL VALUES CHANGED IN THE LABOUR MARKET?	
<i>Francesco Di Tommaso, Arturo Gulinelli</i> .....	236
CONFERENCE INFOGRAPHICS .....	246
CONFERENCE FORUM DISCUSSANTS INDEX .....	253

# INTELLECTUAL ILLUMINATION OF ISOLATED SCHOLARS: AN ONLINE SCHOLARLY CONFERENCE IN THE EPOCH OF PANDEMIC

Alexander Kostyuk<sup>\*</sup>, Maria João Coelho Guedes<sup>\*\*</sup>,  
Dmytro Govorun<sup>\*\*\*</sup>

<sup>\*</sup> Virtus Global Center for Corporate Governance, Ukraine

<sup>\*\*</sup> ISEG, University of Lisbon, Portugal

<sup>\*\*\*</sup> Virtus Global Center for Corporate Governance, Ukraine; TCM Group, Ukraine

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Corporate governance research is grounded on scholarly communications. Scholarly conferences represent one of the methods of scholarly communications and become valuable both at the initial and final stage of scholarly research. Discussing an idea of the research or the final results publicly increases the relevance and impact of the research remarkably.

In this context, the recent conference "Corporate governance: Examining key challenges and perspectives" allows scholars discussing the recent trends in scholarly research and test the most interesting ideas and research results though discussing with experts in corporate governance. Moreover, taking into account the COVID-19 pandemic spreading throughout the world, the remote (online) mode of the recent conference allows all participating scholars still feel tuned to the network discussion that is a major value of the scholarly research. As one of this conference participants stated, during the time of COVID pandemic and quarantine this online scholarly conference is an "intellectual



illumination" allowing the scholarly networks to overcome isolation.

Recently, we had 32 accepted full-text or extended abstracts co-authored by scholars from more than 20 countries of the world. It is a great success for our conference because this is a proof that the world pandemic will not destruct scholarly communications.

Authors of the papers considered both traditional issues of corporate governance and those that are challenging recently. The most popular issues of corporate governance presented and discussed by the conference participants are below.

The nature of the state ownership and family ownership has been considered by the conference participants and contributed to the previous research by Kostyuk, Mozghoyi, and Govorun (2018); Peruffo, Oriani, and Perri (2014); Arouri, Hossain, and Muttakin (2011); Zeitun (2009); Barako and Tower (2007); Carvalhal da Silva and Câmara Leal (2006).

Board of directors as a classical issue of corporate governance research has been considered by the conference participants from various insights, such as board leadership, director turnover, board independence, board committees, gender diversity, CEO compensation and CEO turnover. Altogether the participating scholars contributed to the papers published before by Masmoudi and Makni (2020); Sun (2018); Abdullatif, Ghanayem, Ahmad-Amin, Al-Shelleh, and Sharaiha (2015); Al-Mamun, Yasser, Rahman, Wickramasinghe, and Nathan (2014); Liu, Harris, and Omar (2013); Guerra, Fischmann, and Machado Filho (2008); Davidson and Rowe (2004).

Based on the previous research by Al Fadli (2020); Drogalas and Siopi (2017); Wadesango, Tasa, Wadesango, and Milondzo (2016), scholars participating in the conference introduced the interesting ideas in the field of accounting and auditing. Corporate tax issues, family firm specifics and internal audit in the cross-country context have been successfully explored by the scholars.

Online conference forum lasted for three days from May 7 to May 9, 2020. More than 50 scholars from more than 20 countries of the world and all continents took an active part in the conference forum discussions and provided more than 450 comments related to the conference presentations. These comments are very valuable both for the authors of the presentations and other scholars with a research expertise in corporate governance, accounting and finance.

*Maria Guedes* highlighted the recent trend in gender research related to the board of directors: "The board configuration is still quite static. The typical board has not changed that much, only in the aftermath of gender quotas. We have seen an increase in the number of women, but mainly to NED positions. Women are still not getting to the decision positions, to exec positions and boards are still not open to other nationalities or even qualifications. For example, what if the board had more medical doctors could we have foreseen this sanitary crisis? We need to rethink what we expect from boards, at least the advisory boards

that need to be more diverse”.

*Alex Kostyuk* issued a more accurate vision toward the research of the board of directors: “My idea is that probably we, researchers, need to start finally divide your research for "executive directors" and "non-executive directors" from the point of view of different criteria of their selection and functions they perform on the Board (in practice)... NEDs are products of networks. Executive directors are the products of the profession and recently achieved performance...This is the major question, that is still missed in the scholarly research worldwide. We got used to divide the board for NEDs and EDs. It is too simple now. Challenges are very strong for CG worldwide. So, we need to get inside of the board issue and start configuring the board dividing even the board molecules (its groups, like NEDs) for atoms (with executive experience and NEDs without this experience). This sort, so called "board atomic level" research is a future of CG research for the next decade at least”.

*Iliana Haro* discovered a very interesting issue about the board of directors dynamics and structure: “Great discussion!! So now we have come to the eternal question of why do organizations keep appointing ED from outside the industry? It is said that because it is the best business practice and that it brings fresh air to the company, but are best practices the best practice?”. Later, *Iliana* addressed a resulting comment in the board issue: “We need to clarify our discourse: are we "fighting" for gender equality just for the sake of gender presence, or are we aiming for talent in the benefit of the organizations and their stakeholders not only the shareholders’ interests? I think the case here is not how many women are on the board, as far as the board, its committees and any other bodies are integrated by the talent they need”.

*Dmitriy Govorun* outlined a much promising question related to the board research agenda: “Which combination (or order) among researched gender equality, masculinity, education and happiness should countries/policymakers focus on when reaching higher performance in terms of more presence of women on boards?”

*Dilvin Taşkın* resulted with a large portion of comments with an excellent statement: “I think the reason that we do not find a direct relationship between financing and gender may be due to the fact that in many countries the percentage of women in the boards is still very low”.

*Vikash Ramiah* commented with a recently important idea: “I must add the behavioral literature that argues females tend to be less risk averse than males. Hence in economic conditions becomes a factor whereby females will deliver best in crisis period as they are better with risk management”.

*Dean Blomson* commented in an excellent manner regarding the board diversity and skills: “Appropriate knowledge, skills and experience are vital. But if you want to ensure the oversight of decisions is effective you need independent thinkers who have the ability to bring different lenses/vantage points to bear. Gender diversity is a noble cause – no

doubt – but that is a side issue when it comes to having a board that is able to think critically, divergently and in a challenging way. Those skills exist independently of gender, race, culture, religion. Let's not just zero in on gender diversity because it feels right, and it's easier to measure than cognitive diversity”.

*José Campino* commented with an interesting idea: “Concerning the board, we have been verifying that although there are traditional board positions there are also so many others which we consider as innovative. Besides, the board might not have the traditional composition and strict division of roles and hierarchy”.

*Pedro Água*, participating in the conference forum, answered about a dilemma of the board structure and leadership: “In our perspective, the world has got too much of “compliance structures”, as it could solve the problems. We shall recall that most of the big corporate scandals happened in the presence of codes & regulations. Compliance codes and regulations ensure the “minimums”, but it's “phronesis” and ethics that aspire to the maximums and organization can perform”.

*Brian Bolton* stated about the family firm governance: “The family firm dynamic is unique and introduces relationships among leaders and shareholders that we may not see at non-family firms (even if the CEO is not a family member, she has likely been hired and approved by family members, thus conferring some type of legitimacy)”. Later, *Brian* perfectly concluded about the market for directors: “There was a time during the late 2000s when firms were moving away from entrenched directors, bringing in more new and younger directors (in part to comply with new independence rules). That movement has slowed, and I do think we're seeing longer tenures with both CEOs and directors. We can (and should) dig into these trends and see what the implications are”.

*Karen Hogan* linked her solid comment to the results of her research: “The lack of historical demand for a market in cyber insurance in the foreign countries when it existed in the US markets suggests that the breaches which were occurring in those countries were not from a cost/benefit analysis significant to require a transfer of the risk. As we have increased the regulations of the companies I believe this will change and I am curious to see if these new return patterns move closer to those seen in the US markets.

*Shab Hundal* came with a comment about the busy directors and innovations: “Firms having busy directors invest lesser in the intangible assets, arguable because busy directors do not have time and patience to understand the role and relevance R&D and other innovation activities as they can be engaged in maximizing their 'personal' utility function”.

*Lucrezia Fattobene* fixed an outlook for corporate governance research in Italy: “I think Italy is an ideal setting to study CEO duality because of the weak legal protection of creditors and shareholders, very poor law enforcement, high ownership concentration, and high presence of pyramidal groups”.

In this book we collected all comments provided by the participants during the conference forum discussion that adds more value to the conference outcomes.

This online conference has several innovative outcomes. First, the structure of this book of the conference proceedings is very innovative because it contains not only the materials of the presenters at the conference. We have enriched this book with the full list of comments generated by the conference participants during the forum and divided all these comments by each paper presented at the conference. All the comments are authored in a proper manner.

Second, we have prepared the set of interesting infographics providing very useful analytics about the conference forum. You will find there "Conference forum comments authorship – geographical representation", "Conference forum comments – topics discussed", "Conference forum comments – top-10 most discussed presentations", "Conference forum comments – top most commenting discussants", etc. This sort of analytics will provide a clear vision of the conference forum content and dynamics, very interesting for scholars.

Finally, we sum our Editorial up with a wise phrase based on the idea of Max Alberto Galarza Hernandez, one of the conference forum participants. "*Intellectual illumination of isolated scholars*" – this is the main motto of our online corporate governance conference getting through the issues like pandemic and quarantine. Scholars can be isolated but their intellect cannot!

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## SESSION 1: BOARD OF DIRECTORS: THEORY AND PRACTICE

# 1.1. THE JOINT EFFECT OF BOARD INDEPENDENCE AND CSR COMMITTEE ON CSR DISCLOSURE: EVIDENCE FROM ITALIAN LISTED COMPANIES

Alfredo Celentano <sup>\*</sup>, Luigi Lepore <sup>\*</sup>, Sabrina Pisano <sup>\*</sup>,  
Gabriella D'Amore <sup>\*</sup>, Federico Alvino <sup>\*</sup>

<sup>\*</sup> University of Naples "Parthenope", Naples, Italy

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## Abstract

Sustainability has become one of the most relevant aspects to which economic operators are paying more attention. Respect for the aspects and principles linked to this theme has become a choice to strengthen companies' image, trust, and social legitimacy, and thus for companies' performances. Sometimes conceived as a requirement, sometimes as a strategic choice, sustainability has acquired a specific weight in a global economic context, and corporate social responsibility (CSR) disclosure has become an important tool for enhancing companies' value. This has highlighted the need for carrying out an analysis of firms' behaviour with regard to sustainability disclosure and the corporate governance (CG) mechanisms influencing the information released. Board of directors and its committees are critical CG mechanisms in that sense. This paper aims to investigate the relationship between specific board characteristics and CSR disclosure. More specifically, the study investigates the relation between board independence and CSR disclosure, and how this relationship is moderated by the presence of a CSR Committee.

## 1. THEORETICAL BACKGROUND AND HYPOTHESES DEVELOPMENT

Most scholars investigated the composition and functioning of the board of directors considered one of the most important CG mechanisms affecting both the quantity and quality level of the information released (Brennan & Solomon, 2008; Michelon & Parbonetti, 2012; Rao & Tilt, 2016). In particular, independent directors seem to be more willing to enlarging the audience of companies' stakeholders, as well as into encouraging companies to disclose more information about their social and environmental behaviours. For these reasons, board independence is considered an important and effective CG mechanism (Khan, Muttakin, & Siddiqui, 2013; de Andres & Vallelado, 2008; Rao & Tilt, 2012; Said, Zainuddin, & Haron, 2009). The common literature has hypothesized and empirically verified that a higher level of board independence positively influences non-financial disclosure, in particular in terms of sustainability disclosure (Jo & Harjoto, 2011; Johson & Greening, 1999).

Many previous papers, investigating the relationship between CG mechanisms and CSR disclosure, analysed how a specific CG mechanism individually influences CSR disclosure. However, in studying the determinants of CSR disclosure, it is important to investigate how different CG mechanisms interact each other in affecting corporate disclosure (Bushman & Smith, 2001; Healy & Palepu, 2001; Li & Qi, 2008; Prado-Lorenzo, Gallego-Alvarez, & Garcia-Sanchez, 2009; Sanchez, Sotorrio, & Díez, 2011; Aguinis, Boyd, Pierce, Short, Dalton, D. R., & Dalton, C. M., 2011; Jain & Jamali, 2016), in order to understand whether there are interdependencies between different CG mechanisms. This paper goes further in this line of research by investigating how the previous relationship is moderated by the presence of a CSR committee, considered as a complementary mechanism able to improve propensity and effectiveness of independent directors in stimulating a higher level of CSR disclosure. Thus, this paper aims to investigate the relationship between board independence and CSR disclosure, and how this relationship is moderated by the presence of a CSR Committee. Based on these considerations, we developed and tested the following two hypotheses:

*H1: There is a positive relationship between board independence and CSR disclosure.*

*H2: The presence of CSR committee positively moderates the relationship between board independence and CSR disclosure, in the sense that companies with a CSR committee have a stronger positive relationship between board independence and CSR disclosure.*

## 2. METHOD

The analysis has been conducted on a sample of 119 non-financial Italian companies listed on the Milan stock exchange at the end of December 31, 2017. Financial and accounting data have been collected from Orbis – Bureau Van Dijk and information on board of directors' structure has been gathered from the CG report. To collect data on CSR disclosure, we content analysed (Krippendorf, 2013) the sustainability report released by companies.

Our dependent variable is CSR disclosure codified as follows. We identified the items of CSR disclosure on the base of Directive 95/2014. More specifically, we focused on the requirement to release non-financial key performance indicators related to sustainable aspects. Then we analysed each sustainability report and collected information for each item. We assigned a score of 1 to each non-financial key performance indicator released. The CSR disclosure for each company has been measured as the sum of non-financial key performance indicators released.

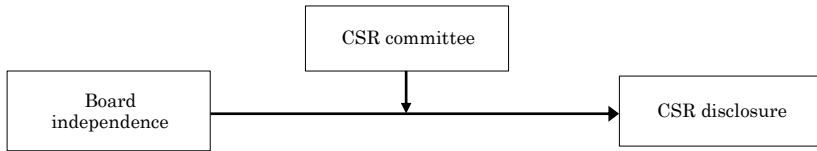
The independent variable is board independence, measured as the ratio between the number of independent directors appointed by minority shareholders and the total numbers of board members. We choose directors appointed by the minority in agree with part of literature that considers this as the best proxy for board independence in context, such as Italian, characterized by high ownership concentration (Brunello, Graziano, & Parigi, 2000; Connelly, Hoskisson, Tihanyi, & Certo, 2010).

We computed the moderating variable (*CSRCom*) using a dummy variable equal to 1 if there is a CSR committee and 0 otherwise.

We add the following control variables: board size, measured as the total number of board members; board meeting, computed as the number of board meetings during the year; role duality, measured using a dummy variable equal to 1 if the CEO of the board is also the chairman; board executive, computed as the percentage of executive directors; multi-directorship, measured as the total number of directors holding positions in other companies; the presence, or not, of a Big Four Auditor Company as auditor of the sampled company; Size, measured as the natural logarithm of total assets; Leverage, computed as the ratio between long-term debt and total assets; Profitability, measured using Tobin's Q, that is the natural logarithm of the ratio between the market value and the balance sheet value of total assets; financial disclosure, measured as the number of financial key performance indicators released; sustainability sensitive industry, that is a dummy variable equal to 1 if the company operates in a sustainability sensitive industry and 0 otherwise. The following Figure 1 shows the research model used:



**Figure 1.** The relationship between board independence and CSR disclosure, and the moderating role of CSR Committee



We performed the following OLS regression model to test the hypotheses developed:

$$\begin{aligned}
 SRDisc = & \alpha + \beta_1 BoInd + \beta_2 CSRCom + \beta_3 BoInd * CSRCom \\
 & + \beta_4 BoSize + \beta_5 BoExec + \beta_6 BoMeetings \\
 & + \beta_7 RoleDual + \beta_8 Big4 + \beta_9 Size + \beta_{10} Lev \\
 & + \beta_{11} TobinQ + \beta_{12} FinDisc + \beta_{13} SustSensSect \\
 & + \beta_{14} MultiDirect + \varepsilon
 \end{aligned} \quad (1)$$

### 3. FINDINGS AND ARGUMENT

The results obtained show the existence of a positive and significant relationship between board independence and CSR disclosure, confirming our first hypothesis. The coefficient of board independence is statistically significant at better than the 5 per cent level for explaining variations in the CSR disclosure. This means that a larger number of independent directors, appointed by minorities, positively impact the level of CSR disclosure.

The findings also reveal that the presence of a CSR committee positively moderates the relationship between board independence and CSR disclosure, confirming our second hypothesis.

With respect to the control variables, all models present a statistically significant and positive *Big4* coefficient. This highlights that companies with a Big4 as auditors present a higher level of CSR disclosure. In fact, auditing companies play an effective monitoring role and positively affect companies' compliance with norms and standards requirements. Auditing companies have built a great image and reputation over the years by its irreproachable operate, as a result, a company with a Big4 as the auditor is more inclined to CSR policy, providing a higher level of disclosure.

Furthermore, *TobinQ* presents a statistically significant and negative coefficient, showing that companies with higher performance are less inclined to disclosure.

#### 4. CONCLUSION

This study contributes to the existing literature in several ways. First, we developed a CSR disclosure index in accordance with Directive 95/2014, which could be useful for future research on the European context on this topic. Also, this study is the first that analyses the moderating role of the CSR committee in the relationship between board independence and CSR disclosure. Findings obtained demonstrated the relevant need to study the complementary effects of different CG mechanisms, rather than the single effect, in influencing CSR disclosure. This can give a contribution in explaining the divergent empirical results scholars highlighted about the effectiveness of board independence in stimulating CSR disclosure, showing the way to solve the dilemma about the effectiveness of board independence: it is a better CG mechanism when other CG mechanisms are in place, i.e. the CSR committee.

However, this study has some limitations. The sample exclusively includes the Italian company and just one-year observations. Future research could extend the sample to other countries. Our CSR disclosure variable exclusively considered the quantity of the information released, but not the quality; this last aspect could be analysed in future research. Finally, our index considered the overall CSR disclosure, which includes different aspects: environmental, social and human capital, human rights and corruption disclosure. Future researchers could extend our study by investigating how different CG mechanisms interact with each other in affecting these disclosure aspects.

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## CONFERENCE FORUM DISCUSSION

**Dmitriy Govorun:** Thank you very much for your participation. I'm sure the paper you present may upgrade knowledge of scholars and researchers in CG mechanisms and disclosure issues. CSR is still attracting the attention of various stakeholders. They care about the company's behavior and communication policy. One question should be pointed here regarding the CSR reporting. I believe it is a good chance to improve the research with a deeper view of the process for such reports. Data samples for a couple of years could strengthen the outcome of modeling. For example, it is good to compare the situation before the directive was implemented (were reporting available and acceptable to the company or not, when the first report was generated etc.). This may influence the result we may receive and additionally test the hypothesis.

**Alfredo Celentano:** Dmitriy, thank you for your message. We absolutely agree with your consideration and sure enough, only one-year observation is the first limitation of our work. We'll improve our research sure.

**Tariq Ismail:** Totally agree with you. CSR and its impact on sustainable development need further investigation, where empirical data is required to test such an impact. An event study would help in providing solid results.

**H A R P Madushanka:** Hi Dmitriy, I agree with you too. Also, there are so many researches done using panel data for multiple years in CSR reporting post introduction of GRI. Also, it is a must that we understand the vacuum in the information flow as well. Since sustainability reporting is still a voluntary measure in most of the countries, the availability of information is still limited. This has a significant impact on most of the researches.

**Vikash Ramiah:** Is it time to expand CSR to include all the SDGs stated by the UN? I think corporations should adopt the 17 goals particularly at a time like this.

**H A R P Madushanka:** Actually, CSR reporting is almost non-existent at the moment, we have moved to sustainability reporting. Concepts like integrated reporting facilitate that. And yes, SDGs are in reporting my majority of the organizations and actually it should be. Some companies are using SDGs as a reporting framework. I suggest you refer the work of Prof. Carrol Adams on this. She has done some excellent work on the subject.

**Alfredo Celentano:** H A R P Madushanka, thank you for your comment and suggestion. My studies are still in progress and I take with very pleasure suggestions that can help me in my research.

**Vikash Ramiah:** I have seen the work carried down by the environmental reporting, etc. in OZ (see Craig Deegan's work). You see now it is regarded as a brand. Some companies are using SDG as a brand and they are successful because of their principles. They report on these like crazy as it is marketing. Even the expensive brands are explaining how they use SDGs as part of their 'designer' approach.

**Alfredo Celentano:** Vikash Ramiah, thanks for your consideration. I totally agree with you. And thanks for your suggestion about Deegan's work, it is very important for me.

**Alex Kostyuk:** Hi Alfredo, it is very much promising research. I expect that you have just fixed a new stream in corporate governance research. Just one proposal to do. I expect that you should keep in mind that CSR is considered by companies as social investments that could prescribe the further concept of "social investments rate of return". I expect that larger companies and public firms have already integrated this concept inside and in this case, the role of independent directors linked to CSR grows remarkably. So, your major hypotheses could be stronger for the larger, public and probably global (at least international) firms. Try to check it up.

**Alfredo Celentano:** Dr Kostyuk, thank you for your comment and your appreciation of our work. Thanks especially for the observation and reference to CSR as a social investment and its link to "social investment rate of return" concept, is so much important and interesting, I really appreciate it. About a new stream of research or new research work, we're at it, and as you propose, our sample is composed exactly of large companies, public firms (utilities, etc.) We hope to be able to improve our hypotheses.

**Dmitriy Govorun:** Alfredo, I have one more comment/question. You've mentioned the synergy effect of governance mechanisms. More effect is reached when several mechanisms interact in one line. I believe this is a good finding from your paper and it may be used to try other combinations with different mechanisms. Which of them may be also used as to your point of view?

**Alfredo Celentano:** Thanks so much for your question. Always thinking about the relationship between CG and CSR I believe that a further mechanism to investigate can be represented by the diversity of the board, especially in terms of gender diversity, and female presence in

the boards. I say this based on some of the considerations that I was able to make in my first research work; women's presence on the boards has been an element of constant growth in recent years, more and more companies have been careful to respect the "pink quotas"; also investigating my sample I was able to see (which, however, is not evident from the work presented today) that the CSR committees presented in the majority of cases at least one female presence among the members. We can think that my opinion is in accord with theory and literature which say that women are more incline to sustainability aspects.

**Dmitriy Govorun:** Good point, thanks. Active comments on the section regarding the paper on diversity and women on boards confirm the idea and the direction.

**Maha Radwan:** Thanks for that good research, CSR is a very important topic and I just only suggest as the previous comments to explore and investigate several years.

**Alfredo Celentano:** We totally agree with you and previous comments: in order to improve our findings, we need to extend observation years absolutely. I think that looking in particular at the trend in the coming years, we could achieve more robust results, above all because in Italy the transposition of the European legislation and the adoption of the provisions contained in it has happened rather slowly, therefore the next years could offer more meaningful data.

**Omrane Guedhami:** Hi Alfredo, I find the idea interesting. I think it would be important to account for the endogeneity of the CSR committee and the potential effect of board independence on the decision to form a CSR committee. In addition, to complete the picture, I suggest that you examine the effects of CSR disclosure on firm value.

**Alfredo Celentano:** You're absolutely right about the endogeneity of CSR comm. variable, particularly if I think that, in my sample, the prevalence of CSR committees is made up of independent directors. Thank you for this detailed reading, I really appreciate it. About "CSR disclosure and firm value" I think it could be the next step of this research.

**Sabri Boubaker:** Hi Alfredo. Great idea. One of the problems common to all similar studies is that the dependent variable (score) does not follow a normal distribution. I suggest that you run a robustness test while using a log or a Box-Cox transformation.

**Stergios Tasios:** Hi Sabri, one way to handle the problems of normality of the disclosure score is to run the regression with the transformation to normal scores.

**Alfredo Celentano:** Thanks for your comment, Sabri. We agree with your observation; we know that these studies do not follow a normal distribution, but we decided not to perform any further verification with respect to the specificities of the research. We appreciate very much your suggestion, so in order to answer to you and to the comments of Stergios Tasios, whom I greet and thank. Do you both think that "mean centering" could fix the problem?

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## 1.2. THE EFFECT OF BOARD STRUCTURE ON DIVIDENDS POLICY: A COMPARATIVE STUDY BETWEEN BRAZILIAN AND CHILEAN FAMILY FIRMS

Guadalupe del Carmen Briano-Turrent \*

\* Accounting and Business School, Universidad Autónoma de San Luis Potosí, Mexico

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### Abstract

Dividends constitute a signal mechanism to the stock market because they communicate information about the financial performance and therefore impact the share price (Roy, 2015). There are several factors that may influence the dividend policy. As from the seminal work of Miller and Modigliani (1961), different studies have analyzed explanations for dividends behavior. In the context of family firms, the agency theory provides a mixed perspective on moral hazard problems in family firms. On the one hand, families are assumed to be better monitors of management than other types of large shareholders, suggesting that lack of alignment between the principal (controlling shareholders) and the agent (managers) better known as agency problem I, might be less prevalent in family than in non-family firms (Anderson & Reeb, 2003; Ben-Amar & André, 2006). On the other hand, controlling families may have an incentive and the ability to extract private benefits at the expense of minority investors (referred to here as agency problem II) (Fama & Jensen, 1983; Shleifer & Vishny, 1997; Bozec & Laurin, 2008).

Family firms account for two-thirds of all businesses around the world, contribute with the 70%-90% of the gross domestic product (GDP) annually, and create the 50%-80% of total employment (Family Firm Institute, 2016). Data from Latin America shows that family firms



represent 75% of firms, generate 70% of job creation and contribute to about 60% of the GDP (EY, 2014). In Brazil, 70% of the largest public business are family-owned and 90% of private companies are family, while these types of companies create 75% of all new jobs (Cambieri, 2012). With respect to dividends, the corporate law in Brazil requires that listed firms specify the percentage of annual profits (normally 25%) to be paid out as dividends in their bylaws, and dividends from Brazilian companies are not taxed (Martins & Novaes, 2012). In the Chilean context, 44% of listed companies are family-owned while 49.6% of small and medium companies are family firms. These companies contribute 70% of the GDP and generate 60% of employment (Watkins-Fassler, Fernández-Pérez, & Rodríguez-Ariza, 2016). Similarly to Brazil, the Chilean Corporation Act requires from open stock companies to distribute at least 30% of their net income each year as dividends, unless otherwise agreed by the unanimous consent of the shareholders (Urzúa, Alvarado, & Hermosilla, 2012). The capital market is characterized by a higher ownership concentration, pyramidal management structures and the presence of institutional investors (pension funds), which have contributed to the efficiency and liquidity of the market (Lefort & Walker, 2000).

The prevalence of family firms in Latin America and the family incentive to extract private benefits raises the question: how family firms adopt dividends to reduce free cash flow and restrict their opportunistic behavior? Family firms that operate within weak institutional environments may distribute higher dividends as a trust-generating mechanism towards minority investors (Crocì, Doukas, & Gonenc, 2011; Miller, Le Breton-Miller, & Lester, 2010). Furthermore, dividend policy is a more credible signal against the minority expropriation investors compared to other corporate governance mechanisms (Pindado, Requejo, & de la Torre, 2012). On the other hand, the board of directors also plays an important role in mitigating agency problems between families and minority shareholders (Fama & Jensen, 1983). The inclusion of independent or female members on the board generally increases the monitoring and restricts the opportunistic behavior of controlling shareholders (Gunasekarage & Reed, 2008). Namely, the board composition may balance (mitigate) the family's power (agency problems) between family and outside investors (Setia-Atmaja, 2010).

From the agency theory perspective, this paper focus on the agency problem II (principal-principal) that is interesting when studying dividends, namely the conflict between the controlling and minority shareholders, who may have diverging interests due to their different preferences to maintain the control over corporate resources (Faccio, Lang, & Young, 2001). Minority shareholders often prefer to receive dividends in order to reduce the free cash flow available for the controlling shareholders, whereas the controlling shareholders adopt a reinvestment preference (Gersick, Davis, Hampton, & Lansberg, 1997).



These conflicts of interests motivate the expropriation of minority shareholders and, consequently, increase the agency problems type II in family firms. In this context, dividends play a disciplining role by forcing controlling shareholders to abstain from expropriation behavior and to pay out (high) dividends (Minichilli, Corbetta, & MacMillan, 2010). This study aims to respond to two main empirical questions related to family firms' dividend policy. First, do Brazilian and Chilean family publicly listed firms distribute more dividends to shareholders compared with non-family firms in order to inhibit agency problems between controlling and minority shareholders? Second, does the board composition affect dividend policy decisions in family firms in these countries?

The sample of the study is composed of 853 observations from 49 Brazilian and 32 Chilean top publicly listed firms in terms of market capitalization over the 11-year period from 2004 to 2014. Using an unbalanced panel data, empirical results demonstrate that family firms pay more dividends than non-family firms, while the board size and female representation on the board have a significant and positive impact on the dividend policy of the firm. In contrast, the COB-CEO duality inhibits dividends. These results support the "substitute" model proposed by La Porta, Lopez-de-Silanes, Shleifer, and Vishny (2000), who affirms that firms with high levels of ownership concentration or in weak investor protection environments, need to pay dividends to alleviate the agency problem II and to establish good reputation. Furthermore, better governance practices such as an adequate board structure, leads to a more efficient dividend policy (Minichilli et al., 2010).

This paper suggests that corporations operating in such environments are more likely to increase dividends in order to reduce the opportunist behavior by controlling families. Thus this research offers an opportunity to examine the key role that family firms play in determining the dividend policy, particularly in the presence of weakness in the institutional framework. This study has important social and practical implications for policymakers and family founders to make knowledgeable decisions and thus increase the competitiveness and economic growth. Policymakers need to promote policies that inhibit family opportunistic behavior in detriment of minority shareholders and increase the participation of institutional investors in providing capital in Latin America.

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## CONFERENCE FORUM DISCUSSION

**Dmitriy Govorun:** I appreciate your efforts in sharing knowledge on Brazilian and Chilean context of dividend policies and board structures. You also focus on differences between family-owned and non-family firms. It will be good to know more about variables used to outline board characteristics. Did you use more or less standard combination of such characteristics given by literature (board size, independent directors, etc.)? Did you study how the adopted committee system influenced the dividend policy among other variables?

**L-F Pau:** Sorry for a clarification/definition question first. How do you define "board structure"? By voting power? By committee tasks? By background? By link to family holdings or interests?

**Egbert Irving:** Thanks for the research and article. I am interested in the definition you used for 'board structure' and whether board characteristics were also included as part of the study.

**Guadalupe Briano:** Hi to all and thank you for your feedback. The board structure is defined with the main four variables: board size, board independence, COB-CEO duality and female participation on the board.

**Guadalupe Briano:** Thank you for your comments. I run an unbalanced panel with fixed effects and robust and other analysis to attend possible endogeneity and heterogeneity problems. I control for company characteristics variables such as size, ROA, leverage, industry type.

**Mireille Chidiac El Hajj:** The research is interesting. We will wait for the final results. Two small remarks: going back to the agency theory and defining the methodology you will refer to while conducting the study would be helpful.

**Guadalupe Briano:** Thank you for your comments! In the Latin American context, the agency problem type II is frequent. So, the main conclusion in this paper is that family firms tend to pay more dividends in order to send good signals to minority shareholders and strengths the confidence in the market.

**Gonzalo Jimenez:** Guadalupe, thank you for sharing your work. Please be advised that the work cited in your paper: "In the Chilean context, 44% of listed companies are family-owned while the 49.6% of small and medium companies are family firms. These companies contribute 70% of the GPD and generate 60% of employment (Watkins-Fassler et al., 2016)" grossly sub estimates the percentage of family firms in Chile. I can happily share with you the only national study of family firms in Chile (in Spanish); which might be useful for you. Please send an email to send it to you [gjimenez@proteus](mailto:gjimenez@proteus).

**Guadalupe Briano:** Thank you, Gonzalo, for your information. I will contact you to update the statistics.

**Dmitriy Govorun:** Guadalupe, I expect my further question will be more general, however, how would you characterize the institutional framework in researched countries? You've mentioned that policymakers should manage policies to increase the participation of institutional investors in providing more capital in Latin America. Which steps do Brazil and Chile lack regarding letting the institutional investors provide more capital in Latin America (in terms of corporate governance)?

**Guadalupe Briano:** Hi Dmitriy, this is a good question. I think in general the Latin American region needs to strengthen the formal institutional framework, increase the institutional investor's confidence through the corruption levels reduction, and promote higher transparency on conflicts of interest and related party transactions issues.

**Iliana Haro:** But your paper refers to Brazil and Chile? So, what are the specific steps that are missing in those countries? And in the case of Mexico what are the specific articles of the Ley del Mercado de Valores and from the Codigo de Mejores Practicas Corporativas that do not address these topics. On the other hand, what do you mean by corruption in corporate governance?

**Guadalupe Briano:** Hi Iliana, I refer mainly to strengthen the formal institutional framework (through mandatory laws) because in the case of Mexican and Brazilian context we have codes of good governance (comply or explain), but there is not enough to attract more institutional investors. At a corporate governance company levels, a good strategy may be increasing transparency on CG practices.

**Maha Radwan:** Interesting paper, I would like to ask if there were any independent members in the boards of the companies that you investigated; have you taken as a variable the number or the presence of independent members?

**Guadalupe Briano:** Hi Maha, yes, I introduce this variable but it is not significant in results.

**Hadfi Bilel:** Dividend policy is still a subject of ambiguity in finance because of the lack of a convincing explanation for the dividend puzzle theory. Despite the presence of several other theories that we tried to find the best explanation but still remains unconvincing. I am interested in the subject; can you please inform me about the results obtained following your estimate? How did you calculate the dividend? And by what method did you estimate?

**Guadalupe Briano:** Thank you for your comments. I used the dividend payout ratio (dividends per share) for 1 year and the 5 year average. I run a panel data with dices effects.

**Sabri Boubaker:** Hello Guadalupe. Great research idea. I have a few suggestions: 1) Run regressions to study dividend increase, a dividend cut and dividend initiation (in addition to the dividend level). 2) Do you include any ownership structure-specific variable to control for Agency Problem type II such as ownership concentration or control-ownership wedge?

**Omrane Guedhami:** Hi Guadalupe. The paper *Attig, N., Boubakri, N., El Ghouli, S., & Guedhami, O. (2016). The global financial crisis, family control, and dividend policy. Financial Management, 45(2), 291-313* includes a good discussion along the lines suggested by Sabri. Also, you can examine the role of profitability and agency problems proxied by free cash flow.

**Guadalupe Briano:** Thank you, Sabri, for your comments. With respect to point 1, I did not consider this classification; 2) yes, I include ownership concentration as a control variable.

**L-F Pau:** Sorry to repeat the question after this discussion, because it omits key factors seen in practice: How do you define "board structure"? By voting power? By committee tasks/organization? By background of members? By link to family holdings or interests like pension funds or VC? I don't believe that board size, board independence, COB-CEO duality and female participation on the board are the key factors for dividend policies. Comes these days as a reminder: if public authorities are represented on board as investors, then dividends are curtailed.

**Guadalupe Briano:** Thank you for your comments, but my paper is focused on board composition. There is extended literature that analyzes different board attributes, for instance, independence or female representation. Variables that you mention may be interesting for further research. Unfortunately, in Latin American companies all information needs to be obtained from annual reports in a handy way. Could you share me some literature in other contexts with the variables suggested?

# 1.3. BOARD LEADERSHIP LEGITIMACY AND DIRECTOR TURNOVER IN FAMILY FIRMS

Jung-Eung Park<sup>\*</sup>, Brian Bolton<sup>\*\*</sup>

<sup>\*</sup> IMD Business School, Lausanne, Switzerland

<sup>\*\*</sup> Moody College of Business, University of Louisiana at Lafayette, USA

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## Abstract

This paper investigates the factors that affect director turnover in family firms based on longitudinal analyses of 77,487 director-year data for large US firms from 2000 to 2010. When legitimate leadership is perceived to exist within the board, the running of the board is more effective and directors are less likely to quit, compared to situations in which legitimate leadership is absent. The negative relationship is stronger when the period of time that a director works alongside the chairperson is longer. This paper contributes to the literature on family businesses and corporate governance in relation to director turnover.

## 1. INTRODUCTION

In this study, we examine the likelihood that a director will exit a company board under certain circumstances of family ownership structure and in a non-crisis setting. We find that perceived legitimacy in a chairperson's board leadership is negatively associated with the turnover levels of outside directors. Particularly, we present exploratory evidence that a lack of perceived legitimacy, despite formal entitlements or superior voting power due to dual-class share structures, increases the likelihood of a director exit. The negative relationship between perceived legitimacy and the likelihood of a director exit is stronger when the director in question has worked with the chairperson for a longer period

of time, reflecting the role that trust plays in keeping directors on the board.

Our findings provide a nuanced view on the fact that the running of boards in family firms is different than in non-family firms as aligned with previous literature. In a family firm, the owner family essentially determines board leadership legitimacy. Since the chairperson, whether a family member or not, has to enjoy the backing of the owner family, his or her legitimacy as board chairperson is pretty much secure, regardless of the individual's experience or qualifications. In the case of non-family firms without significant block holders, the chairperson has to build credibility and prove legitimacy in order to ensure a smooth and effective running of the board and to keep directors from quitting the board. This finding also highlights the difficulties that a new chairperson appointed from outside the board can face. In contrast, when there is a lack of perceived legitimacy, as illustrated by the case of dual-class share structures existing without significant share ownership, the climate inside a boardroom is not so accommodative, and the likelihood of a director exit increases.

Finally, we extend the legitimacy theory in organizational institutionalism by associating its impact on board dynamics and director turnover. We find that perceived board leadership legitimacy is one of the key factors affecting the director's motivation to continue serving the board as aligned with previous research, and this relationship is strengthened by the level of trust that a director holds in relation to the board's leadership. One possible explanation for this result is that regardless of any concern over the lack of legitimacy, directors are influenced more by the desire to continue working in a trusted environment. When a chairperson's perceived legitimacy is weak, a director's position in the board can even backfire, since the director may perceive the chairperson as relatively less qualified for the leadership role than herself.

## 2. MOTIVATION

Legitimacy in organizations is defined as "a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values beliefs, and definitions" (Suchman, 1995, p.574). The theory of legitimacy suggests that legitimacy enhances organizational survivability and helps to achieve organizational goals (Suddaby, Bitektine, & Haack, 2017). A high degree of legitimacy in leadership can bring about active support from stakeholders, whereas a low degree of legitimacy can cause doubts about the leadership. The subject of legitimacy has attracted the attention of management research on the corporate leaders (Vial, Napier, & Brescoll, 2016).



In terms of corporate governance, the running of boards can become problematic if directors start questioning the chairperson's legitimacy in leading the board and lose focus of the subject matters on the board's agenda. This can trigger a precarious psychological state for the chairperson and negative reaction, thus can make the boardroom dynamics difficult. Family firms represent cases in which legitimacy in board leadership is usually more robust, due to the family's significant ownership of the company. Ownership offers a mechanism for institutionalizing power in a firm and the ultimate power of decision-making in business (Koerberle-Schmid, Kenyon-Rouvinez, & Poza, 2013, p. 63). The chairperson of a family firm's board, whether the person is a family member or not, has to enjoy the empowerment by the family who has de facto control of the firm (Braun & Sharma, 2007). We have investigated a particular case where a firm uses a dual-class share structure, with no person or group owning a significant number of shares. Because a small number of shareholders enjoy a greater degree of voting power with which they can influence key business decisions, we have assumed that these shareholders and the chairperson of the board lack legitimacy.

When employees trust their leaders, they focus greater attention on value-producing activities and display greater organizational citizenship behaviors (Mayer, Davis, & Schoorman, 1995). In corporate governance, trust can mean the expectation of the chairperson and a director that the other party will not opportunistically pursue self-interest, will act as stewards and align their interests with those of the board, or will altruistically place the interests of others ahead of or equal to their own. Trust is a fragile commodity that is often easier to breach than to build and a "dyadic construct, where parties may hold diverging perceptions of the level of trust in the relationship." Only when there is no concern about the lack of legitimacy, the more time a director has worked with the chairperson, the less likely the director will exit the board.

### 3. METHODOLOGY

The baseline sample of companies used in this paper comes from the research conducted by Anderson, Duru, and Reeb (2009) and Anderson, Reeb, and Zhao (2012) which provide data on family firms' status and dual-class share structure. Other data are from BoardEx and Datastream. The final sample set used in this study included consisted of 76,966 director-year pairs with 13,616 directors in 1,381 public US companies from 2000 to 2010.

In our data, director exit is a binary variable that equals 1 when a director left the board within three years of the year in which the independent variables were initially measured. We used three measures to test our legitimacy hypotheses: the chairperson's length of time on the board relative to a director's length of time on the board; whether the



company is a family firm; and whether a dual-class share structure exists. The first measure captures how each director perceives the legitimacy of the chairperson of the board. In our study, we have defined a family business as one in which the founder or a member of his or her family (by blood or through marriage) holds a minimum five percent equity stake in the firm (Anderson et al., 2012). We have used binary variables for family firms and dual-class share structures.

We assume that the longer a director has worked on the board with the chairperson, the higher the level of trust between the director and the chairperson and/or the owner family members will be. It is extremely difficult, if not impossible, to assess variations in trust because that would require surveying individual directors consistently over many years. Instead, by using this proxy, our research design allowed us to consider far larger samples than would have been possible with other research designs.

We included control variables for firm-, board-, and individual-level characteristics that could have influenced the likelihood of a director exiting the board. At the firm level, we controlled for size and performance, using net sales and return on assets, respectively. At the board level, we controlled for board size as well as for the ratio of the number of female and independent directors to the number of total directors. We also included the number of directors who joined or left the board, so as to control for the possible effects of group instability. And, at the director level, we included age, gender, and the individual's skills in terms of networking and education.

#### 4. RESULTS

Table 1 presents the descriptive statistics and correlations for all the variables used in the study and Table 2 presents the results of the logistic regressions used to test our hypotheses (see Appendix).

*Hypothesis 1a (H1a)* predicted that the perceived legitimacy of a chairperson in leading the board would decrease the likelihood of a director exit. The results in Model 2 support this hypothesis. The coefficient for the legitimacy of -0.19 was significant at the .001 level. As the legitimacy moves from minus to plus one standard deviation, the likelihood of a director exit decreases by 31 percent. *Hypothesis 1b (H1b)* predicted that a company's status as a family firm decreases the likelihood of a director exit. This hypothesis was also supported. The coefficient of -0.11 was significant at the .001 level. The likelihood of a director exit was 13 percent lower in a family firm than in a non-family firm. *Hypothesis 1c (H1c)* predicted that dual-class share structures strengthen the negative relationship between a family firm status and the likelihood of a director exit. Our results show that the effects of a family firm's status on the likelihood of a director exit are moderated in different ways when dual-class share structures exist. The change in the

likelihood of a director exit was greater between family firms and non-family firms when dual-class share structures exist. On the other hand, when there is no dual-class share structure in place, the difference in the likelihood of a director exit was less between family firms and non-family firms. *H1c* was thus supported.

*Hypothesis 2a (H2a)* predicted that the length of time that a director spends working with the chairperson strengthens the negative relationships between board leadership legitimacy and the likelihood of a director exit. Model 3 supports the hypothesis. The coefficient  $-0.02$  for the interaction was significant at the 0.001 level. Figure 2 shows that the likelihood of a director exit decreases when legitimacy increases, regardless of the amount of time spent on the board by a director. However, when a director has worked with the chairperson for a long time, the decrease in the likelihood of a director exit (due to high perceived legitimacy) is greater than in the case where a director has not worked for a long time with the chairperson. *Hypothesis 2b (H2b)* predicted that a director's time on the board accelerates the decrease in the likelihood of a director exit in the case of family firms. When a director has not worked on the board for a long time, a company's status as a family firm does not reduce the likelihood of a director exit, but when a director has worked on the board for a long time, the likelihood of the director exiting the board decreases more significantly in family firms than in non-family firms. Thus, *H2b* was supported.

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**APPENDIX**

**Table 1.** Descriptive statistics and correlations

		<i>Mean</i>	<i>SD</i>	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>	<i>6</i>	<i>7</i>	<i>8</i>	<i>9</i>	<i>10</i>	<i>11</i>	<i>12</i>	<i>13</i>	<i>14</i>	<i>15</i>
1	Director exit	0.24	0.43															
2	Legitimacy log1p	0.68	1.25	-0.12														
3	Family firm	0.31	0.46	-0.02	0.18													
4	Dual class share	0.1	0.3	0.00	0.09	0.43												
5	Time together	6.74	6.29	0.06	-0.29	0.17	0.06											
6	Firm revenue log	7.74	1.66	-0.01	-0.08	-0.14	-0.06	-0.05										
7	Firm RoA	3.52	13.82	-0.04	-0.01	0.01	-0.03	0.03	0.30									
8	Board size	9.78	2.34	0.04	-0.05	-0.08	0.03	-0.03	0.54	0.12								
9	Ratio independent directors	75.05	14.71	-0.05	-0.13	-0.33	-0.26	-0.11	0.13	0.00	0.05							
10	Ratio female directors	10.97	9.28	0.00	-0.07	-0.06	0.04	-0.08	0.32	0.08	0.29	0.17						
11	Ratio new directors	8.72	10.74	0.06	0.10	-0.05	-0.03	-0.17	-0.02	-0.05	0.06	-0.01	0.01					
12	Ratio directors left	8.41	11.72	0.04	0.00	-0.06	-0.02	-0.14	0.00	-0.04	-0.10	0.01	0.03	0.48				
13	Age	60.95	8.67	0.13	-0.28	0.02	-0.00	0.37	0.06	0.03	0.05	0.04	-0.04	-0.10	-0.07			
14	Gender	0.88	0.33	0.03	-0.04	0.02	-0.01	0.09	-0.11	-0.03	-0.09	-0.05	-0.31	-0.00	-0.01	0.20		
15	Network log	6.35	2.26	-0.15	0.10	-0.11	-0.06	-0.23	0.14	0.01	0.10	0.15	0.13	0.04	0.03	-0.31	-0.12	
16	Qualification	2.1	1.21	-0.05	0.04	-0.08	-0.06	-0.13	0.05	-0.01	0.06	0.10	0.07	0.01	0.02	-0.05	-0.06	0.27

*Notes: N = 77487; correlations with absolute values higher than 0.01 are within 99% confidence intervals.*

**Table 2.** Logit analysis results

	Predicted effect	<i>Model 1</i>			<i>Model 2</i>			<i>Model 3</i>			<i>Model 4</i>			<i>Model 5</i>		
		<i>Coeff</i>	<i>SE</i>	<i>p-value</i>	<i>Coeff</i>	<i>SE</i>	<i>p-value</i>	<i>Coeff</i>	<i>SE</i>	<i>p-value</i>	<i>Coeff</i>	<i>SE</i>	<i>p-value</i>	<i>Coeff</i>	<i>SE</i>	<i>p-value</i>
Legitimacy	<i>H1a (-)</i>				-0.20	(0.01)	[0.00]	-0.16	(0.01)	[0.00]	-0.21	(0.01)	[0.00]	-0.16	(0.01)	[0.00]
Family firm	<i>H1b (-)</i>				-0.11	(0.02)	[0.00]	-0.09	(0.02)	[0.00]	0.05	(0.03)	[0.10]	0.06	(0.03)	[0.06]
Dual-class share					0.61	(0.08)	[0.00]	0.60	(0.08)	[0.00]	0.63	(0.08)	[0.00]	0.62	(0.08)	[0.00]
Time together					-0.00	(0.00)	[0.34]	0.00	(0.00)	[0.41]	0.01	(0.00)	[0.00]	0.01	(0.00)	[0.00]
Family firm x Dual-class share	<i>H1c (-)</i>				-0.73	(0.09)	[0.00]	-0.72	(0.09)	[0.00]	-0.75	(0.09)	[0.00]	-0.73	(0.09)	[0.00]
Legitimacy x Time together	<i>H2a (-)</i>							-0.02	(0.00)	[0.00]				-0.02	(0.00)	[0.00]
Family firm x Time together	<i>H2b (-)</i>										-0.02	(0.00)	[0.00]	-0.02	(0.00)	[0.00]
Firm revenue log		-0.03	(0.01)	[0.00]	-0.05	(0.01)	[0.00]	-0.05	(0.01)	[0.00]	-0.04	(0.01)	[0.00]	-0.05	(0.01)	[0.00]
Firm RoA		-0.01	(0.00)	[0.00]	-0.01	(0.00)	[0.00]	-0.01	(0.00)	[0.00]	-0.01	(0.00)	[0.00]	-0.01	(0.00)	[0.00]
Board size		0.06	(0.00)	[0.00]	0.06	(0.00)	[0.00]	0.06	(0.00)	[0.00]	0.06	(0.00)	[0.00]	0.06	(0.00)	[0.00]
Ratio independent directors		-0.01	(0.00)	[0.00]	-0.01	(0.00)	[0.00]	-0.01	(0.00)	[0.00]	-0.01	(0.00)	[0.00]	-0.01	(0.00)	[0.00]
Ratio female directors		0.01	(0.00)	[0.00]	0.00	(0.00)	[0.00]	0.00	(0.00)	[0.00]	0.01	(0.00)	[0.00]	0.00	(0.00)	[0.00]
Ratio new directors		0.01	(0.00)	[0.00]	0.01	(0.00)	[0.00]	0.01	(0.00)	[0.00]	0.01	(0.00)	[0.00]	0.01	(0.00)	[0.00]
Ratio directors left		0.01	(0.00)	[0.00]	0.00	(0.00)	[0.00]	0.00	(0.00)	[0.00]	0.00	(0.00)	[0.00]	0.00	(0.00)	[0.00]
Age		0.03	(0.00)	[0.00]	0.02	(0.00)	[0.00]	0.02	(0.00)	[0.00]	0.02	(0.00)	[0.00]	0.02	(0.00)	[0.00]
Gender		0.06	(0.03)	[0.03]	0.06	(0.03)	[0.05]	0.05	(0.03)	[0.08]	0.06	(0.03)	[0.06]	0.05	(0.03)	[0.08]
Network log		-0.10	(0.00)	[0.00]	-0.10	(0.00)	[0.00]	-0.10	(0.00)	[0.00]	-0.10	(0.00)	[0.00]	-0.10	(0.00)	[0.00]
Qualification		-0.04	(0.01)	[0.00]	-0.03	(0.01)	[0.00]	-0.03	(0.01)	[0.00]	-0.04	(0.01)	[0.00]	-0.03	(0.01)	[0.00]
Constant		-2.26	(0.09)	[0.00]	-1.34	(0.10)	[0.00]	-1.31	(0.10)	[0.00]	-1.40	(0.10)	[0.00]	-1.37	(0.10)	[0.00]
Log-likelihood		-41076.89			-40612.44			-40580.43			-40584.68			-40555.06		

## CONFERENCE FORUM DISCUSSION

**Dmitriy Govorun:** I'm very pleased to read a paper concerning director turnover with the focus on USA family firms. Following the statement regarding directors' perception of legitimacy, it may be a good point to receive qualitative data with the subjective perception of directors and to compare results with those already received in research. Such data may bring new discussion as well. Did you somehow measure the legal background for leadership in those boards (like clear code of corporate governance, corporate governance principles implemented and followed)?

**Brian Bolton:** Hi Dmitry – Brian Bolton here. Thanks for the comments. I really like the second suggestion about legal background and codes of governance. All of our sample firms are U.S. firms, but that doesn't mean they have the same codes or legal backgrounds. So that's a great idea that we could implement relatively easily. I like the first suggestion, too, about the perception of directors. My co-author (Jung) and I have discussed this, but we haven't figured out an effective way to incorporate it into our models. Consistent with both of your comments, we've debated some measure of "culture" that might set the tone within the boardroom. We did not include that because we couldn't find a measure that would have enough cross-sectional variation to tell us much. But your idea of legal background could go a long way towards controlling for all of these issues. Thank you very much.

**Patricia Bortolon:** Congratulations on your paper! In the USA, do directors have mandates stipulated by the companies' by-laws or any legal rule? Because the existence of mandates should influence turnover. That is, with mandates, some changes will not have to do with the legitimacy of the leadership. Is it possible to consider this aspect in the research? Do the authors consider this aspect relevant?

**Iliana Haro:** Hi Jung and Brian, I have some questions about your presentation. 1) You define legitimacy leadership, but you don't mention what do you understand by leadership in the first place, could you clarify this, please? 2) What models of leadership approach are taking into account, the trait approach, the skills approach, the behavioral, the situational, the path-goal, the transformational, the authentic, the servant or the adaptive? Because according to the theory of each model none of them uses power and coercive ways to induce compliance, because compliance is not part of leadership that is part of rulership. 3) In your sentence "In corporate governance, trust can mean the expectation of the chairperson and a director that the other party will not opportunistically pursue self-interest, will act as stewards and align their interests with those of the board, or will altruistically place the interests of others ahead of or equal to their own", who is the other party? Thanks for your comments.

**Iliana Haro:** Hi Patricia, according to the New York Exchange Commission, US companies generally do not have specific term limits on director service, though some companies indicate in their by-laws a "mandatory" retirement age for directors (72 to 75 years old) which can be waived by the board of directors. Also, it is important and interesting to note that regulations and law in the USA do not prevent a director from qualifying as independent, which might mean that a retired director may still become an independent director

**Iliana Haro:** I have another question, sorry, your topic is very interesting to me; therefore I would like to go deeper if you don't mind. In your research are you considering the impact of mega-trends in the business context like digitization, disruption, changes in public regulation, changes in customer behavior, political insecurity, scarcity of resources and new business models, as factors influencing members of the board decision to exit?

**Mireille Chidiac El Hajj:** The research is very interesting and has an added value. However, allow me to give you some remarks: 1) according to the research questions in slide 2, you asked 3 questions; but you based your research on legitimacy leadership without going back to money and/or respect; 2) moreover, in slide 5, you only defined legitimacy but not leadership; 3) the director turnover model is built on an interesting equation in slide 11. Can you please explain how you built it and on which basis? Thank you so much for your cooperation.

**Brian Bolton:** Hi Patricia. Good point, good question. In the US, most companies will have a formal director mandate, but that mandate is pretty general. Our mandates do not include term limits or length of service. They speak to "fiduciary duty" and "stewardship" in high-level terms. As you suggest, company by-laws may influence tenure, as each company will have different by-laws and different director protections (but very few will have anything about director tenure). Your suggestion along with Dmitriy's suggestion of using legal-background would make a lot of sense and should capture some of the firm-specific framework what might make it more or less enjoyable to be a director. We have not considered this yet – but we will in the next version. Thank you very much, Patricia.

**Brian Bolton:** Hi Iliana. Thanks very much for all of this. Jung does strategy work and I'm mostly a finance guy, and we tried to find a balance between the two perspectives with this paper. As such, we do not go into leadership at the level that you are suggesting – we kept it very simple, assuming that the CEO and/or board chair were the de-facto leaders. We did not and could not look at specific leadership approaches to see how this affected directors or executives, but we essentially looked at it from the other direction, by looking at director turnover to see what this suggested about leadership styles. I'll talk to Jung, but perhaps you've given us a nice idea for our next paper – to learn more about the leadership approaches based on director turnover characteristics and

dynamics. Thank you for that. And to (3), thank you for calling that out – our writing is a little sloppy. The "other party" could be the CEO, the chair, a director or really any stakeholder directly involved in the governance. We can re-write this to clarify that governance is ultimately a system of relationships and trust can go a long way to determining how successful each relationship will be.

**Brian Bolton:** No problem at all about the questions: short answer: no. At least not in this paper. We have industry and year controls in the models, but you're asking about much more. If you have any suggestions on how to incorporate such macro issues in this work, I would love to talk with you about it. In another paper, not included in this conference, Jung and I have created a method to measure "disruptive innovation." We are working on the actual measures, but once we have confidence in them it could be helpful to include them in this director turnover paper. Your point is a really good one – because, while mega-trends are macro by definition, different companies will respond to them in different ways, and that could influence director turnover and leadership effectiveness. Thank you very much.

**Iliana Haro:** Hi Brian, first let me congratulate you both, you are very lucky working together a strategist and a finance guy in my perspective are a great combination for CG purposes. On the other hand, it is true that most of the time we all assume that the CEO and board are the leaders, but the point is that leadership understanding it as a process to influence people's actions cannot be appointed, has to be developed maybe it would be helpful for you to check what Northouse says about it, it is just a suggestion of course.

**Brian Bolton:** Hi Mireille – thank you for your comments. Perhaps, I was a little sloppy in preparing those slides, as I wasn't trying to tie them directly to what we did in the paper, but rather to introduce the issues we were thinking about with the paper. Ultimately, we felt that these issues were all related and in an empirical study the effects would be the same. To (2) as far as leadership, we did not go into details about specific models or approaches on leadership – we simply assumed that the individuals in leadership positions – the CEO and board chair – were the de facto leaders and director turnover would be an indication of their legitimacy as determined by the directors. For the model, we wanted to keep it relatively simple, both due to data constraints and due to the inability to measure many of the nuances that you and Iliana mentioned – we cannot differentiate leadership styles, so we did not try to. We simply wanted to try to identify why directors left. The family firm dynamic is unique and introduces relationships among leaders and shareholders that we may not see at non-family firms (even if the CEO is not a family member, she has likely been hired and approved by family members, thus conferring some type of legitimacy). So that's a key variable. And then we added the legitimacy and trust variables. We included the interaction terms because of the uniqueness of family firms



– we had to control for family firms being different. We did not have one single basis for constructing this model, but we built it based on my finance perspective and Jung's leadership research.

**Iliana Haro:** Yes, I have some ideas, for example, in your opening questions you ask "Why do directors leave boards? Is it lack of money? Is it lack of respect? Is it about their respect for board leadership?" but this could not be the only reason. I give you an example, take the case of digitization which is also a disruption factor for organizations. If the CEO or the members of the board do not understand it, or do not have the capacity to visualize the impact of digitization and still the organization moves forward on that direction they may leave due to their lack of "shared believes". Another example is the changes in public regulation, companies may not be public, but their CEO or board of management still has a duty to comply, if corporate, criminal and tax new regulations impose new burdens on their CEO and management boards they may also leave due to the risk this represents to them. I am a lawyer and see this happening all the time particularly in SMEs, which leads in some cases to even selling the entire organization to other one where their CEO or board are willing to take major risks. I hope this be of help.

**Iliana Haro:** Probably one differentiation that could help you in your research regarding this presentation is to differentiate between management roles, those are the CEO and the board members, and leadership which is a completely different thing, that is a process.

**Brian Bolton:** Thank you, Iliana. This is a lot of good perspectives to think about. I'll work with my co-author to see what we can incorporate into the paper.

## 1.4. CEO DUALITY: NEWSPAPERS AND INVESTORS' OPINIONS<sup>°</sup>

Marco Caiffa<sup>\*</sup>, Vincenzo Farina<sup>\*\*</sup>,  
Lucrezia Fattobene<sup>\*\*\*</sup>

<sup>\*</sup> Deloitte Financial Advisory, Italy

<sup>\*\*</sup> University of Rome "Tor Vergata", Italy

<sup>\*\*\*</sup> LUM Jean Monnet University (Italy)

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### CONFERENCE FORUM DISCUSSION

**Lucrezia Fattobene:** Welcome to my presentation. The purpose of this research is to observe how investors react to news associated with CEO duality thus examining the impact of the phenomenon on firm's value on the stock market. We collected newspapers articles mentioning Chairmen, Vice-Chairmen and CEOs over an 18 years period; we then extracted the sentiment of the news and observed the impact on the stock market through event-study (with maximum 20 days of event-windows).

**Lindrianasari:** CEO duality is a very interesting research topic in the area of corporate governance. We all know that agency theory and stewardship theory can clearly explain and predict the relationship between CEO duality and market performance. The market performance you are using is AR or CAR, and it seems like you are using the annual period observation method. It would also be very interesting to research the window period observation method, which is when there was a change from CEO to dualism. Of course, this research aims to examine the efficiency of the capital market.

**Alex Kostyuk:** Hi Lucrezia, I found your main research ideas very interesting. Just one issue to note. In 2013 at the conference in Rome I discussed publicly this issue with Benjamin Hermalin from Berkley. We compared the US and the UK CEO duality experience. Finally, we both agreed that the role of shareholder rights protection is very important here. Thus, in the US practice with more popular CEO duality, there is not a need for the independent status of the Board Chairmen because the shareholders are protected seriously by the legislation of the USA. But in the UK, where the soft law is dominating, the independent status of the Chairman is a serious instrument to protect the rights of shareholders therefore in the UK the positions of CEO and Chairman are separated

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<sup>°</sup> The material has been presented at the conference and was being discussed within the conference forum. The authors preferred not to publish the material in the conference proceedings.

more than in the USA. So, you should take the issue of shareholder rights protection in your further research.

**Lucrezia Fattobene:** Alex, I agree with you and I should also mention this aspect in my Introduction. I think Italy is an ideal setting to study CEO duality because of the weak legal protection of creditors and shareholders, very poor law enforcement, high ownership concentration, and a high presence of pyramidal groups.

**Alex Kostyuk:** So, Lucrezia, you have just outlined this CEO duality concept for Italy. It should be the way of the UK.

**Dmitriy Govorun:** Lucrezia, thanks for your efforts in researching such an interesting topic. Practitioners and scholars are interested in combined methodologies on how to use the data collected from the media for research. You state that a positive sentiment of the news is associated with a positive and statistically significant impact on share prices, while negative content is associated with a statistically significant negative one. Were news in Italian or English when mentioning the sentiments concerning a certain company in your sample? Who was the consumer of such information finally – the same language trader/investor? It would be also interesting which type of investor reacts more on newspaper news.

**Lucrezia Fattobene:** Thank for your feedback. We downloaded articles from Italian newspapers. It would be very interesting to see which type of investor reacts more but how could we classify investors?

**Dmitriy Govorun:** I mean is there any classification or data to receive concerning was the investor an institutional investor (fund, etc.) or an individual; to get their risk profile/strategy in a sense of sensitivity to news obtained.

**Lucrezia Fattobene:** I observed investors' behavior by looking at stock market reaction around the day the news is published – so I have only aggregated data. I will think about finding a way for what you suggest because it is very interesting!

## 1.5. A CONFIGURATIONAL APPROACH TO THE DETERMINANTS OF WOMEN ON BOARDS<sup>°</sup>

Maria João Coelho Guedes<sup>\*</sup>, Alice Galamba  
Monteiro<sup>\*</sup>

<sup>\*</sup> University of Lisbon, Portugal

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### CONFERENCE FORUM DISCUSSION

**Alex Kostyuk:** It was very interesting to discover your presentation. The title is very innovative as this goes even further – to the theory of games related to the strategic decisions of the shareholders about the board of director size, structure, and gender. I outlined several issues to ask: Should the configuration of the board directors be a subject of furthermore strict regulation? If it should not be, who should push this issue in practice forward? Is the role of cultural stereotypes still important in outlining the configuration of the boards from country to country? How could you explain the more dominant position of women on the board as NEDs than executive directors (30% in contrast to 12%)?

**Maria Guedes:** The board configuration is still quite static. The typical board has not changed that much, only in the aftermath of gender quotas. We have seen an increase in the number of women, but mainly to NED positions. Women are still not getting to the decision positions, to exec positions and boards are still not open to other nationalities or even qualifications. For example, what if the board had more medical doctors could we have foreseen this sanitary crisis? We need to rethink what we expect from boards, at least the advisory boards that need to be more diverse.

**Vikash Ramiah:** The Prime Minister in New Zealand has been praised for her leadership role in the current crisis. Do you think we will see similar outcomes in companies?

**Maria Guedes:** Well...not just New Zealand: Germany, Denmark, Finland. So, we cannot ignore it and learn lessons from there.

**Vikash Ramiah:** So, right! Even the behavioural finance literature argues that women are better when it comes to risk management.

**Alex Kostyuk:** I see your point of view, Maria. You state that women can still not compete with men for executive positions of the

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<sup>°</sup> The material has been presented at the conference and was being discussed within the conference forum. The authors preferred not to publish the material in the conference proceedings.

boards. Yes, that is true. In this case, we need to keep in mind that executive position requires absolutely different professional criteria than non-executive ones. I expect that the "Executive director club" is more closed than the "Non-executive club".

**Maria Guedes:** Maybe becoming an executive needs to be more "professional" and not just looking to the usual and old network of friends...getting the right persons, with the right qualifications, experience, etc...man or woman, but less restricted to the old same old persons.

**Alex Kostyuk:** My idea, Maria, is that probably we, researchers, need to start finally divide your research for "executive directors" and "non-executive directors" from the point of view of different criteria of their selection and functions they perform on the board (in practice).

**Iliana Haro:** Could you clarify what does "to be more professional" is, please? Also, how do you determine who is the right person, who has the right qualifications? What is the right person for you and what are the right qualifications for you?

**Maria Guedes:** By professional I mean, the position opens and is competitive with proofs for the job not just because it is part of the network. Basically, the chosen persons come from the same/existing pool...not opens that much for new persons and the new ones are "copies" of the ones who are there already. It needs to be open for new talents, experience, expertise, for example, digital expertise.

**Alex Kostyuk:** That is the case. NEDs are products of networks. Executive directors are the products of the profession and recently achieved performance.

**Maria Guedes:** Alex, I partially agree with you. Not all exec are products of professional selection. Some are purely recommendations based on "we know a guy.....". The right person, man or woman, is someone who has no strings attached, has experience in the area needed, for example: we need someone from digital, so let's see what the market/or internally....not the one that comes from commercial but is bored of it.

**Iliana Haro:** If by professional you only consider that the position is open and competitive, then in what place do you leave personal competences, technical competences, innovation and creativity, flexibility and resilience?

**Alex Kostyuk:** Yes, some EDs are not products of only a profession and achieved results. Companies should be criticized for this a lot.

**Maria Guedes:** That is not excluded. Why would we exclude personal competences, etc.? That definitely needs to be taken into consideration in the selection part.

**Iliana Haro:** You didn't mention them.

**Maria Guedes:** I did not mention them because that is pivotal in any selection process that is fair and transparent. Not as much the connections part.....that is a blurred area.

**Alex Kostyuk:** Iliana, by professional competence and achieved performance I mean exactly all set of competencies you meant above.

**Iliana Haro:** Do you have research that sustains your statement that the new ones, I assume you mean the new members of the board, are "copies" of the ones that are already there?

**Sven-Olof Collin:** You do not control for regulation in the different countries. Why not? I am a Swede. We have strong public pressure, but no legal regulation. Norway has made it illegal to not have at least 40% females. So, whatever happens in Norway, they have to have, by definition, at least 40% females.

**Issam Buhaisi:** I think that there are social, cultural, and regional considerations to examine.

**Iliana Haro:** Alex, why do you think that executive positions require "absolutely" different professional criteria than non-executive ones, could you please give me an example?

**Iliana Haro:** Issam, I agree with you.

**Juliet Wakaisuka:** But the institutional environment is equally a key to enhance women's value to the organisation.

**Issam Buhaisi:** Environment, culture, and religion are important factors affecting women over the world.

**Marius Gros:** Could it be, that management requires different skills (leadership, etc.) than supervision (some kind of professional skepticism)?

**Issam Buhaisi:** Agree with you, Marius Gros.

**Maria Guedes:** Yes, that is true and needs to be acknowledged.

**Alex Kostyuk:** Iliana, professional competencies of ex. directors are absolutely wider than those addressed to NEDs. Who are NEDs – former CEOs...and not only! NEDs could be academics, politicians, etc.

**Iliana Haro:** Alex, if I understand you correctly, you mean that ED are the only ones who have a greater set of skills, something like the Gods of the organization, is it that? But that may not always be the case. For example, there are organizations that offer management careers and expert careers, and the differences are that in the former they manage people and administrative tasks while in the latter the expert is among the most recognized knowledgeable and skilled members in the entire organization such is the case of the "IBM Fellows" and there are no more than 10 in the entire organization, but just because they are not managing, that does not mean they do not have the skills to do so. So here we are in a case in which NEDs may have wider competencies than EDs.

**Alex Kostyuk:** Iliana, probably, I mean listed companies. These companies are public and large, as a rule. Therefore, their executive directors should have a greater set of practical skills. Appointing such executives, such listed companies perform in the way of rational behavior. In this context, I am not sure that NEDs could become effective

executives, but executives could become effective NEDs. This is an evolutionary way at the corporate ladders.

**Iliana Haro:** I get your point, Alex, however in my example IBM is a public company, so it may apply here. This is a very interesting discussion, so I hope you don't mind continuing it. So why are you not sure that a NED would become an effective executive? Isn't it that all executives were at some point in their lives NEDs? The only cases that come to my mind in which an executive becomes an executive without previously being a NED are the ones of unplanned successions in family companies, but I may be wrong, there could be others. On the other hand, what makes you believe that all executives could become effective NEDs? Let's take an example, Thomas Burbel is a member of the board of directors of IBM, and he is the CEO of AXA, he is as you say an executive. On the other hand, Gustavo Stolovitzky, an IBM Fellow who is a NED, is a Master Inventor and Program Director, Translational Systems Biology and Nanobiotechnology, he pioneered the use of crowdsourcing for research in computational biology. Can we assume that Thomas can be NED the size of Gustavo? Probably, not. I am trying to understand your concern here, so please help me with this.

**Alex Kostyuk:** Iliana, you have just fixed the balance of our points of view on this EDs-NEDs issue. Your case with Thomas Burbel is perfect for this. So, my point is that to become an effective NED, Thomas Burbel should be a CEO in the company of the same industry. IBM and AXA belong to different ones. Only in this case, we can correctly compare the professional skills and competencies of CEO and NEDs. Yes, you would ask me about the reason for companies from the same industry to share the same person as CEO and NED. No reason. As a result, to become an effective NED, CEO should resign after (I hope, a successful CEO career) and then become a NED in the company of a similar industry. This is my vision of the most effective NED.

**Maria Guedes:** I think a NED shall go beyond that. For example, if we have medical doctors, engineers, etc. they can alert for new risks, new perspectives. And along with NED who were former CEOs we can have an interesting balance. I do not think NED can come just for the set of former executives....we need fresh air.

**Alex Kostyuk:** Maria, I think this is the second group of NEDs I entirely accept – NEDs without previous experience as executive directors. Composing the NED part of the board with these two groups of NEDs (former executives and those without executive experience) gives a balance not only between NED and executives on the board, but also within the group of NED directors.

**Iliana Haro:** great discussion!! So now we have come to the eternal question of why do organizations keep appointing ED from outside the industry? It is said that because it is the best business practice and that it brings fresh air to the company, but are best practices the best practice? Maybe not, what do you think?

**Alex Kostyuk:** This is a case, Iliana. This is the major question that is still missed in the scholarly research worldwide. We got used to dividing the board for NEDs and EDs. It is too simple now. Challenges are very strong for CG worldwide. So, we need to get inside of the board issue and start configuring the board dividing even the board molecules (its groups, like NEDs) for atoms (with executive experience and NEDs without this experience). This sort, so-called "board atomic level" research is a future of CG research for the next decade at least.

**Khaled Otman:** Alex, it is a good point, but how can you measure the experience or no experience for NEDs?

**Alex Kostyuk:** Khaled, I see your question entirely. The term "experience" I used for NEDs in the context of the NEDs previous experience as an executive director – a member of the board of directors. So, one group of NEDs has such experience, another group – has not. It is easy to divide all NEDs on the board of any company by these two groups.

**Iliana Haro:** Completely agree.

**Dmitriy Govorun:** Maria, thanks for your material which is under live discussion here. I'd like also to clarify some determinants you've mentioned in your paper. Which combination (or order) among researched gender equality, masculinity, education, and happiness should countries/policymakers focus on when reaching higher performance in terms of more presence of women on boards?

**Maria Guedes:** Thank you for your question. I would not "dare" to define an order, as it really depends on the countries stage of development on each of those determinants. But I would definitely say that education is a very good start to reach gender equality.



# 1.6. THE HOLISTIC FRAMEWORK FOR THE ECONOMICALLY AND SOCIALLY FAIR CEO COMPENSATION

Mehtap Aldogan Eklund \*

\* Accountancy Department, University of Wisconsin, La Crosse, the USA

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## Abstract

This paper aims to conceptually discuss how to reach the *economically and socially* fair and optimal CEO compensation based on equity principle, behavioral agency, and stakeholder theories and to suggest future research avenues for scholars. It contributes to practice and academy by providing the guidelines for socially and economically fair and optimal CEO pay, which is still a highly controversial issue. It also contributes to the literature by informing the researchers of the overlooked themes.

## 1. INTRODUCTION

This paper has three main objectives. First, it aims to reveal the traditional framework of the corporate governance and executive compensation, developed based on shareholder approach, and then to conceptually discuss how to reach the *economically and socially* fair and optimal CEO compensation according to equity principle, behavioral agency and stakeholder theories. It also emphasizes that the holistic executive compensation structure should be supported by the new corporate governance (KISS) system. Finally, it concludes with the proposal of a future research agenda for the understudied and overlooked themes regarding executive compensation. This paper is structured as follows: First, the conceptual and theoretical frameworks and challenges are explained by referring to social and economic fairness. Then, the future research avenues of executive compensation are summarized to

guide the scholars on the implementation of these suggested structures into the qualitative and quantitative research and the emerging themes in this area.

## 2. BACKGROUND

In this section, first, the traditional corporate governance and executive compensation structures are illustrated, and then the alternative approach of holistic and fair CEO compensation framework is introduced, which requires a new KISS approach of the corporate governance structure. Unfortunately, the corporate failures and public distress over the lucrative compensation have revealed that fairness has not taken into consideration when executive compensation schemes are designed (Chaigneau, 2018; Ferracone, 2010). Fairness is a social and ethical norm and it deals with 'what is just' and 'what should be done' (Pepper, Gosling, & Gore, 2015). It includes two approaches: the *equality (egalitarian) approach* and the *equity approach*. The *equality principle*, such as Scandinavian countries applying, states that "all people should be treated the same way regardless of their performance". On the other hand, the *equity principle* is satisfied "if those who perform better than others are entitled to higher compensation" (Rost & Weibel, 2013, p. 353). Thus, the fair and optimal CEO compensation framework in this paper, derived from the equity principle, not equality, answers the question of 'which factors should be taken into consideration to have an economically and socially just compensation scheme'.

### 2.1. The existing framework

Corporate governance is a system that governs, directs, and controls the firm at the top (Hilb, 2016; Wixley & Everingham, 2002). In general, in the literature, two types of corporate governance systems have been mentioned: the shareholder (market-based competition) approach and the stakeholder (relationship-based cooperation) approach (Hilb, 2016). In this commentary paper, the third model, new corporate governance (KISS) approach, is explained since it goes hand in hand with the holistic and economically and socially fair compensation system. If the governance system of the organization is a shareholder based traditional model, then the fair and holistic compensation framework may not be implemented successfully. Thus, first, the traditional corporate governance model and the new corporate governance model are summarized in Table 1 and Table 2, respectively. Then, the compensation frameworks are analyzed. Table 1 illustrates the traditional corporate governance system which is not situational, strategic, integrated, and holistic. The traditional approach, depending on the shareholder theory, focuses on and controls only the financial dimension to maximize the shareholder value. The board of directors

(BoDs) does not involve strategic development, it is mainly handled by the executive board. Nomination and remuneration committees are isolated from each other, and governance structure does not consider the differences in corporate culture, industries, and nations. In simpler terms, the system is very standard, with no diversification or differentiation, and it is mainly financially driven and managed (Hilb, 2016).

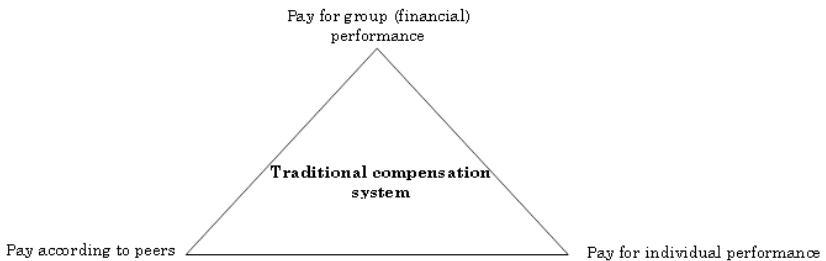
**Table 1.** Traditional corporate governance

<i>Dimensions</i>	<i>Traditional corporate governance</i>
Situational implementation	No difference between national, industry, and corporate culture
Strategic direction	Strategic development is not a function of the supervisory board
Integrated board management	Only isolated nomination and remuneration committees in publicly listed companies
Holistic monitoring & holistic structure	Controlling the financial dimension only

*Source: Hilb (2016, p. 8).*

In the traditional compensation framework, which is generally accompanied by traditional corporate governance structure in practice, there are three main evaluation criteria: pay for financial performance, pay according to peers (benchmarks), and pay for individual performance (Figure 1). In this model, the CEOs’ compensation schemes are designed based on some key financial indicators, such as total shareholder return (TSR), earning per share (EPS), net operating income (EBIT), etc. (Ferracone, 2010), benchmarking or relative performance evaluation (RPE), and the individual performance, such as leadership skills, intrinsic motivation, behavior, etc. (Bushman, Indjejikian, & Smith, 1996; Lobo, Neel, & Rhodes, 2018).

**Figure 1.** Traditional compensation framework



*Source: Prepared by the author.*

On the other hand, to have a holistic and economically and socially fair executive compensation framework, the organizations should improve their corporate governance system and executive compensation scheme, which are integrated and which support each other. This is discussed in detail in the following section.

**2.2. The holistic and fair framework**

Compared to traditional corporate governance structure, disclosed in Table 1, the new corporate governance model is discussed below. Table 2 depicts the new corporate governance (KISS) model which is situational, strategic, integrated, and holistic. It is developed based on the stakeholder approach and agency theory, but it values each party in the stakeholder's group equally. Thus, it differentiates a bit from a stakeholder approach. The stakeholder approach weighs the society, environment, and the public strongly than shareholders. In the reversed KISS approach, all the parties are equally important. KISS stands for Keep it (S)ituational, (S)trategic, (I)ntegrated and (K)eep it controlled (Hilb, 2016).

A new corporate governance system controls both the financial and non-financial dimensions to maximize the stakeholder value (keep it controlled and holistic). The board of directors does involve strategic development. In essence, it is the central function of the board of directors (keep it strategic). Nomination and remuneration committees are integrated. In simpler terms, the selection, recruitment, appraisal, and compensation processes of the executives and BoDs are considered all together, so they are paid for competence, characteristics, and individual performance as well as corporate and group performance (keep it integrated). Governance structure does consider the differences, so each firm has its own specific corporate governance context based on its corporate culture, industry, and nation (keep it situational) (Hilb, 2016). In short, the system is with diversification or differentiation, and it considers the wellbeing of investors, customers, employees, suppliers, government, political groups, trade associations, society, environment equally, and as a whole.

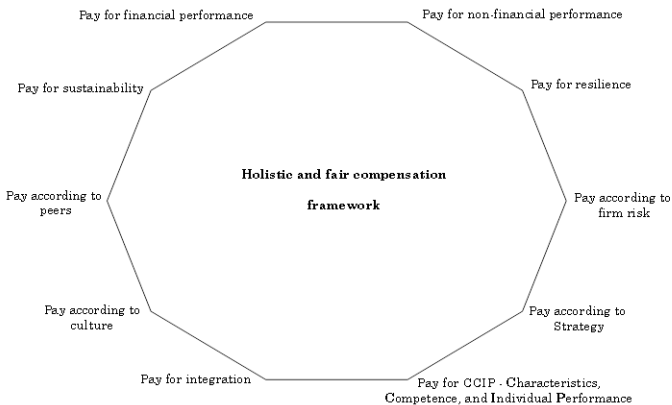
**Table 2.** New corporate governance (reversed KISS approach)

<i>Dimensions</i>	<i>New corporate governance</i>
Situational implementation	Implementation appropriate to the specific context of each firm (Keep situational)
Strategic direction	Strategic development is a central function of the supervisory board (Keep it strategic)
Integrated board management	Integrated and targeted selection, appraisal, compensation, and development of the supervisory and managing boards (keep it integrated)
Holistic monitoring & holistic structure	Holistic monitoring of results from the perspective of shareholders, clients, employees, and the public (keep it controlled)

Source: Hilb (2016, p. 8).

In the holistic and fair executive compensation framework, which is suggested to be implemented with the new corporate governance (KISS) structure, there are 10 components (Figure 2): pay for financial performance, pay for non-financial performance, pay for sustainability, pay for resilience, pay according to peers, pay according to firm risk, pay according to culture, pay according to strategy, and pay for integration, and pay for characteristics, competence, and individual performance. All of these 10 factors have to be considered and satisfied to have the desired effect (Eklund, 2019). In this model, which is developed in line with the tenets of the stakeholder and behavioral agency theories, all parts of the stakeholders have been equally valued. In addition to the three common factors (*pay for financial performance*, *pay for individual performance*, and *pay according to peers*) which were also illustrated on Figure 1 and discussed above, the holistic framework in Figure 2 includes *pay for non-financial performance* and *pay for sustainability*, such as customer, suppliers, and employee satisfaction, environmental, social, and governance performance, etc., *pay for resilience*, which is the key factor during the crises, such as social and financial indicators measuring the CEO’s performance to protect the health of the employees and to make a resilient organization at the same time during Covid-19 crisis. *Pay according to a strategy* indicates that the CEO compensation and its structure should be in line with the long-term goals and strategy of the organization, and CEO should be rewarded if the strategy and long-term goals are accomplished. *Pay according to culture* means that CEO remuneration should be pertinent to corporate and national culture. *Pay according to risk* presents that the variable pay of a CEO should depend on the systematic and unsystematic firm risk. *Pay according to integration* is related to concepts of the pay gap within the management level, internal fairness, and equity in the pay levels in the organization (Eklund, 2019).

**Figure 2.** Fair and holistic compensation framework



Source: Prepared by the author by deriving from Eklund (2019, p. 11).

### 2.3. Meeting the challenge

Although the suggested frameworks in this paper are scientifically driven, holistic, and fair, none of the models are without limitations. The frameworks may reveal a statement of executive compensation and corporate governance that may seem obvious and simple, but this is not the case. Moreover, these approaches do not mean that they propose a "one-size-fits-all" approach, which would be very risky and harmful. They are only the tools to discover the organization's own best, fair, and optimal structure. Despite the limitations and caveats, both frameworks meet the criteria for a good model, proposed by Brown (1965), — they are simple, clear, logical, and applicable to real-life situations (Eklund, 2019; Hilb, 2016; Melis, 2011).

### 3. FUTURE RESEARCH

This conceptual and holistic executive compensation framework opens future research avenues to the scholars because they can apply and test this scientifically driven framework in their empirical and qualitative studies. Moreover, it is evident that abundant attention has been given to the financial aspects of executive compensation, but there is still scarce research on the ethical, social, and environmental aspects.

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## CONFERENCE FORUM DISCUSSION

**Mehtap Eklund:** Welcome to my presentation. The purpose of this presentation and the working paper is to conceptually discuss how to reach the economically and socially fair and optimal CEO compensation from the perspective of behavioral agency and stakeholder theories and equity approach. The further aim is to empirically test this framework. If you have comments or feedback on this concept, feel free to drop your comments here. Your valuable comment and feedback are highly appreciated.

**Alex Kostyuk:** I fixed a set of interesting ideas coming from your paper. First, I feel that the optimization of the links you mentioned in your paper we need to refer to the national business rules and cultural stereotypes (globalization is still weak in this case). Second, it was mentioned in the paper that "Stakeholder theory postulates that firms must demonstrate the commitment to socially responsible behavior to achieve legitimacy". Probably, there is a difference between companies with strict regulation (such as banking) and less regulated. Do not you think that in the strictly regulated industries social responsibility is substituted by meeting the requests of strict regulation? Do not you think that because of the above-mentioned role of regulation makes the banks as less responsible during a crisis and the bank CEO compensation during a crisis is outside of any social responsible context (for example, when non-profitable banks pay higher compensations to their CEOs as it was in 2008?)

**Vikash Ramiah:** What I have observed is to be socially responsible costs money. Organizations that are govt owned or semi govt own tend to engage more responsible. Also, it is time to expand CSR to SDGs.

**Alex Kostyuk:** Vikash, that is true about SOE and CSR investments from the point of view of the concept. In practice, the costs of this concept can be extremely higher because the corruption is very popular exactly in SOE in many countries and as a result, the costs of control over the SOEs grow remarkably making CSR investments not effective.

**Vikash Ramiah:** Some organizations are capitalizing on this now. They call it branding and marketing it. There is a market for it. For instance, organic products cost more but there are clients buying just organic stuff. You can see a small car cleaning business using the logo "green" or "enviro-friendly".

**Mehtap Eklund:** Thanks, Alex and Vikash, for your valuable inputs. I will definitely control the ownership (governmental and non-governmental) effect into consideration when I will empirically test it in the Swiss market. Thanks for the valuable comment. It is very interesting to hear that banks may not be as much as socially driven compared to other sectors. Maybe, they are not environmentally malignant as much as other sectors, like mining, oil, manufacturing, etc.

**Mehtap Eklund:** Do you suggest any other factors that we need to consider in the holistic CEO compensation framework? Any factor that I missed? Any comment is highly appreciated.

**Vikash Ramiah:** Banks finance the polluting sectors, Mehtap. They become partners in crime and they don't want to be perceived as the bad guys. Some banks refuse to handle certain polluters (for example, coal electricity producers). In fact, the costs of debt for polluters are higher. Green bonds tend to be cheaper as it does not have environmental risk. Banks are offering cheaper debt if you are environmentally responsible as they have enjoyed a cheaper rate too. I get questions a lot on why are lenders asking about my emissions? Well, even if they do not report publicly, some banks request this information to give cheaper rates. Banks are building their portfolio to show social investments as the world is watching.

**Mehtap Eklund:** It is very promising to hear that environmental risk is considered in addition to the systematic and unsystematic risk of the firm by the banks. Then, I wonder how the banks reflect this to their own CEO compensation schemes? Through the ESG performance of the bank? What do you think?

**Vikash Ramiah:** I have not done any work around that and you raise a good question. The only thing that comes to mind now is the style of leadership. I think the leader of AESOP is quite vocal about SDGs and shows how her company is addressing these goals. She sells more and at a higher price too. I guess high sales means high profit. But she is known to be an advocate in this field. I guess if the companies profit increases, they can cash in their options, bonuses, etc. It will be a good area to study.

**Mehtap Eklund:** Thanks for the valuable input.

**Maha Radwan:** Very interesting discussion and I agree with Vikash regarding banks' need to show that they are socially responsible for impact investments; however, Mehtap raised a good point of that this would affect the CEO compensation, could you please shed the light on the results of the research?

**Mehtap Eklund:** What do you mean? It is a working paper and the preliminary results are available. The robustness checks are needed to be done.

**Omrane Guedhami:** Hi Mehtap. This is a very interesting paper. I have two comments. State vs. private ownership can matter. However, I am not sure to what extent state ownership is important in Switzerland. If you are interested in the theory underlying the role of the state, please see *Boubakri, N., Guedhami, O., Kwok, C. C., & Wang, H. H. (2019). Is privatization a socially responsible reform? Journal of Corporate Finance, 56, 129-151.* You can consider controlling for family control and especially the role of institutional owners (*Dyck, A., Lins, K. V., Roth, L., & Wagner, H. F. (2019). Do institutional investors drive corporate social responsibility? International evidence. Journal of Financial Economics, 131(3), 693-714.* Finally, can you consider examining the consequences of compensation in terms of performance or cost of capital?



**Alex Kostyuk:** Hi Omrane, welcome to our online forum. I see your comment and entirely share your point of view. My vision is about the national specifics of state ownership and its regulation. Moreover, the process of privatization adds even more national specifics to this issue. When more than two decades before in Ukraine we experienced privatization, we introduced a German model of CG, based on a two-tier model of the board of directors, but....we forgot to provide the employees with a right to delegate their representatives to the supervisory board, and since that time any social effect of privatization in Ukraine was over. That was a paradox, but this is the case.

**Omrane Guedhami:** Hi Alex. Thanks for these insightful comments. I agree with you. In fact, we discuss/document differences of state ownership across a different institutional environment.

**Alex Kostyuk:** I absolutely agree, Omrane. Finally, corporate governance in SOEs seems to be a very specific science. Yes, it is still called "corporate governance", but this still requires more fundamental research and empirical papers considering a large variety of countries.

**Mehtap Eklund:** Thanks, Omrane and Alex, for the valuable feedback. I am sorry for the delay in the reply due to time difference (-7 h) and I had to teach during the day. I will definitely control ownership and state effect and board structure as a control variable in my empirical data. Thanks for sharing valuable ideas and journal articles. Appreciated.

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## 1.7. WOMEN IN THE BOARDROOM AND THEIR IMPACT ON FINANCIAL PERFORMANCE AND RISK-TAKING: A BIBLIOMETRIC ANALYSIS

Michalis Bekiaris<sup>\*</sup>, Pantelis Papanastasiou<sup>\*</sup>

<sup>\*</sup> Department of Business Administration, University of the Aegean, Greece

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### Abstract

In recent years, corporate governance has received increased attention in academic research and business due to several corporate failures. Within this context, there is an ongoing debate on the crucial role of the board of directors in the corporate governance of firms, as it affects financial performance and the organization's strategy. Firms have to make risky investments, both over-investment (i.e., excessive risk-taking) and under-investment (i.e., excessive risk avoidance) that may damage firm value and endanger their survival. Efficient risk-taking along with managing uncertainty is essential parts of doing business and a key responsibility of the board. The literature highlights the importance of the board of directors as supervising executive management in the representation of the shareholders and providing business resources and assessment (Pucheta-Martínez & Bel-Oms, 2019).

This study aims to identify the current dynamics of gender, a key characteristic in the field of board diversity using bibliometric analysis and visualization tools. Apparently, there has been a decisive trend that has led to women holding board positions while the vast majority of boardrooms are still made up of male directors (Torchia, Calabrò, & Huse, 2011). This recent increase of board gender diversity has been mainly stimulated by the action of some countries which have lately enacted guidelines and/ or mandatory laws with the aim of increasing the

presence of women on the boards of the listed companies (Pucheta-Martínez & Bel-Oms, 2019). We use the ISI web of science (WOS) database as a primary search engine to identify the most influential articles, authors, and journals in this topic between 2006 and early 2020. Similar to Baker, Pandey, Kumar, and Haldar (2020), we devised a WOS database and conduct a topic search during February 2020. To the best of our knowledge, this study is one of a few that combine a bibliometric analysis and literature review on board diversity.

The bibliometric methodology highlights the multi-disciplinary nature of research on board diversity and its impact on financial performance and risk-taking, covering the fields of accounting and finance, business, economics auditing, and management, as well as strategy. Bibliometric analysis is fundamentally classified as a quantitative method that provides a different analysis of the literature based on the related statistical data (Ellegaard & Wallin, 2015). Through a bibliometric analysis, we aim to provide a quantitative analysis of literature based on the related statistical data and transform scientific quality into a manageable entity (Wallin, 2005). Our goal is to construct systematic knowledge regarding patterns, trends and impact of relevant publications through a visual approach (Ellegaard & Wallin, 2015; Van Eck & Waltman, 2014). Furthermore, citation network analysis, co-citation analysis, co-authorship analysis, and keyword co-occurrence analysis helps reveal the core theoretical and conceptual articles by mapping out the intellectual structure of the knowledge base in this context. The analysis of collaborating networks is important to explore the centrality of authors and institutions in the production of research output (Andrikopoulos & Kostaris, 2017).

Employing diverse theoretical perspectives and reviewing a wide range of prior studies on ownership structure and corporate governance, this study provides the foundation for high-quality research on corporate governance and the important role of boards of directors. Our findings aim to provide useful guidance to other researchers in the area by exploring the interrelatedness between key articles and authors that have been cited most frequently.

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## CONFERENCE FORUM DISCUSSION

**Lindrianasari:** Good morning to all my colleagues, I want to introduce myself; I'm Prof. Lindrianasari from The University of Lampung, Indonesia. Related to research on women in the boardroom and their impact on financial performance, can you explain what variables are used, how the variables are measured, and what are the results of this research? Thank you.

**Pantelis Papanastasiou:** Good morning to all, I'm Pantelis Papanastasiou the author of this research from the University of Aegean in Greece. This is a working paper and the methodology that we used is bibliometric analysis with data from the ISI Web of Science (WOS) database. Our goal was to contribute in board gender diversity research by showing the state of the art of research on board gender diversity, identifying the annual evolution of publications on the topic, the most prolific journals, countries, authors, and institutions supporting research, as well as identifying the main trends and pointing to potential future lines of research and topics.

**Alex Kostyuk:** Hi Pantelis, referring to Table 1 of the presentation it is possible to conclude that the female representation on the boards is lower in those countries where the shareholder dominance in corporate governance is more evident (the USA, Australia, Canada) and higher in the countries with a stronger role of employees (Sweden, the Netherlands, France, Germany). Do not you think that under the stakeholder concept of corporate governance women are considered as a very good mediator of possible conflicts between various stakeholders including shareholders and employees? Do not you think the dominant role of shareholders in the country (if any) does not allow female representation on the corporate board growing and under such circumstances the role of other stakeholders starts playing a key role to move the female representation forward?

**Vikash Ramiah:** Following Alex's comment, I must add the behavioral literature that argues females tend to be less risk-averse than

males. Hence in economic conditions becomes a factor whereby females will deliver best in crisis period as they are better with risk management.

**Alex Kostyuk:** Yes, this is the case Vikash has just fixed. In particular, this issue is important for financial companies including banks.

**H A R P Madushanka:** Hi Pantelis, would you mind elaborating on any specific characteristics of women that impact an organizations' financial performance that you have come across so far?

**Mbako Mbo:** Hi, it is important also to reflect on the process by which merit and gender are balanced in constructing an effective board.

**Alex Kostyuk:** That is right, Mbo. The only issue is who should be responsible for balancing merit and gender on the boards. Should it be a task of the whole board or just a nomination committee? What is the role of the outside director search agencies? I see that to get all the above balanced we should expect to have an effective system inside and outside the company (in the country too).

**Pantelis Papanastasiou:** Alex, I agree with your comments and also we see from the research that women still remain significantly underrepresented.

**Vikash Ramiah:** This issue has come up a lot. In some areas, it is hard to find a female with the same expertise as the male. Males have an unfair advantage in that they do not go on maternity leave. In those situations, it is important to make it right by looking at output versus opportunities to ensure there is the right balance.

**Mbako Mbo:** At a country level, the Institution of Directors (or equivalent) should ideally have selection criteria, based on some scoring approach that achieves a good balance on expertise, stakeholder and gender. However, the approach for state-owned enterprises would typically be carried.

**Alex Kostyuk:** IoDs could assume such responsibility, Mbo. Logically, IoDs should do it, but in practice? Do we have data around the world how many countries' IoDs do it?

**Pantelis Papanastasiou:** I agree with Vikash Ramiah that females tend to be less risk-averse than males and also they have great monitoring and strategy involvement characteristics that impact an organizations' financial performance.

**Iliana Haro:** Good morning to everybody, first I would like to introduce myself. My name is Iliana Haro and I am a Ph.D. candidate at California Southern University in the USA and the Hochschule Furtwangen University in Germany. So now, regarding the moment of Vikash Ramiah in Germany men do go on maternity leave and they can take up to one year, and it is my understanding that that is the case in most northwestern European countries, so that may not be the issue here.

**Vikash Ramiah:** This is good progress, Iliana. Unfortunately, this is usually not the case in countries like Australia, etc.

**Iliana Haro:** Alex, it is indeed a relevant factor to have to different systems the shareholder and stakeholder orientated, being the latter the one that applies in Europe, which is why we have Sweden, Netherlands, France, and Germany. However, we should not forget the influence that the cultural context surrounding the system plays, and which therefore affects the personal expectations and behavior of shareholders, members of the board, and other stakeholders. Everything works as a whole, like an onion system one aspect affecting the other ones.

**Mbako Mbo:** Alex, data from practice is sparse; more worrying is that IoDs in developing economies are largely ineffective.

**Mehtap Eklund:** Then, if the women have risk-averse and stakeholder approach, then the countries that suggest the female BOD quota should have lower firm risk and higher sustainable growth. Is it the case, Sari Lindrianasari?

**Iliana Haro:** This is a great question, however, don't you think we should try to understand first what merit is and what would be better for the organization meaning what it is its strategy. Are we searching for merit, gender, or talent? I give you an example without gender, let's assume there is a start-up where you need to appoint the president of the company, there is an executive who has been in a company for 25 years and holds now a top management position, we also have a board candidate who has never been working at any company but has been working in the industry for more than 25 years and we have a young entrepreneur with no more of 6 months in the company, who is actually the one who created the company. So, who has the merit? Who has the talent? Who is the best for the company?

**Iliana Haro:** That would be a difficult question to answer in broad terms. First, what kind of company and strategy of the company are we talking about? With women and men, there is not a specific set of competencies that could work in all contexts.

**Mehtap Eklund:** Yes, Iliana, I totally agree with you. Merit should be the key decision criteria. On the other hand, for the countries which ask for minimum female BOD quota, then the most talented and experienced female leader should be selected. Some scholars found the positive impact of the female BODs on firm performance and firm culture and corporate environment. Diversity is good, of course, based on merit.

**Iliana Haro:** Hi Mehtap, thanks for your kind comment. But my point here is it is merit enough or should we try to find talent. See, the simple definition of merit is a work well done that deserves praise. But who evaluates if that work is well done? Other men? Other women? Other colleagues, who have the same level of responsibility as you? Who decides what merit is? On the other hand if select people, not only women but people, without regard to gender, color, religion, physical handicaps, etc., only on the basis of their talent which are their natural and acquired skills, wouldn't be the organization benefiting even better? But

then we should not generalize, as researchers, we have the obligation to recognize when there are no general contexts.

**Juliet Wakaisuka:** The presence of women on any corporate board should focus on what they will be able to bring to the performance of the board and not be a sign of tokenism; implying that these women must have the skills and competence to deliver.

**Maria Guedes:** Women bring the same and new things to the board. We have passed the tokens argument. It is a matter of social justice, equity, not focus what it is different only. They can bring the same and are totally entitled to be on the board.

**Pantelis Papanastasiou:** Thank you all for the comments and your distribution on board gender diversity. Do you have any comments on the research methodology that we used?

**Maha Radwan:** Good research, however, I would like to ask you after analyzing the current literature regarding women in the board and their impact on performance, what is still missing in your view to be studied or need to be more deeply investigated?

**Pantelis Papanastasiou:** Maha, I think it would be useful to examine other demographic characteristics such as age, education, ethnicity, and professional background.

**Maria Guedes:** I think we should move from studying the impact of gender. Men or women does not matter, both are competent or incompetent. So, focus on thinks that may be changed and improved. The question can also be: lots of diversity (age, ethnicity, etc.) is manageable? How do we incorporate the benefits of diversity in companies?

**Dilvin Taskin:** I think the inclusion of other controlling factors, like the experience, education is of crucial importance. I believe if you consider those factors, the outcomes of the paper will be more striking. Still, a very good paper.

**Alfredo Celentano:** I agree with your consideration, Pantelis. Actually, also I wrote a research project where the aim is to investigate the relationship between board diversity and CSR; specifically, my idea is to construct a Diversity Complex Index, which can represent diversity through a unique and encompassing perspective of all its characteristics (gender, age, background, independence, etc.) and do it by a structure literature review examining the prevailing literature on the diversity subject, so as to understand how this has been treated by different authors and studies, using tools such as WoS for articles' research and bibliometrix for bibliometric analysis.

**Pantelis Papanastasiou:** Dilvin, I have the same opinion about this. Thank you for your comments.

**Pantelis Papanastasiou:** Alfredo, great idea! In my research actually, I wanted to examine the literature review of gender diversity using bibliometric analysis and I think I got useful insights.

**Pedro Agua:** It could be interesting to bring in the subject of family firms and national culture into the subject and investigate if there are

cultures with better governance performance within the context of this subject, Japan, for example.

**Pantelis Papanastasiou:** Pedro, I think culture nowadays matters more than everything and it would be interesting to examine the variables that affect it. Great idea, Pedro, thank you! Also, we know that family businesses are the backbone of the economy and incubators for entrepreneurship.

**Dean Blomson:** Putting aside skills and experience, required by each company (depending on its unique context and strategic challenges), the only kind of diversity that matters is cognitive diversity. Ultimately a board is there to ensure that the right decisions are made. Appropriate knowledge, skills and experience are vital. But if you want to insure the oversight of decisions is effective you need independent thinkers who have the ability to bring different lenses/vantage points to bear. Gender diversity is a noble cause – no doubt – but that is a side issue when it comes to having a board that is able to think critically, divergently, and in a challenging way. Those skills exist independently of gender, race, culture, religion. Let's not just zero in on gender diversity because it feels right, and it's easier to measure than cognitive diversity.

**Pedro Agua:** Don't disagree... in fact, boards shall not fall under the trap of "groupthink" as well. Good point.

**Pantelis Papanastasiou:** Dean, completely agree with you. According to Baker (2020), researchers should examine cognitive diversity because studies of how cognition affects strategic decision-making are scarce (Kilduff et al., 2000; Parayitam & Papenhausen, 2016).

**Pedro Agua:** We shall also take care of how do we define cognition, and in particular "intelligence", as there are many of them and their relevance depends on the situation the board has at hands (Gardner's theory of multiple intelligences).

**Iliana Haro:** This is, in my opinion, the most relevant point. We need to clarify our discourse: are we "fighting" for gender equality just for the sake of gender presence, or are we aiming for talent in the benefit of the organizations and their stakeholders not only the shareholders' interests? I think the case here is not how many women are on the board, as far as the board, its committees and any other bodies be integrated by the talent they need.

**Alex Kostyuk:** Pedro has just addressed an issue of the leadership of the board. A board of conformists is a disaster for a company. It should be a board of leaders. So, it means that "a one leader concept" like Chairman or CEO is not enough now. Certainly, we are talking about not formal leadership. Leadership that is based on decision-making. Under such a concept of "a group leadership" women are considered very naturally even by the absolutely traditional, male-driven concept of corporate governance.



**Pantelis Papanastasiou:** Thank you all for your suggestions! I think the decision-making process and what are the most important variables that affect is our goal. Pedro, I will examine Gardner's theory of multiple intelligences, thank you again.

**Iliana Haro:** But then what is a leader? And more important which is the right leader for the organization? Should he-she display a static and stable behavior? Or should he-she be flexible and behave according to the context of the organization and the followers? If we think about the context and the followers, then we should pay more attention to the process of leadership, and probably it should not be static which is what happens with traditional boards and their interaction of CEO. We may have come to a historic point that we need to accept that the traditional formula of governance is not working anymore or at least may not work for a long time. The Coronavirus crisis is leaving a lot of lessons to be learned on this regard.

**Alex Kostyuk:** Iliana, formally the leadership reins should belong to the board chairman. This leadership is based on the issue of responsibility on behalf of the whole board. Informally, during the process of decision making, this concept should be behind the concept of "a group leadership" where the board is a team of leaders. this will let the board become more far from the bed nickname "a rubber stamp".

**Pantelis Papanastasiou:** Iliana, I totally agree with you. Alex, I find a very interesting initiative the special COVID-issue of *Corporate Governance and Sustainability Review* and more specific the topic "board behavior and practices".

**Alex Kostyuk:** I expect, Pantelis that any unexpected issue, like COVID in this case, is able to give birth to a new stream in research of corporate governance.

**Ahmed El-Masry:** I totally agree; a special issue on COVID-19 effect is needed especially with a focus on women's role.

**Pantelis Papanastasiou:** So, the decision-making process and leadership in the age of COVID-19 would be very interesting and also insightful according to our matter.

**Iliana Haro:** Alex, if I understand correctly this only partially answers my second "which is the right leader for the organization". In a public company that has been your focus so far, as you say, "Yes", the board is the unquestionable leader by law, but not necessary by competence. But in non-public companies where having a board of directors is not a requirement, the need for their leadership is arguable and we need to accept this fact and analyze it because just in countries like Germany, the "Mittlestand" companies (SMEs and non-public) who generate more than one out of every two euros and provide well over half of all jobs in Germany, so we cannot overlook this. CG is not only for public companies, and even though they are big enough, economies are not sustained by them.

**Guadalupe Briano:** I would like to suggest some ideas to extend this research:

1. Institutional context: developed vs emerging countries
2. Imposed quotas. For instance, in Nordic countries is mandatory the gender equality.
3. Cultural dimensions.
4. Independence of women on boards.
5. Stakeholders' role in corporate decisions.

**Pantelis Papanastasiou:** Thank you all again for your comments and your suggestions. It will be very useful and insightful.

## 1.8. THE IMPACT OF CAPITAL STRUCTURE AND BOARD OF DIRECTORS CHARACTERISTICS ON INVESTMENT DECISIONS AND PERFORMANCE OF NORDIC FIRMS

Shab Hundal<sup>\*</sup>, Elmira Sarbassova<sup>\*</sup>, Nikita Staroshvetkii<sup>\*</sup>

<sup>\*</sup> School of Business, JAMK University of Applied Sciences, Jyväskylä, Finland

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### Abstract

The phenomenon of firm financing and the board of directors' characteristics are two important determinants of investment and performance of firms, *ceteris-paribus*. The financing of a firm underpins the financial resources of a firm that can be utilized to acquire assets, which are necessary to run it. Similarly, corporate boards of directors provide leadership and guidance to the firms and at the same time participate in the monitoring and control activities. The quality of corporate boards of directors depends on several characteristics including human capital, relational capital, and board diversity, among others. The current study examines whether firm-level capital structure impacts firm-investments and performance. The results show that the financing of firms affects the investments and performance of firms. Similarly, the busyness of directors and board size affect intangible investments negatively, whereas the education of directors affects the same positively. A major theoretical contribution of the current study is that the capital structure has been taken as an explanatory as well as an intermediate variable to examine its effect on firm investments, and performance.

## 1. INTRODUCTION

The capital structure of firms and the board of directors are important determinants of investment and performance of firms. However, these firm-level relationships are extremely complex for the several reasons: firstly, the board of directors can directly impact the capital structure of the firm, and subsequently, the changes in the capital structure of the firm can further affect its investments and performance; secondly, the board of directors of the firm can directly impact investment decisions and performance of firms by bypassing the capital structure of the firm; and thirdly, the abovementioned relationships can also be inclusive of mutual causation of a firm's investment and its performance. Henceforth, one can argue that the set of relationships between the board of directors, capital structure, investments, and firm-financing is anything but simpler.

In the finance literature, the concept of optimum capital structure has been discussed extensively; however, it is noticeable that the notion of firm-level optimum capital structure is a mirage. Academic researchers and corporate managers have been seeking endlessly to formulate the optimal capital structure; however, there is no universal and across the board understanding of this concept. Many scholars suggest that rather than endeavoring to achieve the specific point of optimality of capital structure, firms should aim to achieve the range of capital structure.

The total capital requirements underpin the financial resources of a firm, and these resources can be utilized to acquire assets, which are necessary to run firms. The capital structure generally indicates the relative share of debt and equity in the total capital of a firm. To find the right financing path a firm needs to balance the advantages of debt, for example, because debt is a cheaper way of financing, and the risks associated with debt, for example, the financial distress costs associated with the debt can have substantial unfavorable effects on the firm. The choice of the capital structure depends on many factors such as the size of the company, industry, profitability and corporate tax level, the tangibility of assets, and growth opportunities. Corporate boards of directors provide leadership and guidance to the firms and at the same time participate in the monitoring and control activities. There are several determinants of the quality of corporate boards of directors and to name a few are- independence of boards, human capital (e.g., education, experience, expertise) of directors, relational capital (e.g., multiple directorships) of directors, board diversity (e.g., gender, nationality, ethnicity). Investments, including tangible, intangible and financial assets, are the reflection of firms' future and these are undertaken to enhance the firm-value by generating more cash flow. The capital structure and board of directors' characteristics play an important role in influencing firm investments. The concept of firm

performance has been extensively researched in finance discipline and assumes a great deal of significance in the field of corporate governance. Since the concept of capital structure, the board of directors' characteristics, investments and firm-performance are intertwined, therefore, the current study endeavors to solve this puzzle by exploring the following research questions:

1. Does the firm-level capital structure impact investments and firm-performance?
2. Do board of directors' characteristics impacts the investments and firm-performance so that the firm-level capital structure acts as the intermediate variable?
3. Does the firm-level capital structure, as an intermediate or predictor variable, impacts the firm-performance through investments or directly?
4. Does firm-level investing affect firm-performance?

The secondary data has been for the period 2003-2018. The data sources have been firms' official annual reports, corporate governance reports, financial statements, and the Nasdaq OMX database. The key capital structure variable is the debt-to-equity ratio, which includes various categories of debt that are the book, and market value of debt as well as the current, and non-current debt.

The empirical findings show that the financing of firms affects investments and performance of firms, in general. The firm leverage ratios affect non-current investments negatively, however, the same ratios affect investments in intangible assets positively. Similarly, leverage has a negative effect on the operating profit ratio and some other performance measures. Nonetheless, the above results become more significant when firm-level capital structure acts as the intermediate variable and the predictor variables are corporate governance characteristics of firms. The busyness of directors and board size affect intangible investments negatively, whereas the education of directors affects intangible investments positively. The busyness of directors affects non-financial firm performance positively. Similarly, the busyness of directors and board size affect accounting-based performance negatively. Education of directors, age and gender affect accounting-based performance positively. The busyness of directors and the education of directors affect market-based performance positively, whereas, age affects market-based performance negatively.

## **2. THEORETICAL LITERATURE REVIEW**

Economic and business situations play an important role to influence the corporate capital structure. The financing underpins the capital structure, which is an important strategic decision of corporates, and it affects various aspects of firms including their operations, investments, performance, survival, growth, and solvency. The most common sources

of firm-financing are equity and debt. Firms having access to an abundance of capital at the minimum cost of capital experience more opportunities to grow, expand and acquire larger market share. Nonetheless, it is worth noticing that the discussion is not merely confined to ascertaining low-cost finance in adequate quantity on favorable terms, but it goes beyond and includes more vital issues such as determining the optimum capital structure (Berk & DeMarzo, 2016). Firms endeavor to achieve financial stability, achieve the liquidity, and solvency benchmarks and generate a higher return on capital on a sustainable basis, and these objectives can be achieved when firms attempt to obtain the optimal capital structure (Graham & Leary, 2011). The determining of an optimal capital structure is not an exogenous phenomenon as several macro-economic determinants, firm-management features, institutional settings, industry/sector characteristics, and regulatory requirements, other things being equal (Salim & Yadav, 2012). Business and economic factors highlight the macro-economic scenario, which is uncertain and influenced by globalization among other factors, and resultantly the needs and requirements of firm-level financing also change. Similarly, the firm management features including functioning, leadership, monitoring, control, and decision-making also influence optimal capital structure. Firm financing can play an important role to enhance the profitability of firms. The right amount, composition of financing and cost of capital can play an important role in maximizing return on capital for a given level of financial risk. The firm-specific risks, also known as unique risk, micro risk, unsystematic risk, can be influenced by the risk appetite of firm managers, among other factors (Kang, Wang, & Xiao, 2018). The nature and composition of capital structure can be influenced by corporate governance dynamics (Aguilera & Crespi-Cladera, 2016; Basu & Sen, 2015). Similarly, institutional characteristics of firms influence the capital structure of firms. For example, the influence of founder members, also known as promoters, represents an institutional characteristic of firms, also affects the choice of firm-financing (Hundal, 2016, 2017).

The current study explores the following hypotheses:

*H1: Firm-level capital structure influences investments.*

*H2: Firm-level capital structure influences firm-performance.*

*H3: Board of directors' characteristics impact capital structure.*

*H4: Board of directors' characteristics impact investments.*

*H5: Board of directors' characteristics impact firm-performance.*

*H6: Firm-level investing affects firm-performance.*

### 3. DATA AND METHODOLOGY

A sample of as many as 73 non-financial publicly traded firms listed on the Nasdaq OMX Nordic Stock Exchange has been selected to test the hypotheses. Twenty-three firms have been chosen from Finland and Sweden each, whereas fifteen and twelve firms represent Denmark and Norway, respectively. The unbalanced pooled data covers a period of sixteen years (2003 to 2018). Due to the unavailability of data a final sample of 983 firm-years and the country-wise classification is 313 firm-years (Finland), 322 firm-years (Sweden), 201 firm-years (Denmark) and 147 firm-years (Norway). The market data have been obtained from the Nasdaq OMX Nordic Stock Exchange and respective central banks, whereas, those of the accounting and corporate governance variables have been extracted from the annual reports (especially financial statements and corporate governance reports) of the sample firms. Several econometric techniques including multivariate ordinary least square method and factor analysis have applied to analyze the data.

### 4. KEY FINDINGS

The empirical findings show that the financing of firms affects investments and performance of firms, in general. Leverage ratios, measured by total debt to equity ratio and long-term debt to equity ratio, negatively affect non-current investments, however, the same variables affect investments in intangible assets positively. Similarly, the debt-to-equity ratio has a negative effect on the operating profit ratio and some other performance measures. Nonetheless, the above results become more significant when firm-level capital structure acts as the intermediate variable and the predictor variables are corporate governance characteristics of firms. For example, the share ownership of the boards of directors and the education level of directors influence the debt-to-equity ratio positively. Similarly, the board size and independence of the boards affect the debt-to-equity ratio negatively. Furthermore, incentive-based pay to the CEO affects most of the firm-level performance measures positively.

The busyness of directors and board size affect intangible investments negatively, whereas the education of directors affects intangible investments positively. The busyness of directors affects non-financial firm performance positively. Similarly, the busyness of directors and board size affect accounting-based performance negatively. Education of directors, age and gender affect accounting-based performance positively. The busyness of directors and the education of directors affect market-based performance positively, whereas, age affects market-based performance negatively. Board size and age affect systematic risk negatively. Education, gender, and busyness affect systematic risk positively.

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## CONFERENCE FORUM DISCUSSION

**Alex Kostyuk:** Hi Shab, and welcome to our conference forum. Corporate governance in Nordic countries is a very contributive topic. I saw that your statement in the presentation that "the busyness of directors and board size affect intangible investments negatively". What do you mean by "the busyness of directors"? Do you mean the number of directorships taken by one director at the same time elsewhere?

Do not you think that the director's gender issue could influence debt-to-equity ratio, especially taking into account the Scandinavian specifics? You concluded that "gender affects accounting-based performance". Does it mean that this is a positive effect (the more females the more positive effect)?

**Shab Hundal:** Hello Alex, I appreciate your query. When the directors of firms also take multiple directorships in other firms on top of the firm they are affiliated to then, on the one hand, it brings "virtues" to the firm they represent in the form of relational capital which can be justified by the resource dependence theory, for example, however, when these directors become overbusy so much so that their "busyness" deter them to perform their core responsibilities, then this phenomenon becomes a component of the agency costs that can be inflicted upon the



firm. Hence, you got it correct. Firms having busy directors invest lesser in the intangible assets, arguable because busy directors do not have time and patience to understand the role and relevance of R&D and other innovation activities as they can be engaged in maximizing their 'personal' utility function. In a similar vein, larger boards may find it difficult to make decisions with respect to intangible investments due to infighting, lack of common understanding (poor consensus), power blocs, and other delays. The gender variable (proportion of women on board) affects the accounting performance positively. There is no sufficient evidence that gender variable (proportion of women on board) could influence firm financing (e.g., debt-to-equity ratio). Interestingly, Scandinavian society gives unparalleled status to women in society, however, the same is not "so true" in corporate settings.

**Dilvin Taskin:** I think the reason that we do not find a direct relationship between financing and gender maybe due to the fact that in many countries the percentage of women on the boards is still very low.

**Maria Guedes:** Agree, there is no really balanced board, or at least a critical mass that can tell us a good story from there.

**Shab Hundal:** Thanks, Dilvin and Maria, for your feedback. Maybe corporate culture is not always in sync with the national culture...

**Maria Guedes:** Something to think about: does culture really matter? Everywhere there are boards that perform badly, and the reasons behind the bad performance are similar....so what does culture mean here?? Nothing really...

**Dilvin Taskin:** I think culture can be considered as a factor. Of course, there are many other relevant factors for failure, but in some cultures, nepotism plays a big role in the failure of businesses.

**Maria Guedes:** Nepotism causes to appoint the wrong persons for the boards, for example.

**Shab Hundal:** Maria, I think culture matters...culture does reflect on the mindset of corporate directors which further reflects on their decision making, etc.

**Shab Hundal:** Dilvin, it is so true...I have done quite a bit of research in the field of multiple directorships (busyness) and I found that invariable nepotism, inter-locking of directors, quest to extend control for a given proportion of ownerships, consumption effect and entrenchment effect are the key factors.

**Alex Kostyuk:** Shab, it is very much promising statement by you "Interestingly, Scandinavian society gives unparalleled status to women in society, however, the same is not "so true" in corporate settings". This means that there are two different standards of female role. The first is in our ordinary world. The second – corporate world. Even in countries, where ordinary world standards are very favorable for women. So, the role of "the right soil" is not enough to grow "a seed"? Probably, it should be slightly pushed by the regulation?

**Shab Hundal:** Exactly, Alex, Finland is a very SME driven economy and the participation of women on board of SMEs is even thinner.

**Alex Kostyuk:** I see, Shab. In this case, there are ways out. The first is regulation. The second – stakeholder activism.

**Shab Hundal:** You are right, Alex, that regulations and stakeholder activism can do a word of good. Nonetheless, the participation of women at the executive positions is at a very impressive scale.

**Alex Kostyuk:** I would say, an extremely impressive scale, at least for certain countries. I think that a cultural stereotype is still a key issue here, Shab.

**Shab Hundal:** Alex, my last comment was in the Finnish context.

**Mireille Chidiac El Hajj:** Hello Shab. The presentation is very interesting. And Professor Kostyuk had made his point when he asked about gender diversity. His argument is very important. One more element can be added though: it is about the difference between the executive and non-executive members of the board of directors. It can be added as a characteristic that can influence the firm's performance and its investments.

**Shab Hundal:** Mireille, thanks for your inputs. Executive and non-executive distinction can unfold important findings.

## 1.9. DOES CEO TURNOVER INFLUENCE THE DIVIDEND POLICY?

Victor Barros<sup>\*</sup>, Maria João Coelho Guedes<sup>\*</sup>, Pedro Santos<sup>\*</sup>, Joaquim Miranda Sarmiento<sup>\*</sup>

<sup>\*</sup> ADVANCE/CSG, ISEG, University of Lisbon, Portugal

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### Abstract

In this study, we assess whether firms' dividend policy is associated with CEO turnover. Both topics have been intensively studied by academics throughout the years, although independently. Existing empirical evidence on CEO turnover has mostly focussed on corporate performance, finding support for a negative relation between firms' performance and CEO turnover (Puffer & Weintrop, 1991; Kang & Shivdasani, 1995; Huson, Malatesta, & Parrino, 2004), although more pronounced if the firm is underperforming in the industry (Kang & Shivdasani, 1995; Jenter & Kanaan, 2015). Despite the extensive focus on performance, other factors can also influence the frequency of a CEO being dismissed from its role. Not surprisingly, the CEO's age is an important factor to justify a turnover (Brickley, 2003), especially for CEOs with pre-retirement age (Murphy & Zimmerman, 1993). The likelihood of turnover also appears to be shaped by other characteristics, such as CEO tenure (Kaplan & Minton, 2012; Dikolli, Mayew, & Nanda, 2014), CEO's earnings management behaviours (Hazarika, Karpoff, & Nahata, 2012), and whether companies are publicly listed (Gao, Harford, & Li, 2017). Board composition may also trigger CEO turnovers if independent or outside directors are added to firms' Boards (Hermalin & Weisbach, 1998; Brickley, 2003). Most existing literature has been focusing on CEO turnover and performance, although changes in strategic decisions after modifications in the corporate architecture have been overlooked. A key strategic decision is precisely the dividend policy.

Existing literature has timidly connected CEO characteristics with the dividend policy. The work of Deshmukh, Goel, and Howe (2013) is among a few exceptions, yet they focus on levels of payout ratios for overconfident CEOs. In this study, we take the additional step to assess whether the dividend policy is shaped following CEO turnovers, being such changes exclusively derived from the turnover.

Our sample covers firms on the S&P 500 Index from 2004 to 2017, covering up to 4,155 firm-year observations and 487 turnovers. To ensure the validity of the data, manual crosschecking was performed over CEOs' biographies and news on the turnovers.

The empirical evidence suggests that CEO turnover increases firms' dividend yield. Moreover, the positive association between CEO turnover and the dividend yield appears to be more pronounced during the financial crisis period (2008 to 2012), although decreasing the dividends paid by firms in such a period. During this distressing period, stock prices volatility increased, and the market appears to have reacted less smoothly to CEO turnover announcements, leading to potentially lower stock prices and rising dividend yields. Results for the aftermath of the financial crisis are dissimilar. Evidence indicates that CEO turnover and proxies for the dividend policy are statistically associated, with turnovers increasing firms' dividend per share and dividend yields.

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## CONFERENCE FORUM DISCUSSION

**Alex Kostyuk:** Hi Victor, welcome to our conference network! In the paper, you concluded that "The empirical evidence suggests that CEO turnover increases firms' dividend yield". Does it mean that a signaling theory is still valuable at the market since James Poterba and Lawrence Summers conducted their research almost 40 years ago? Does it mean that information asymmetry is still the case to study and take into account? Do not you think that your major research conclusion is linked to the classical issue of ownership concentration? Does ownership concentration influence the CEO turnover?

**Victor Barros:** Hi Alex. Our preliminary results suggest that the signaling theory holds for CEO turnover, which may due to the aim of the new CEO to signal a positive outlook and to satisfy a clientele of shareholders aiming to collect a higher dividend (results point to an increase in DPS following the turnover). This conclusion leads to another question that you addressed. Ownership concentration is not captured in our model; however, this is a very interesting feature to consider in the revision of our study. Thank you.

**Alex Kostyuk:** This is what I intended to fix, Victor. Surely, your vision is far and strong, so you could try to include in your consideration also a postulated issue of corporate governance – ownership concentration. I expect that your model would have a lot of benefits in this way too.

**Patricia Bortolon:** I would like to suggest that in your regression model some explanatory variables should be considered outdated, especially the performance ones since it would be reasonable to assume that past and not contemporary performance influence the CEO's change. I also believe that the variables CEO and CEO\_crisis could be used simultaneously in the models, in order to allow the analysis of the

differential effect, that is, how (and if) the crisis affects the CEO coefficient in the model.

Once again, congratulations on the interesting research problem addressed!

**Victor Barros:** Hi Patricia, thank you for your suggestions. Past and contemporaneous figures may yield different outcomes, so this is an issue that we will revise. Thank you once again for all suggestions.

**Mbako Mbo:** Hi Victor, my question on the interaction of internal (push) and external (pull) factors on influencing CEO's stay, and also, external influences on a company dividend policy. I am currently in practice and PE industry averages are influential in company dividend policies. Would you consider infusing these into your future study perhaps?

**Victor Barros:** Hi Mbako Mbo, we will definitely account for market multiples in our research. Thank you.

**L-F Pau:** I am no researching this field but have a long time CEO experience. You must add to your regression variables the age of the firm. Summers theory is outdated. Today a venture capital fund and founders have not at all the same dividend policy views as a 100-year company with dominant long term institutional investors and pension funds.

**Maha Radwan:** L-F Pau, I totally agree that the age of the firm is an influencing variable.

**L-F Pau:** Then another obvious issue: is there a supervisory board or not (binary variable)?

**Maria Guedes:** Can you point studies that the existence of a supervisory board is related to more or less turnover?

**Khaled Otman:** The age of the firm can be used as a control variable in this research.

**Maria Guedes:** Yes, as a control variable. Although it is not pivotal because all are well-established firms. But that would be a different question.

**L-F Pau:** Supervisory boards in practice have a big say on dividend policy; I didn't say on turnover.

**Maria Guedes:** To include the supervisory board has a predictor in this aspect we would need to justify that turnover is also related. And I am not aware of any papers that address that. It could be quite interesting.

**L-F Pau:** A third one, but difficult to include as it is not quantitative for your quantitative only analysis: regulatory paradigm shift(s) affect dividend outlook, or more precisely the outlook for pay-out ratio. Don't believe you find all in ex-post papers...Experience plays more. There is almost no connection between supervisory board presence and turnover, except if very large investments come to play.

**Hadfi Bilel:** Dividend policy is still a subject of ambiguity in finance because of the lack of a convincing explanation for the dividend

puzzle theory. Despite the presence of several other theories that we tried to find the best explanation but still remains unconvincing. For the article, the authors have attempted to investigate the influence of CEO turnover on the decision to distribute dividend. But, I have a few questions: 1) What are the other variables used in your estimate? 2) In your article did you mention the rooting behavior of leaders? 3) Which empirical method did you choose for your estimate?

**Maria Guedes:** Thanks for your questions. For the determinants of dividend payments we use either a probit or logit model for the rest RE or FE (using Hausman test to choose). We have not addressed any traits of the CEOs in terms of variables, please see Table 5 (too many to write here) but basically, no control variables related to CEO traits or leadership behavior.

**Hadfi Bilel:** Thank you, Maria, you used the logit or probit method for your estimation, but did you use a binary dependent variable?

**Maria Guedes:**  $D\_dividendsit = \beta_0 + \beta_1 CEOit + \beta_2 ln\_Assetsit + \beta_3 ROEit + \beta_4 FinCrisisit + \beta_5 NPMit + \beta_6 Levit + \beta_7 MBRit + \beta_8 TaxRateit + \varepsilon it$ . So,  $D\_dividendsit$  is a dummy that equals one if firms pay dividends and zero otherwise.

**L-F Pau:** I am far from convinced that quantitative models can be suitable, except fitting data to the model (!). Statistical data analysis is far more useful.

**Maria Guedes:** I am not sure I understand what you mean. Can you explain/give an example how statistical data analysis is not quantitative?

**L-F Pau:** Multivariate statistical analysis, factorial analysis, cluster analysis (the best for that problem), discriminant analysis for dividend interval classes.

**Karen Hogan:** Hello Victor and all. This is an interesting study. It appears to be a well thought out hypothesis. I just finished co-authoring a paper on CEO facial masculinity and firm performance. We find high-fWHR CEOs are not more likely to face forced turnover and that there is a negative relationship with CEO fWHR and firm cash holdings. They also tend to hold less investment in the firm themselves. I find it interesting that there are so many factors that could be shaping these choices. I see that you discussed at least one paper that looked at characteristics. It is interesting how these are intertwined in the research but usually behind the scene.

**Maria Guedes:** Hi. What interesting research. Can you share your paper please (if it is in that stage already)?

**Karen Hogan:** Hi Maria, here you go:  
<https://www.virtusinterpress.org/CEO-facial-masculinity-and-firm-financial-outcomes.html>

## 1.10. HAS THE TRADITIONAL BOARD GOVERNANCE MODEL PASSED ITS USE-BY-DATE?<sup>o</sup>

Dean Blomson \*

\* Sextant Consulting Pty Ltd, Australia

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### CONFERENCE FORUM DISCUSSION

**Alex Kostyuk:** Hello Dean. Welcome to our conference forum. You outlined that “too many topics in a packed board agenda demanding attention”. This is a very solid statement. Entirely, I agree with you. What are the most demanding topics in the board agenda recently? Could you name a few such topics? What is your point of view about the issue of CEO-chairman of the board duality? Do not you think that these positions on the board should be separated and taken by different directors according to the logic of separation of strategic control and strategic management?

**Dean Blomson:** Hi Alex – thanks for your initial questions. I think the agenda list in the main contains the standard/predictable items such as CEOs report; various committee reports; financial reports; people and HR reports. There will be a range of items either for noting, endorsing, or for deciding (including capital projects, major initiatives, etc.). These are what I would call the business as usual agenda items. In addition, there are a range of regular or more periodic items such as risk update; culture and engagement review; environment, sustainability; strategy updates/reviews; cybersecurity, and digital. Plus of course, let’s not forget compliance and other license to operate agenda items. The list goes on.

**Alex Kostyuk:** I see your point, Dean. Do you mean internal or external reporting, for example, if we talk about the CEO as a public person?

**Dean Blomson:** Internal reporting by exec directors and management to non-executive directors.

**Alex Kostyuk:** Internal reporting corresponds to the interests of the shareholders first of all. I see this point, Dean. But if we are talking about banks depending mainly on client finances, not shareholder equity? Do not you think that external reporting should be a strong case to implement too?

**Dean Blomson:** Alex, thanks for your follow up question. Would you mind explaining this point to me in a slightly different way, please?

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<sup>o</sup> The material has been presented at the conference and was being discussed within the conference forum. The authors preferred not to publish the material in the conference proceedings.



I'm not sure I follow what you're asking/saying? External reporting to prudential regulators (in the case of banks), investment communities/analysts, stock exchange, etc. is critical and in my view, won't change anytime soon. But internal Mgt reporting must be effective (i.e., consistent and reliable) as a foundation, otherwise, external reporting will be speculative and inaccurate...

**Alex Kostyuk:** Dean, I absolutely agree with you that your point to strengthen the system of internal reporting is strong. My experience with CG in banks tells me that very often the banking panics are the result of very weak communications of banks with their clients, both institutional and individual. This function is in the hand of the central bank. I do not agree with this because central banks communicate clients of banks aimed for inflation control and economic stability in a whole. This is a macro issue and this influence could be beneficial rather for big banks consuming a larger portion of refinancing by central banks. So, I think that the bank should act separately and more actively in reporting to their clients. This is a still under-evaluated issue by the banks which should start with designing the parameters of this reporting (info disclosure).

**Iliana Haro:** Hi Dean, regarding your assertion 2 "A heavy focus on compliance and risk means less exploration of uncertainties where value often lies" I completely agree with you. From my perspective one path to change this focus could be by changing the corporate culture, for example increasing tolerance to error and reducing risk avoidance, not only in C-level executives but in the entire organization. But if this is right that would mean that corporate culture fosters a specific corporate governance framework for each company, would you agree with that? Or in any case what are your thoughts?

**Iliana Haro:** Dean, you are asking "If companies claim to be different, why do their governance systems largely look so similar?" in public companies we could assume that it is because their specific regulations make it mandatory. But in non-public companies what could it be? Certainly there is the issue of the supposed "best practices" which in my point of view they should be considered and adopted with caution because none of them are taking into account the specific context of each organization, but it is also true that not all organizations follow best practices and still their CG system does not reflect the company essence, do you think that this could be an issue of introducing the solution first – meaning the corporate governance system – and analyzing the problem later – meaning taking into account the context and strategy of company afterwards?

**Dean Blomson:** I definitely think you are on to something, correctly. I think first and foremost this could be a failure of "imagination" or maybe more correctly "contextualization" and design thinking. Boards need to be asking: what is our purpose? Why do we exist? And what is it that we need to do, both generally (i.e., taking into account directors' duties) and specifically (recognizing the purpose and

unique context and strategy of the company) to design and implement a "fit for purpose" governance model?

**Egbert Irving:** While the 'fit for purpose' model would be ideal there are other environmental and institutional constraints. This may explain the seemingly slow pace of governance model reform (i.e., transformational vs incremental). Another question is whether there is a need for a transformative change?

**Iliana Haro:** Egbert, could you explain what do you mean by environmental, what by institutional and what is the difference between them and the context of the organization, please?

**Egbert Irving:** Sure. It's all part of the context of the organization, institutions meaning (rule of law; regulatory framework; cultural/social norms); similar environmental (e.g., economic, social, political, technological, and legal forces). So, both concepts are similar in that they are external to the organization and therefore are beyond its ability to singularly control. This leads to the question of an internal (or agency-based view) verses an external (or institutional approach) to governance models. The reality is both forces, internal and external, impact and influence governance models and all organizations must exist within some institutional framework.

**Iliana Haro:** So, if you agree that what you call environment and institutional constraints are part of the context, what is exactly your point? Because the context issue is mentioned since slide 3.

**Maria Guedes:** One question please, how can we incorporate the new digital means, that now the crisis shows so necessary, to the new models that are to come? What shall be the future directions at this respect?

**Iliana Haro:** Not at all, I am just trying to understand what is your point because my research is focused on the context of organizations and I need to understand why you are making such a differentiation, maybe I am not aware of certain literature that I should consider, so could help me and explain your point, please?

**Dean Blomson:** Iliana, great to have your participation and commentary. Of course, context is highly important but I don't see the legislation as an immutable constraint. If changes are required to Corporations Acts in different countries, to catch up to new realities (such as directors' duties) then that should be on the table. The first question to consider remains: is the general model broken (where and why)?

**Dean Blomson:** To Maria, we should be able to take important learnings out of COVID for enterprise and board modes of operating. Digital enablement should extend well beyond use of Zoom, to far bigger questions like how to use AI to improve real-time board decision making, use of current data (not "old" or dated board packs), etc.

**Karen Hogan:** That would be an interesting piece, "the use of AI for real-time board decisions".

## SESSION 2: CORPORATE GOVERNANCE AND OWNERSHIP STRUCTURES

# 2.1. THE INFLUENCE OF CHINA'S INTELLECTUAL PROPERTY POLICIES SINCE ITS ACCESSION TO WTO ON THE FOREIGN OWNED PHARMACEUTICAL R&D

Alina Bari \*

\* Aberystwyth University, the UK

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### Abstract

Strengthening of intellectual property rights (IPR) has taken the centre stage during the last two decades, the world over. This development has raised tremendous controversies between developed and developing countries. The developing nations debate that strengthening of IPR will result in augmented rent extraction by patent owning multinational firms, as a consequence. While supporters of stronger IPR are asserting that it will lead to an enhancement of innovation in both developed and developing countries, leading to economic growth.

“Intellectual property is a term that refers to creations of the mind: inventions, literary and artistic work, symbols, names, images & design used in commerce. Intellectual property is divided into two categories: 1) industrial property which includes inventions (patents), trademark, industrial design, and geographic indications of source; and 2) copyright which includes literary and artistic works such as novels, poems and play” (World Intellectual Property Organization, n.d.).

China, since the times of Deng Xiaoping's leadership, has been trying to integrate with the Western world despite its deep-rooted

cultural and political differences. One such move was the membership of the World Trade Organisation (WTO) which China gained in 2001. Subsequently, it brought another policy change in 2008. The aim of this research was to explore the influence of these reforms and the policy change on the IPR and on the research and development (R&D) being carried out in China's pharmaceutical industry. The purpose of this research was to first investigate whether China's intellectual property (IP) environment has improved after its accession to the WTO and to weigh if the resulting reforms and policy change had a positive effect on the R&D activities of the foreign owned Pharmaceutical firms.

From 2003, China became one of the major recipients of foreign direct investment (FDI) in the world (U.S. Department of State, 2018). Despite having IP laws of international standards on record, IP infringement is still one of the highest in China (Maskus, 1998a, 1998b). China produces 80% of the world's counterfeits (Shepard, 2018). According to Rapoza (2012), IP protection will always be an uphill struggle in China for companies doing business there. Although China has achieved great technological advancement, there is a danger that failing to enforce IPRs, China may find it difficult to sustain the present economic growth. This is due to China's economic growth's high dependence on the technology that is transferred via FDI (World Bank, n.d.).

Foreign investment enterprises or multinational enterprises (MNEs) are skeptical of transferring the latest technology to countries with poor IP protection, like China (Ramona, 2001). In order to lay a firm foundation for its future economic development, especially for the growth of the pharmaceutical industry, China should concentrate its efforts towards enforcing IPRs. Although effective IP protection helps to encourage FDI and technology transfer through other channels, it is crucial for attracting investment in R&D (Sherwood, 1997). Corruption, paucity of rule of law as well as transparency and struggle with enforcement; challenges the efficacious enforcement of IPR in China. Recently, the US has imposed tariffs on imports from China as punishment for the alleged theft of American intellectual property (Clark & Hagan, 2018).

Infringements are frequently seen as a way to exploit authoritative measures by local officials. Frequent interference by the officials, in cases in the form of ordering judges to pass rulings in favour of the local party, poses a great risk to foreign investors who are transferring technology to China. The foreign investors fear that their IP centric assets will be pirated since disclosing information to third parties, such as suppliers of raw materials, contract manufacturers and distributors is quite common (Chow & Li, 2002). In fact, just applying for a patent, copyright or trademark opens the door for infringement because information disclosure is necessary for their registration.

Furthermore, the companies should be mindful of the fact that

China has the right to the compulsory licensing of any patent that the companies have failed in exploiting or licensing it in China (Han, 1996). According to Schiappacasse (2004), stronger enforcement of IPR is required to facilitate foreign direct investment in technologically advanced sectors and R&D operations. He stated that China's economy might collapse without foreign investment in R&D intensive sectors.

Maskus (2000a) states, that in a developing country, having a strong intellectual property regime encourages advancement in technology and innovation. This also attracts local innovation, which helps in closing the gap between developed and developing countries. This view is also supported by Lippoldt (2006), who stated that the flow of foreign direct investment & international technology transfer is likely to increase if a country enhances its intellectual property rights laws.

For example, Kalande (2002) stated that most multinational enterprises are agreeable to invest in non-manufacturing sectors or extractive industries instead of investing in technology and research in countries whose IPR protection is inadequate. Likewise, Nicholson (2002) noted that stringent IPR protection stimulates firms to commence offshore production by taking advantage of the protection provided for their ownership.

But the literature also points towards the increase in foreign R&D in China. According to Asakawa and Som (2008), there has been an increase in the number of Western and foreign companies which have established their R&D centres in China. The Economist Intelligence Unit (EIU) stated that China is one of the world's foremost R&D locations.

The Wall Street Journal also disclosed that nearly 75% of R&D sites scheduled during 2007 were intended for China and India (Rajagopalan, 2006). This view is also supported by Tung (2005), who stated that several the US and European companies invested heavily in R&D in China and predicted that China will dominate as an upcoming location for R&D investment.

Asakawa and Som (2008) stated that there is still uncertainty about the scope of R&D internationalization in China with regard to opportunities and challenges. Academic research has lagged behind this increasing disposition of foreign R&D investment in Asia. Most of the literature available on R&D internationalization deals with the research centred on international R&D and R&D headquarters in the West (Ambos & Schlegelmilch, 2004, 2007; Dalton & Serapio, 1995; Håkanson & Nobel, 1993; Håkanson & Zander, 1986; Niosi, 1999; Ronstadt, 1977). Asakawa and Som (2008), debated that a criterion based on the previous experiences in Western settings should not be relied upon. Different and specific criteria other than the universal ones need also to be considered (Gassmann & Han, 2004; Walsh, 2007). Nonetheless, there is an apprehension about IPR in China, which is important in the rapidly changing environment (Peng, 2002).

Pharmaceutical industry is a patent sensitive industry. When a

company patents its product, it gains monopoly for a certain period of time. According to Pammolli, Magazzini, and Riccaboni (2011), IP policies of a country have a huge impact on the pharmaceutical industry and it is imperative for the governments to have an Intellectual property policy that not only protects the inventor's interest but benefits the industry in the country as well because infringement of IP can hinder innovation and lead to unavailability of life-saving drugs in a country. The pharmaceutical industry is one of the biggest industries in the world with revenues of USD 1,105 billion (Statista, 2019). It is estimated that global pharmaceutical spending on R&D will reach nearly USD 1.5 trillion by 2021 (IQVIA, n.d.).

This is an interesting situation, particularly for pharmaceutical R&D in China. The average annual growth rate of China's pharmaceutical industry has been 16.72% over the past couple of decades (IQVIA, n.d.) and currently it is the second biggest market for pharmaceuticals, a title that it has held since 2012 (IQVIA, n.d.). However, the industry is still in its infancy with a geographically scattered distribution, replicated production methods, obsolete manufacturing technology and organization.

The Chinese pharmaceutical industry has not yet attained competitiveness at an international level and has a low market concentration; domestically developed pharmaceuticals along with a lack of patents add to this scenario (IQVIA, n.d.).

According to a report published in 2014 by IMS health which is the pharmaceutical market research firm; China became the third-largest prescription drug market in the world in 2011 (IQVIA, n.d.). The report stated that China's pharmaceutical revenue is growing exponentially and that its market had doubled during 2013 and that sales of prescription drugs in China grew by "USD 40 billion" through 2013. The report further added, "The value-added output of China's pharmaceutical industry increased by 14.9% as compared to the previous year in 2009, according to statistics released by China's Ministry of Industry and Information Technology. From January to November 2012, the medicine sector's combined net profit was RMB 89.6 billion, growing by 25.9% year on year" (IQVIA, n.d.).

Even as recent as 2014, there were concerns about intellectual property infringement in China (Cao, 2014). In 2015, the US accused China of still having a weak IP system which acted as a deterrent to foreign investment (Hornby, 2015).

The above provides an interesting background for this research. This research aimed to find the impact of intellectual property rights strength and enforcement on foreign owned R&D after China's accession to WTO. The pharmaceutical industry is an R&D intensive industry and allocates a large number of resources to it; in 2011, the industry spent USD 92 billion on R&D (OECD, 2015). In China, the pharmaceutical industry spent USD 700 million on R&D in 2015 (NBS China). Therefore

this industry was chosen to study the R&D in China with respect to intellectual property rights.

The approach adopted for the purpose of this research is deductive and exploratory in essence. The research sample comprises of seven foreign owned pharmaceutical MNCs that have their R&D centres in China. The research found that the IPR reforms brought in by China's accession to the WTO had a positive effect on the foreign pharmaceutical investment in R&D concluding that China's IP environment has improved since it's gaining membership to WTO, at least for the pharmaceutical sector.

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## CONFERENCE FORUM DISCUSSION

**Alina Bari:** Hi all, I thought to introduce myself. I am Alina, I graduated last year with PhD from Aberystwyth University. This research is my PhD research. In this research, I attempted to study the impact that China's IP policies since it became a member of WTO in 2001 have on foreign-owned pharmaceutical R&D. I looked at the 7 pharmaceutical MNCs which were conducting R&D in China at the time.

**H A R P Madushanka:** Hi Alina, thanks for sharing your findings with us. It is very interesting. I would like to know if you can shed any insights on the initial objectives of China's move to join the WTO? Was IPO a reason at any level for this? Or was this outcome a random incident?

**Alina Bari:** Hi H A R P, thanks for reading my research. Initially, China wanted to join WTO to have access to the global market. But to become a member of WTO China had to reform its IP law. I hope I have answered your question. If not please let me know and I'll try again.

**Shab Hundal:** Hi Alina, a very interesting field of research.

**Alex Kostyuk:** Hi Alina, I see that your paper can address many interesting streams in the way of corporate governance and international business. It was wisely mentioned in the paper that "The average annual growth rate of China's pharmaceutical industry has been 16.72% over the past couple of decades (IMS Health, 2014) and currently it is the second biggest market for pharmaceuticals, a title that it has held since 2012 (IQVIA, 2018). However, the industry is still in its infancy with a geographically scattered distribution, replicated production methods, obsolete manufacturing technology and organization". What is the role of the state-owned enterprises in the trends above, and would the foreign-owned companies be able to become a new engine for R&D in China?

**Alina Bari:** Hi Alex, as for the first question, I didn't look into what the state-owned enterprises and their contribution to GDP as I was mainly focused (please read obsessed) with IP policies foreign-owned R&D in China. However, it does raise an interesting avenue for research. For your second question: the evidence suggests that at least for the pharmaceutical sector it seems to hold true. As China is making hubs for pharmaceutical R&D and foreign-owned pharmaceutical companies are working in collaboration with Chinese pharmaceutical companies. And they are specifically doing R&D for the Asian market.

**Karen Hogan:** This is a very interesting paper. I teach international finance and also do a class in cyber where we talk a lot about IP, etc. We talk in the international class a lot about trade and R&D is always a big one. Are you planning on looking at any other industries?

**Alina Bari:** Hi Karen, thanks, eventually yes. My research has developed a few indicators which can be implemented in different industries and I would like to implement them and see if it works.

**L-F Pau:** We are extensively followed and analyzed electronics, computer, and software industries. Anyway, pharmaceutical IP and process IP anyway is rather different from IP in other sectors where the emphasis is on a device, or a construct, or a logical sequence (like in embedded software), or a functionality. Therefore, IP indicators do not migrate well across fields of application. Also, the span of the claims can be very narrow or quite wide. And finally, geographical claims by Chinese IP are often very limited. Next, on R&D in China, beware most of the budgets are engineering, testing, and pre-production, not the innovative part except in a few companies and labs; so, using R&D budget analysis must be refined much more.

**Lindrianasari:** Alina, yes, R&D is another interesting variable. This year, I investigate R&D intensity; R&D cost divided to total assets. As I argued before, we try to investigate carefully about envi accounting, not only disclosures but also funding.

## 2.2. CORPORATE GOVERNANCE, FAMILY FIRMS AND INNOVATION

Brian Bolton<sup>\*</sup>, Jung-Eung Park<sup>\*\*</sup>

<sup>\*</sup> Moody College of Business, University of Louisiana at Lafayette, USA

<sup>\*\*</sup> IMD Business School, Lausanne, Switzerland

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### Abstract

We provide a comprehensive study of how corporate governance influences innovation at family firms. We find that family firms do indeed generate more productive innovation than non-family firms, perhaps because they are able to have a longer-term perspective. We then show how different corporate governance mechanisms influence this relationship. Board ownership and CEO ownership are associated with more productive innovation at all firms. Importantly, we find that managerial entrenchment leads to more productive innovation in general, but not at family firms, suggesting that it's the ownership relationship, not managerial entrenchment, that drives innovation. We also find that independent boards are associated with greater innovation at family firms but not at non-family firms. Our primary contributions are identifying how firms with different ownership structures focus on creating productive innovation and analyzing how the ownership structure interacts with different corporate governance mechanisms to allow the firm to make longer-term investments in innovation.

### 1. INTRODUCTION

Recent academic research has uncovered quite a puzzle with respect to the relationship between corporate governance, corporate innovation, and value creation. For years, we have assumed that entrenched corporate governance structures restricted value creation (Gompers, Ishii & Metrick, 2003; Bebchuk, Cohen, & Ferrell, 2009). More recently,

significant work by Chemmanur and Tian (2018) and Sapra, Subramanian, A., and Subramanian, K. V. (2014) suggest that entrenched corporate governance structures lead to more corporate innovation. We have long believed that corporate innovation is a key driver of firm value, but then what are we to make of these seemingly contradictory effects of different corporate governance structures?

In this paper, we focus on this puzzle using the unique context of family firms. We argue that the key to firms producing value-enhancing innovation is not entrenched management, but rather committed and devoted ownership. We find that the effect of committed, relational ownership dominates the management effect and that family firms generate more productive innovation than non-family firms, perhaps as a result of the long-term perspective developed through the relationship between the family, management and the board of directors. When we focus on how different corporate governance mechanisms influence this dynamic, we see that more independent boards are associated with greater productive innovation at family firms but have no impact on non-family firms. We find that board ownership is associated with greater productive innovation at all firms. Importantly, we find that managerial entrenchment at family firms is associated with less productive innovation, suggesting that the ownership structure dominates the management structure. And, finally, we find that having a dual-class share structure is harmful to generating productive innovation for all firms. Thus, this study contributes to unraveling the puzzle of why managerial entrenchment can be bad for firm value but good for innovation, suggesting that the key factor is how entrenched the ownership is and not merely how entrenched management is.

## 2. MOTIVATION AND HYPOTHESIS DEVELOPMENT

We specifically study whether different corporate governance and ownership structures have an impact on the innovation produced by a firm. With respect to the relationship between ownership and innovation, there is some evidence that it matters. When institutional ownership is high, managers are less likely to cut R&D expenditures (Bushee, 1998). And Aghion, Van Reenen, and Zingales (2013) further this notion, by developing a theoretical model which shows that greater institutional ownership is associated with more innovation output.

Knott (2008) studied this specific dynamic, with respect to all firms, not specific to family firms. She suggests that the productivity of a firm's R&D investments is what is most important. It doesn't matter if a firm is investing a lot in R&D, and it may not matter if a firm is generating a lot of patents; what ultimately matters is the productivity of those R&D investments. A firm's ability to convert R&D investments into productive innovation leads it to invest more in R&D, not the reverse. To measure this, she created Research Quotient (RQ) as a measure of R&D investment productivity. She showed this result using a large sample of

U.S. firms; to the best of our knowledge, we are the first to apply this idea to family firms.

Duran, Kammerlander, van Essen, and Zellweger (2015) point out their findings concerning family firms and innovation depend on the ownership and leadership characteristics of each firm and country-level factors. A firm's corporate governance structure is likely to be a significant moderating or determining factor in how productive a firm's R&D investments are. Manso (2011) shows that the managerial incentives necessary for innovation must be long-term. Chemmanur and Tian (2018) and Sapra, Subramanian, A., and Subramanian K. V. (2014) show that entrenched managers and directors are most likely to invest in innovation. Wang and Zhao (2015) find that firm ownership matters for innovation, as hedge fund ownership increases both the quantity and quality of patents and increases firm value through this innovation effect.

Based on this brief literature review, and our expected relationships between innovation, governance and family ownership, we have two primary hypotheses for our study:

*Hypothesis 1 (H1): Family firms generate more productive innovation than non-family firms.*

*Hypothesis 2 (H2): Family firms with stronger corporate governance structures generate more productive innovation than non-family firms.*

### 3. DATA

We study innovation and corporate governance at family firms in the U.S.A. from 2001 to 2010. Anderson, Duru, and Reeb (2009) characterized "family firms" as firms in which the founding family currently holds a five-percent equity stake in the company (based on cash flow rights). We use Compustat for financial statement data, CRSP for stock price data, Execucomp for compensation data, and ISS for corporate governance data. Our primary measure of innovation is Research Quotient or the percentage increase in revenues from a 1% increase in R&D expenditures; thus, RQ is estimated from financial data available from Compustat.

Approximately 34% of the sample firms are family firms and 10% have dual-class share structures; 26% of all family firms have dual-class share structures and 87% of dual-class firms are family firms, showing that family firms are more likely to use dual-class share structures. Seventy-one percent of directors are independent and the average director owns \$2.09 million of stock. Fifty-eight percent of CEOs also serve as board chair; average board tenure is 10.58 years, while 21% of directors have served on the board for more than 15 years and 20% of directors have served for fewer than 5 years. Nine percent of the directors serve on more than three other boards, with the average director serving on just less than 1 other board. In terms of innovation statistics, the average Research Quotient is 0.11%, meaning that the

average firm increases revenues by 0.11% for each 1% increase in R&D investment; the data also show how skewed this measure is, suggesting that there is a wide disparity in the impact of investing in innovation.

#### 4. RESULTS AND DISCUSSION

We study whether family firms are more productive with their investments in innovation than non-family firms are and how a firm's corporate governance structure may affect this relationship using the following simple model:

$$\text{Innovation}_{i,t+1} = \alpha + \beta_1 \text{Family Firm}_{i,t} + \beta_2 \text{Governance}_{i,t} + \theta \text{Controls}_{i,t} + \varepsilon \quad (1)$$

We initially use OLS estimation. We use a one-year lag between the time of the explanatory variables and the measurement of the firm's innovation to allow for the time it may take for an ownership or governance structure to impact a firm's innovation productivity. We use firm, industry and year fixed-effects to capture unobservable, time-invariant firm and industry dynamics outside of our primary governance-innovation relationships.

The results from our analysis on the impact of family firm ownership on innovation are in Table 1 (see Appendix). We see a positive and significant coefficient on the *Family Firm* variable, indicating that firms with greater than 5% ownership by the family are better at creating innovation that leads to increased revenue. When we include the *Dual-Class* dummy variable and a *Family Firm x Dual-Class* interactive term, dual-class firms, by themselves, produce less productive innovation than firms with a single class of stock; the interactive term is negative and significant, suggesting that the productive innovation that family firms generate comes from those family firms that do not employ a multiple class share structure. Thus, we conclude that *H1* holds that family firms generate more productive innovation than non-family firms.

The results in Table 2 (see Appendix) show how the relationship between family firms and innovation can be augmented or moderated by different corporate governance mechanisms. In these regressions, we keep the same structure as in *Family Firm-Innovation* models in Table 1, continuing to include the dual-class share variable, and add on different corporate governance mechanisms and interact them with *Family Firm*. In all Table 2 models, the measure of Innovation is *Research Quotient (RQ)*. For conciseness, we only show the primary *Family Firm* and *Governance* variables and exclude the results for the control variables.

In model 1, the governance variable is *Board Independence*. More independent boards produce slightly more productive innovation than boards with fewer independent directors, but only in family firms, where

the impact of independent, outside directors perhaps serves to balance the inside and traditional perspective of the founding and owning family.

In model 2, the governance variable is *Director Ownership* or the median dollar value of common stock owned by the individual members of the board of directors (Bhagat & Bolton, 2008). Boards that own more stock are associated with higher *RQ*, both in family firms and in non-family firms.

In model 3, the governance variable is *CEO-Chair Duality*, a dummy equal to 1 if the CEO is also the board chair. These show that *CEO-Chair Duality* is negatively related to innovation at all firms; however, based on the *CEO-Chair Duality x Family Firm* variable, the negative relationship is most profound at family firms. Thus, the improved level of *RQ* at family firms is a result of the family influence and not a result of entrenched management.

In model 4, the governance variable is the Gompers, Ishii, and Metrick (2003) *G-Index* of managerial entrenchment. For all firms, we see a positive relationship between *G-Index* and *RQ*. This suggests that entrenchment may insulate firms from short-term pressures, allowing the company to focus on longer-term investments, such as innovation. However, when we include the *G-Index x Family Firm* variable, we find a negative relationship between *G-Index* and *RQ*. This suggests the innovation benefits from overall entrenchment are a function of the ownership dynamic and not of entrenched management. This result, along with the results in model 3, may shed some light on why entrenchment appears to be beneficial for innovation, even though we know it destroys firm value. The relationship between managers and owners is what matters.

Overall, these results show that a firm's corporate governance structure can have a substantial effect on whether a firm is able to generate productive innovation, but this depends on what aspect of the governance structure we are looking at. In most cases, there is not a significant difference between how the governance structure impact innovation in family and non-family firms. Importantly, when we include proxies for entrenchment as our governance variables, we see that entrenchment is beneficial for innovation at all firms, but not at family firms, suggesting that it is the relational benefits of the family ownership and/or leadership that creates productive innovation. Thus, we see mixed evidence with respect to *H2*, as we do see different dynamics from certain corporate governance variables between family firms and non-family firms. Summarizing these results, we highlight several key findings:

- *Research Quotient* is different from other measures of innovation, such as patents and citations; that is, the different proxies are indeed measuring different dynamics.

- *Family Firms* do generate more productive innovation than non-family firms do.

- *Dual-Class* share structures are associated with lower levels of productive innovation.



- Corporate governance structures do influence innovation, both at family firms and non-family firms. *Board Independence* and *Director Ownership* are associated with more innovation, while *CEO-Chair Duality* is associated with less innovation.

- *Board Independence* has a disproportionately greater impact on productive innovation at family firms relative to the influence it has at non-family firms; this is perhaps due to the different perspectives that independent, outside directors bring to a family firm.

- And, managerial entrenchment, which has been associated with lower firm value, leads to greater productive innovation, but not at family firms. This suggests that the long-term ownership relationship that family firms provide is what leads to productive innovation.

These findings are important because they shed light on the structural and institutional trade-offs that firms need to make in order to achieve long-term success. We have long known that there is no "one-size-fits-all" corporate governance structure, but we can identify best practices that will make a difference at the margin for many firms. Our findings in this study should provide some guidance for owners, directors, and leaders at family firms as to what they need to do to generate the most productive innovation and what corporate governance mechanisms they need to choose as they pursue long-term success.

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## APPENDIX

**Table 1.** Regressions of innovation on family firm ownership

	<i>Research Quotient (RQ)</i>	<i>Research Quotient (RQ)</i>	<i>Research Quotient (RQ)</i>
Family Firm	1.837*** (2.86)	1.902*** (2.93)	2.137*** (2.69)
Dual-class Shares	- (-)	-0.638* (-1.76)	-0.706* (-1.66)
Family Firm x Dual-class Shares	- (-)	- (-)	-0.422** (-2.13)
Ln (Assets)	0.062* (1.77)	0.058* (1.78)	0.059* (1.70)
R&D/Assets	-0.327 (-0.83)	-0.341 (-0.89)	-0.338 (-0.82)
CapEx/Assets	0.243* (1.71)	0.268* (1.70)	0.257 (1.62)
Tobin's Q	0.101 (0.98)	0.108 (0.92)	0.107 (0.95)
Debt/Assets	-0.037 (0.89)	-0.044 (0.82)	-0.046 (0.80)
Cash/Assets	0.236* (1.83)	0.240* (1.81)	0.241* (1.86)
Institutional Ownership	0.074 (1.34)	0.071 (1.31)	0.072 (1.30)
Equity/Total Pay	0.143** (2.13)	0.142** (2.19)	0.148** (2.24)
Firm Age	0.487*** (3.24)	0.475*** (3.08)	0.472*** (3.01)
Constant	-1.371*** (-2.73)	-1.682*** (-2.79)	-1.736*** (-2.82)
Observations	5,836	5,836	5,836
R-squared	0.257	0.263	0.268
Firm, Industry and Year FE	Yes	Yes	Yes

*Note: This table presents regression results of innovation on various measures of family firm ownership and structure. Research Quotient (RQ) is the measure of innovation. Family Firm and Dual-class Shares are the explanatory variables of interest. All regressions contain firm and year fixed effects. T-statistics are reported in parentheses. Standard errors are clustered by firm. \*\*\* indicates significance at the 1% level, \*\* 5% and \* 10%.*

**Table 2.** Regressions of innovation on family firm ownership and corporate governance structures

	<i>Research Quotient (RQ) as measure of innovation</i>			
	<i>Board Independence 1</i>	<i>Director Ownership 2</i>	<i>CEO-Duality 3</i>	<i>GIM G-Index 4</i>
Family Firm	1.708*** (3.04)	1.601** (2.47)	1.708*** (2.92)	1.843*** (2.74)
Dual-class Shares	-0.598* (-1.67)	-0.608 (-1.37)	-0.566* (-1.74)	-0.637* (-1.74)
Family Firm x	-0.389**	-0.328**	-0.386**	-0.431*
Dual-class Shares	(-2.08)	(-2.15)	(-2.21)	(-1.92)
Corporate Governance	0.059	0.006**	0.834	0.010*
Variable	(1.07)	(1.98)	(1.21)	(1.71)
Family Firm x	0.528***	0.318*	-0.663**	-0.037***
Corporate Governance	(2.66)	(1.70)	(2.32)	(2.75)
Observations	5,769	5,769	5,769	5,351
R-squared	0.307	0.315	0.307	0.279
Firm, Industry and Year FE	Yes	Yes	Yes	Yes

*Note: This table presents regression results of innovation on various measures of family firm ownership and structure and various measures of corporate governance. Research Quotient (RQ) is the measure of innovation in all analyses. Control variables are omitted for brevity. Each column considers a different corporate governance mechanism. All regressions contain firm and year fixed effects. T-statistics are reported in parentheses. Standard errors are clustered by firm. \*\*\* indicates significance at the 1% level, \*\* 5% and \* 10%.*

## CONFERENCE FORUM DISCUSSION

**Alex Kostyuk:** Hi Brian, I am glad to see you contributing and participating in our conference forum. It was very interesting to see one of the statements by you in your paper: "Managerial entrenchment leads to more productive innovation in general – but not at family firms, suggesting that the family ownership dynamic is what drives innovation, rather than managerial entrenchment". Does it mean that the type of the owner (in this case it is a family owner) allow us outlining a new model of corporate governance matched to the type of the owner (including revising the well-known terms like "managerial entrenchment")?

**Juliet Wakaisuka:** Hello Brian and Jung, I was of the view that ANOVA should be included among the methods so that you test the difference between their means and therefore connect them properly to the issue of family firms generating production innovations than the non-family firms.

**Brian Bolton:** Hi Alex – we keep getting close to actually meeting in person, but, alas, the world has other ideas. First, thank you very much for organizing this conference and getting it to be a beneficial experience; despite what the virus wants (Olha and Kate have done a phenomenal job, too). Now, to your question – yes, that's the key finding. We are working on other studies to study this more and see how robust it is. But we think it's very interesting and promising. For the past 15-20 years, we've thought that "entrenchment" in governance is bad for firm performance or value (with the studies of anti-takeover provisions in the 2000s). Maybe we even started thinking that in the 1990s with studies on CEO-chair duality. We kind of accepted that as general or universal. Then in the past 5 years, a lot of work has focused on specific aspects of governance. And two really good papers on innovation and governance (Sapra, Subramanian & Subramanian, 2014; Chemmanur & Tian, 2017) showed that entrenchment is good for innovation. This is confusing – that entrenchment is good for innovation but bad for value creation. Perhaps it's the time frame; perhaps we're capturing short-term value creation whereas innovation is a long-term process. Or, perhaps there's something in ownership structure that can moderate or manage the entrenchment. My co-author Jung has done a lot of work with family firms, and I remembered decent literature from the 1990s on "relational investing," or the idea that owners are long-term partners in the firm. Well, obviously family firms are the highest form of relational investors, so we chose to focus on that dynamic. And that's what we find – managerial entrenchment leads to greater innovation, in general, as the other papers found, but not in family firms.

**Brian Bolton:** So, yes, I think this means we should be looking at different models of governance, considering other mediators or dimensions that drive differences. We all generally agree that "one size" governance does NOT work or does not fit all. And that's because relationships and people drive governance. We generally agree on best practices in governance (ownership, board independence...), but even that

will be influenced by the contextual background. In our case, we look at family ownership. But legal framework, country factors, industry, and other factors are also very important. And I do believe that this creates many opportunities for us to dig a little deeper into the best practices to explore the governance factors that ultimately drive certain firm behaviors. To me, this is very exciting as we get to look at relationships and tell stories that are more interesting than just looking at overall firm value or performance – but, it also means that we have to be prepared for one dynamic to 'work' in one situation but not in another, and we have to be able to figure out those differences. That is both a responsibility and an opportunity.

**Brian Bolton:** Hi Juliet – thank you for the comment. I know we performed an ANOVA earlier in the research process, and that encouraged us to continue the study and explore the relationships a little deeper. We did not include it in the paper as we focused on the multivariate regressions. But, we can certainly re-create it and add it to the paper as additional support.

**Alex Kostyuk:** Hi Brian, I am sure that someday we will meet in person and discuss this very interesting much promising issues related to "managerial entrenchment". I come with one more idea in this way. I remember that two decades ago, Saul Estrin, who was director of one of Centers for emerging market research at London Business School, gave me an advise what to do with absolutely entrenched directors (CEOs) of Ukrainian, just privatized companies. "You should rotate them more often", that was a suggestion. I remember that Saul supported this suggestion with his research results. Probably, now this is the case too? Do not you think? CEO tenure becomes longer and longer. It is more than 8 years now (<https://www.chieflearningofficer.com/2016/11/30/long-ceos-tenure/>). It is almost one year more than 15 years ago. This could be empirically tested without a problem.

**Brian Bolton:** I love this line of thinking – lots of opportunities. There was a time during the late 2000s when firms were moving away from entrenched directors, bringing in more new and younger directors (in part to comply with new independence rules). That movement has slowed, and I do think we're seeing longer tenures with both CEOs and directors. We can (and should) dig into these trends and see what the implications are.

**Hadfi Bilel:** The subject of governance and especially that which takes into account. The rooting behavior of the leaders always remains a subject of current events that relates to a behavior of expropriation of the wealth of the company generally. The author has tried to investigate the relationship between entrenchment and innovation. It is a good idea for research. I have a proposal for the author if it is possible Brian and Jung in the behavior of entrenchment of the leaders one can find three phases of the strategy of entrenchment leaders: phase 1: valorization (neutral); phase 2: limitation of control (offensive); phase 3: consumption (defensive); if it's possible to estimate the relationship between different phases and the innovation.

**Mireille Chidiac El Hajj:** Hello Brian and Jung, the research is very interesting. It opens doors to a new line of thinking. However, I would like to point to some elements. 1) The slides need some editing. 2) I am not sure if you discussed the ownership of family business in the paper, but it is not obvious in the slides. Therefore, I would suggest that you go back to some authors such as Andres (2008) who argued that the founder should hold 25% of the voting shares; or to Goel (2011) who reduced it to 20%; and then to Block (2012) who argued that it would be sufficient that the founder or the descendant maintains at least 5% of own stake. 3) You compared family to non-family businesses; but you didn't mention in the context: In which country the research took place? In which period of time? Are the firms small, medium or big? Are they listed or not? 4) The results are good, but they are more concerned about the family firms. I didn't see any calculations concerning the non-family firms. Which can have an impact on Hypothesis 1 in slide 9? I nevertheless repeat that the research is very interesting.

**Brian Bolton:** Hello Mireille – thank you for these comments. Many of these issues should be clear in the paper: large listed U.S. firms, 2000-2010. We indeed use the 5% threshold as the definition of a family firm – this has been the standard with U.S. firms since Shleifer and Vishny (1986), at least. A more generous definition of "family firm" is necessary for U.S. studies since we do not have as many truly family firms as many European and Asian countries – a company like Facebook isn't necessarily what we think of as a family firm, but it meets the requirement. And, to (4), the tests we perform focus on family firms simply because that's where we think the interesting story is. In the multivariate regressions, we code firms with a 1 if they are family firms and with a 0 if they are not family firms. We could have just as easily applied the opposite coding and focused on non-family firms. The interactive terms in the regressions capture this distinction, looking at whether a particular factor has a greater impact (or significance) at family firms relative to non-family firms. That is, the default or baseline comparison is to non-family firms...because, by definition, in our study if a firm is not a family firm it is a non-family firm. Thus, if we find that a factor within a family firm is significantly different, we could just as easily say that that factor is significant at non-family firms, just in the opposite direction. The perspective we chose was simply to better address our specific research questions.

**Brian Bolton:** Hi Hadfi – thanks for the suggestion. We have not included this perspective on leadership entrenchment as neither of us is particularly familiar with it. But you're right – it might be interesting to see if the entrenchment issues we find are driven by phases of the leader as opposed to the ownership structure of the firm. We used a definition of "entrenchment" that has been popular in the finance and strategy literature over the past 20 years – but of course, there's more that we could have done. We will look into these phases of a strategy of entrenchment perspective to see if there's anything we can do with it.

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## 2.3. CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES: CARRIS COMPANY CASE STUDY

Joana Andrade Vicente \*

\* Lisbon School of Economics and Management, University of Lisbon, Portugal

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### Abstract

This paper analyses state-owned enterprises' (SOEs) corporate governance, addressing whether there are differences between these and private enterprises that makes it necessary to formulate a specific corporate governance theory for the former. This will be achieved through a case study based on Companhia Carris de Ferro de Lisboa S.A. company ("Carris"), according to its legal status until 2017, i.e., until it was transferred to Lisbon City Council jurisdiction. Topics such as the multiple principals' problem, inadequate compensatory allowances, financing model, and public managers recruiting process will be addressed.

Due to their importance and impact in society and public finances, and the specific characteristics that they present, SOEs should be treated differently. Carris company case study enabled to confirm that there are indeed differences between private and SOEs. The latter have a different legal status, more volatile operating goals, soft budget constraints, lack of public service contracts (and consequent mismatch of the corresponding compensatory allowances due for the public service provided), and different criteria for professional appointment and selection. More importantly, they suffer from the multiple principals' phenomenon: multiple principals, multiple problems.

It is, therefore, recommended some changes regarding SOEs' corporate governance, such as: incorporation of the comply-or-explain principle, introduction of a code of best practices in the public managers' appointment process, and contractual arrangements regarding the public service provided, with multiannual allocation of the corresponding compensatory allowances.

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## 1. INTRODUCTION

Bearing in mind the need to contain public expenditure and avoid tax burn increases, there is great urge to adapt corporate governance practices to SOEs, which is a fundamental element to reinforce SOEs performance and competitiveness in the long run, to ensure better management and efficiency, and to reduce potential distortions in the market (Shleifer & Vishny, 1997; OECD, 2015).

This paper intends to address a simple key question: are there any significant differences in public and private companies' governance that require different corporate governance techniques depending on the type of companies? To answer that, it will be performed an analysis of the governance of companies belonging to the Portuguese public business sector, which encompasses the state, local and regional business sectors. The case study will lie on a Portuguese road transport SOE, Companhia Carris de Ferro de Lisboa S.A ("Carris"), focusing on the period until 2017 (when Carris was still part of the state business sector – afterwards, it was transferred to the local business sector).

The paper is structured in three main sections: the first one addresses SOE's importance to the economy and their particularities; the second focuses on Carris case study; and the third one proposes recommendations on what should be implemented in the governance of non-financial SOEs and discuss the conclusions.

## 2. CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES: WHAT MAKES THEM SO SPECIAL?

SOEs have great significance for the economy and society, reflected in their provision of public service, presence in international trade and infrastructure industries, and weight in GDP and employment (Christiansen, 2011; OECD, 2012; Kowalski, Büge, Sztajerowska, & Egeland, 2013). They can have a very expressive impact on public finances, whether through the compensatory allowances receive, capital endowments, loans granted, or debts assumed.

There are, indeed, differences between state-owned and private companies' corporate governance. SOEs have specific characteristics that makes them unique: more complex and sometimes contradictory operational purposes, exposure to softer regulatory restrictions, little competition and lack of rigor in professional selection (Filho & Picolin, 2008; De Miranda & Amaral, 2011; OECD, 2015). They also have privileged access to information and financing resources, have multiple control legislators, are constantly subject to political interference and are often protected against acquisitions and insolvency proceedings (Forfás, 2010). And one must not forget the soft budget constraint problem, where the state acts as an insurance company: managers know *ex ante* that they will receive *ex post* financial assistance from the state, if needed, meaning that they do not have the right incentives regarding management, not worrying much about making efficient decisions, because they know that the future is somehow assured (Vahabi, 2012).

And we still need to consider the multiple principals' problem. Usually, the bilateral relation between the agent (who manages the risk) and the principal (who bears it) it's not easy. But SOEs have an increased problem because they have a set of principles. Each one can supervise the work being done by the bureaucratic agent, to reduce information asymmetries and offer incentives. However, there is a mitigation of control due to problems of collective action created by the dissemination of control and supervision authorities, which enhances free-rider actions (Foresberg, 2006; Gailmard, 2009). In addition, principals have different goals and perspectives over the agent, which means that one cannot treat this as a simple bilateral problem between principal-agent (Dixit, Grossman, & Helpman, 1997).

### **3. GOVERNANCE OF THE STATE BUSINESS SECTOR: CARRIS COMPANY CASE STUDY**

Carris' main task is to explore land transport concessions carried out by the state or local authorities, promoting social well-being and sustainable mobility. Being a SOE, does it also face some of the problems previously mentioned? Does it have multiple principals that mitigate efficient control? Does it have agreed contractual terms that ensure an adequate level of compensatory allowances? Does it have a fair public managers' appointment process or there is a relation between those appointments and the political cycle?

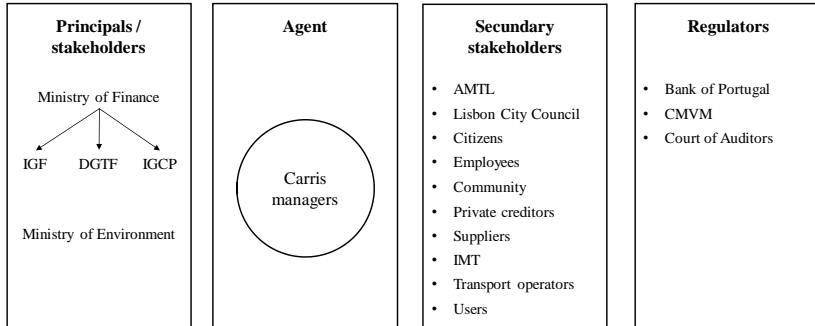
#### **3.1. Carris' multiplicity of principals**

Regarding Carris' external governance structure, the main bodies up to 2017 were: Directorate-General for Treasury and Finance (DGTF), as the shareholder; Ministry of Finance, as the financial authority; Ministry of Environment as the relevant sectoral authority; and the Institute for



Mobility and Transport (IMT) as a regulatory body. Some of these acts as principals and stakeholders, and others only as secondary stakeholders (Figure 1).

**Figure 1.** Carris' principals, stakeholders and external regulators



*Notes: Portuguese Inspectorate-General for Finance (IGF), Portuguese Treasury and Debt Management Agency (IGCP), Lisbon Metropolitan Transport Authority (AMTL), Portuguese Securities Market Commission (CMVM).*

*Source: The author's elaboration.*

This multiplicity of principals creates problems and is partly due to the lack of relation and communication between them, which leads to conflicting and disconnected goals imposed on the SOE (Dixit, 1998) and ineffective control. The swap contracts case is a good example. Carris carry out swap contracts, starting from 2005, to set interest rates. At the time, they were steadily rising, and the expectation was that they would continue to do so. However, these expectations were not met, and interest rates started to fall sharply from 2008. Carris started then paying a lot more interests for having its fixed rate (Tribunal de Contas, 2013). The question is: who regulated the contract of these instruments? No one took full responsibility.

The work developed by the Parliamentary Inquiry Commission (2014) showed the following chain of disclaimers:

- The Court of Auditors stated that it had warned Carris that careful management was necessary, disclosing that the lack of a visa regarding these contracts constituted a violation.
- CMVM stated that these contracts assumed authorization by the Bank of Portugal and supervision by CMVM.
- Bank of Portugal argued that the regulation and supervision of swap contracts are excluded from its supervision powers.
- IGF issued alerts on the use that Carris was making of these instruments and projected recommendations, which did not include a prior control and authorization mechanism, because it was DGTF's responsibility.

- Until 2009, SOEs did not need to reveal the true value of these instruments, so it would be difficult for DGTF to quantify their true financial impact.

- As for IGCP, only after 2012 did it become responsible for the management of the derivatives portfolio of companies within the public business sector.

The result was the dismissal of public managers involved in the negotiation of these contracts, including the chairman of Carris' Board of Directors at the time, for alleged engage in speculative and unbalanced swap contracts.

### **3.2. Providing a public service without its contractual binding**

SOEs that provide services of general economic interest must present a plan with proposals for its contracting. It is then the responsibility of the sectoral Ministry to define the level of public service to be provided, so the corresponding compensatory allowances can be transferred. These allowances reimburse companies that jeopardize their economic and financial viability by providing public service, applying tariffs below market prices to extend goods and services to a greater part of the population.

Despite Carris provision of public service, it has consistently suffered reductions in the compensatory allowances received for that service. After 2014, it completely stopped receiving any. The discrepancy and mismatch between the financing needs arising from the provision of the public service and the compensatory payments received (which never reached the amount proportional to the losses resulting from tariff impositions) directly aggravated the public service exploitation deficit and Carris dependence on indebtedness (Tribunal de Contas, 2009).

The lack of a contractual proposal regarding the public service violates national and community law, jeopardizing the company's future viability. What we see is an annual negotiation between Carris and the financial and sectoral authorities, to outline the amount to be assigned as compensatory allowances. Additionally, these payments are only paid in December, which implies a public service compensation deficit throughout the respective year.

### **3.3. Finding the right person for the job or the most convenient?**

By linking the composition of Carris' Board of Directors and the political party in power at the time, we can observe that it suggests some association between the nominations and the political cycle, meaning that when changing from a government to another, there are some significant changes in the composition of the board (Table 1).

**Table 1.** Carris’ Board of Directors and respective political cycle

<i>Government</i>	<i>Mandate</i>	<i>President</i>	<i>Member</i>	<i>Member</i>	<i>Member</i>	<i>Member</i>
Social Democratic Party/CDS (2002-2004 & 2004-2005)	2003-2005	José Rodrigues	Jaime Quaresma	Augusto Proença	António Silva	José Oliveira
Socialist Party (2005-2009 & 2009-2011)	2006-2008	José Rodrigues	Isabel Antunes	Maria Rocha	António Silva	Joaquim Zeferino
	2009-2011	José Rodrigues	Isabel Antunes	Maria Rocha	Fernando Silva	Joaquim Zeferino
Social Democratic Party/CDS (2011-2015)	2012-2014	José Rodrigues (until June '13)	Pedro Bogas	Luis Barroso	Maria Figueiredo	-
	2015 <sup>1</sup>	Rui Loureiro	Pedro Bogas	Tiago Santos	Maria Figueiredo	José Roque
Socialist Party (2015-2019)	2016 <sup>2</sup>	Tiago Farias	José de Matos	Luis Barroso	Maria Campos	António Pires

*Notes:* <sup>1</sup> The development of new transport policy, based on the transition of the operational supervision of urban transport from the Ministry of Economy to the Ministry of Environment at the end of 2015, dictated the need to appoint a new team for the Board of Directors.

<sup>2</sup> This composition of the Board was valid for the 2016-2018 mandate. Notwithstanding, given the municipalisation of Carris at the beginning of 2017 (period after which we will not analyse in this paper), new elections were held.

Source: Carris. (n.d.).

Positively, it should be highlighted the absence of politicians or ministers as members in any of the mandates, as well as the consistency in the Chairman of the Board over a decade, from 2003 to 2013, and in different political cycles. However, as it can be perceived, the same consistency is no longer observed in the remaining members.

#### **4. FINAL CONSIDERATIONS: RECOMMENDATIONS FOR SUITABLE CORPORATE GOVERNANCE OF PORTUGUESE SOES**

It was possible to conclude from Carris company case study that it was the existence of social tariffs (which from a commercial point of view is not profitable) associated with 1) a lack of definition of the compensation criteria for the public service provided; 2) the persistence of negative net results; 3) the absence of an adequate financing model, that made Carris unsustainable and detrimental to public finances.

We need to consider that SOEs impose costs on public funds, namely through compensatory allowances that directly affect the public administration budget, and the assumption of liabilities that affects public debt (Pereira, Afonso, Arcanjo, & Santos, 2009). Hence, greater

attention to their corporate governance techniques is necessary. As SOEs are subject to soft budgetary constraints, multiple principals, lack of rigor in the criteria for professional selection, imbalances in the State's shareholder and public responsibility functions, and more inconstant operational goals, it is necessary to apply a different corporate governance model, more specific to their characteristics.

The following set of recommendations has the power to identify critical elements that need change to improve SOEs' management and accountability. The goal is to help developing a regulatory framework on SOEs' corporate governance that ultimately will lead to better adequacy of corporate governance to the Portuguese SOEs. From the possible recommendations, the following ones should be highlighted:

- Implementation of the comply-or-explain principle (Pinto et al., 2013) to increase SOEs' accountability. There is no point in setting high-efficiency standards and governance rules if they do not comply without any type of penalty. This presents itself as a discouragement to good behaviour.

- Creation of a coordinating or centralized entity (OECD, 2015), as a way of solving, in part, the multiplicity of principals' problem, by requiring greater articulation between different entities, so that there is neither a gap nor overlapping of functions. That should act as a practical tool for the management and oversight of SOEs, helping the state to manage its roles as regulator, shareholder and service provider. The technical unit for monitoring the public business sector, created in 2013, is not yet efficient in that mission, and still falls short of its potential.

- The imposition of stricter budget restrictions, which highlights the need to diversify sources of financing (besides tariffs and compensatory allowances), especially for those providing public service. Budgetary restrictions should be imposed to prevent excessive levels of debt and operational deficit.

- The imposition of the contractual relationship between the state and SOEs that provide services of public interest (according to what is specifically expressed in national and community regulations), so that the latter can be adequately compensated. It is also necessary to improve the adequacy of the formula for calculating these payments, so as not to pay inefficient management nor make the provision of the public service unfeasible. Additionally, the payments should be allocated on a multi-annual basis and in regular instalments throughout the year.

- Creation of a Code of Good Practices for the appointment of public managers and an independent position that guarantees its compliance, alongside the work developed by CRESAP (Recruitment and Selection Committee for Public Administration). The goal is to reduce political favours and obtain a more objective and transparent selection process, subject to public scrutiny.

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## CONFERENCE FORUM DISCUSSION

**Alex Kostyuk:** This is a very interesting paper, Joana. Finally, the issue of SOE governance is still not resolved worldwide. You fixed the most important idea of your paper – “It is necessary to apply a different corporate governance model”. What elements of this model of corporate governance of SOE make it different from those applied by private companies?

**Joana Andrade Vicente:** Hi Alex! The problem of SOEs governance is not indeed resolved worldwide, and Portugal is no exception. SOEs show very specific characteristics (they cannot be resumed to a ‘normal’ private company), and those need to be considered when defining the governance of the company. In my opinion, there are 3 main elements of the SOEs corporate model that significantly differ from the one applied by private companies. First, they are subject to multiple principles distributed among the management, control, supervision and accountability powers, and those entities do not have good communication among themselves and sometimes not even a good relationship, so the SOE sees itself facing disconnected and conflicting goals allied to ineffective control. To ease that problem, it should be created and implemented a coordinating/centralized entity to oversee the SOE and help the shareholder (the State) to manage its different roles (regulator, shareholder, service provider). Second, some SOEs are in charge of providing a public service, and for that they need to follow

stipulated requirements from the sectoral Ministry, such as applying tariffs below market prices. And many times, we see that there is no real contractual binding of this public service, so the corresponding compensatory allowances are not paid or are paid in a level substantially lower than they should be. That problem – providing a public service without its contractual binding – is a problem very intrinsic only to SOE, a problem that highly jeopardizes their economic and financially viability. This means that SOEs must rethink their financing model. Finally, it is especially on the SOEs that one needs to ensure that there is no link between the appointment process of managers and the political cycle, to ensure better management and total independence and transparency. To ensure that, Portugal created an entity (CRESAP) to monitor the choice of SOEs' management positions, but since its opinions are non-binding, it lacks the power that it should have (and, additionally, its appointment is not totally independent from the government).

**Mbako Mbo:** It is very interesting when entities fail to realize the need to accept politics and manage them than trying to ignore their existence and fail badly. So, a governance model really starts with the appointing authority (if it is by a centralized entity as is the case in my jurisdiction), the ability of that entity to manage politics then matters. It then boils down to a criterion that lays down the basics (reconcile stakeholder&agency, but recognize and manage public choice). Then seal it off with enforceable performance compacts, drawing from reputable corporate governance codes, in my jurisdiction we adopt the King III code.

**Joana Andrade Vicente:** Hi Mbako Mbo! Thank you very much for your comment. Can you please tell me what is your paper (with the two case studies)? In fact, I think that case studies on this topic can be very enlightening because they show with no doubt that corporate governance theory applied to private companies cannot be directly applied to SOE! And by failing to recognize that, it will only lead to bad quality management and the SOE will not achieve its highest potential. I am sure that your 2 case studies had similar findings, because this is not a problem only observed on Portuguese SOEs. Like you said, trying to ignore the problem (existence of politics in the SOEs' boards, poorly oversight performance, not an appropriate reconcile among stakeholders & agency) will only lead to a worse situation. And the ability of the entity who has the appointing authority needs to be taken into account because someone has to be accountable for the decision and supervision. In fact, in my jurisdiction, we also have like a Code of Good Corporate Governance Practices, but it is designed by a private non-profit association, so it's not something we can bind to the appointment authority unfortunately and it's not even specifically for SOEs matters.

**Max Alberto Galarza Hernandez:** The paper states that ".....it is necessary to develop and implement a Code of Good Practices in the public managers" appointing process, also creating an independent



position to regulate and enforce compliance with that mandatory code." Question: Is there any good corporate governance questionnaire? I mean in order to implement a Code of Good Practice for a public manager, you need to seize it first. How can you measure it? You should have a validated questionnaire, don't you agree?

What I have seen is a corporate governance compliance questionnaire the so-called CGCQ, but I have not found yet a good corporate governance questionnaire. Would you please provide info?

**Joana Andrade Vicente:** Hi Max! Thank you very much for your intervention. All comments are welcome, to improve research. I see your point... but the fact is that to have a good questionnaire, first you should have a code of good practices regarding corporate governance to follow. Only then is it possible to assess if the Code is being or not accomplished (through a questionnaire, for instance, like you stated)? You already have respectable examples of Codes of Good Practices applied to general corporate governance (for instance, from OECD, and many at the national level, as the Code of Practice for Ministerial Appointments to Public Bodies from the UK), where you can base your questionnaire. But the same does not happen for SOE (yes, you also have guidelines from OECD, but at the national level there is few guidance).

In Portugal, for instance, there are good questionnaires being made, but on the private companies' sphere. For example, you have this one (only in Portuguese, sorry) applied to companies of the insurance sector, which is based on the set of good practices disseminated in documents issued by OECD and the International Association of Insurance Supervisors:

<https://www.asf.com.pt/winlib/cgi/winlibimg.exe?key=&doc=15365&img=1746>

**Hadfi Bilel:** The subject of governance is a very important field in research and especially when we talk about public governance where companies are governed by the state and we must arrive at different results and in the long term. Also, regularity, control, monitoring, limiting conflicts and operational risks are always the objective for government ownership.

**Joana Andrade Vicente:** Hi Hadfi! Thank you very much for your support. I also share your opinion on the importance of corporate governance especially regarding SOEs, because their mission and goals usually have increased importance when compared to private companies. SOEs are essential to provide public goods and services, to fight market failures, and to operate in industries with important spillovers. Its supervision and good management are essential because it can compromise public finances and in the end, it is our money (taxpayers) that is being invested.

**Max Alberto Galarza Hernandez:** Hi Joana, this is the same weir situation when they ask you what came first the chicken or the egg. Let me tell you that first time I read of the corporate governance term was in



2016 and it came from King IV report from South Africa, which meant that the egg (or chicken) came from there a long time ago, that late document struggled with the concept for standardization and a Code of Good Practices as proposal. What I am trying to say here that it's a matter of time and patience to see the GCGQ questionnaire unless one start hatching it. Thank you very much for your input on the CGQ, I appreciate. It was quite ease to read, fortunately, Portuguese is a broken Spanish.

**Omrane Guedhami:** Hi Joana. This is an important topic given the role of state ownership around the world. In addition to the separation problem you identified based on Shleifer and Vishny, managers of SOEs are insulated from markets mechanisms, leading to more severe agency problems (see *Boubakri, N., Cosset, J. C., & Guedhami, O. (2005). Postprivatization corporate governance: The role of ownership structure and investor protection. Journal of Financial Economics, 76(2), 369-399*) I think your paper would benefit from discussing the advantages and disadvantages of state ownership. See *Boubakri, N., El Ghouli, S., Guedhami, O., & Megginson, W. L. (2018). The market value of government ownership. Journal of Corporate Finance, 50, 44-65.* In this paper, we find that the tradeoff between the benefits and costs of state ownership suggests a nonlinear relation between state ownership and performance.

**Joana Andrade Vicente:** Hi Omrane! Thank you very much for your comment. The fact that SOEs' managers are insulated from market mechanisms this sure leads to more severe agency problems that can have regional or even national impact on public finances. Your suggestion of addressing the advantages and disadvantages of state ownership is very interesting for future research, and it can even be an extension of this case study. Because the company in question was transferred from the state business sector in 2017 to the local business sector, and privatization was also above the table. so, better research and evaluation of the advantages and disadvantages of that choice would be very interesting.

**Mireille Chidiac El Hajj:** The paper is very interesting. I think that the main problem in SOEs is that they cannot exercise independent judgment if only politicians or those who serve them are allowed to sit on their boards. Therefore, it will serve to appoint independent or external neutral directors who can take decisions freely. Another problem can occur when employees are misrepresented. They should nominate some representatives to enhance their board representation. Not to forget that they are the citizens' voice.

## 2.4. RUNNING A SUSTAINABLE STATE-OWNED FINANCIAL INSTITUTION

Mbako Mbo \*

\* Former Chief Financial Officer and Chief Risk Officer at Botswana Development Corporation; Alumni of the University of Stellenbosch Business School

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### Abstract

Public finances face ever increasing priorities, private financiers are dealing with a rapidly changing credit risk landscape at a time when investor returns are under a microscope. This leaves a gap which Development financial institutions (DFIs) are filling, thus projecting their continued importance in the modern world, particularly in developing countries and economies in transition. DFIs are often seen as unsustainable burdensome institutions for governments to own. This normally stems from the fact that their financing structures are often vaguely understood, adding to their ill-defined objectives. This paper concludes that the type and cost of capital available to DFIs is fundamental determinants of how effectiveness a DFI becomes, and proposes a framework for sustainably raising and applying capital according to specific objectives.

### 1. INTRODUCTION

Development finance, as an alternative source of investment funds, is a concept gaining widening attention. This is propelled by DFIs, which Calice (2013) defines as 'an institution which is majority owned by the government and that has an explicit legal mandate to foster economic and social development in a country, sector or target market, mainly by providing investment finance' (p. 3). DFI's often carry a dual mandate infusing commercial outcomes with social development impact.

In the context of developing countries, a wide range of development needs continues to impose a widening gap between private sector

financing interests and public sector budgetary possibilities, thus emphasising the basic importance of DFIs.

The basic operating model of financial institutions entails sourcing funds for the purposes of lending and investing for a return, wherein sustainability is additionally supported by re-investing internally generated profits (Duraj, Imeraj, & Moci, 2013). DFIs face challenges in raising funds, and this is complicated by increasing competition for allocations from national budgets, despite pressures to prudently apply profits, if any.

## **2. DRIVERS OF PROFITABILITY IN A FINANCIAL INSTITUTION – DO DFIS FIT IN?**

A number of researchers in this field have dissected factors affecting the profitability of financial institutions into two broad categories: external and internal factors (Kamran, Yaseen, Ashraf, & Haroon, 2016; Duraj & Moci, 2015; Revell, 1979).

Management quality, portfolio mix, loan concentration and the extent of customer deposits within an institution's liability book are the most commonly cited determinants of profitability (Kamran et al., 2016; Zimmerman, 1996). On the other hand, trends in local gross domestic product (GDP), inflation, capital availability, regulatory and other economic pressures are commonly cited as those external factors with a bearing on the profitability of financial institutions (Revell, 1979; Perry, 1992). DFIs are not immune from most of these factors.

According to Duraj and Moci (2015), management's quality determines the strength of institutional policies, commercial decisions, objectives, choices and actions all of which translate into operational results. In extending this view, Zimmerman (1996) stresses the role of quality management in dealing with portfolio concentration related risks and their impact on institutional performance. The unique process by which state-owned DFIs appoint managers, therefore, must remain under scrutiny.

External factors, however, can exert themselves beyond management control. Whilst management may make macro-economic assumptions when planning (Perry, 1992), reality may turn out differently (Revell, 1979) and significantly compromise earlier decisions. A slump in economic activity usually translates into reduced spending activity and demand for credit, diminished disposable income, job losses all with a significant and negative impact on portfolio quality of financial institutions (Sturm & Sauter, 2010; Khamis & Iossifov, 2009). All these factors combine to contribute to an upsurge in non-performing loans (NPLs) and actualised credit losses. High economic stress levels, on the other hand, lead to constrictions of the capital markets, wherein lending

may become stringent or capital simply becomes unavailable (Khamis & Iossifov, 2009).

The case of state-owned DFIs has additional considerations; though expected to make some profit, they are not purely profit-centric, and may be expected to carry low to zero profit investments, the non-commercial aspects of their operations directly constrain their ability to freely raise adequate capital from the market place, their risk profile, as influenced by their usual low portfolio quality exposes them to the high cost of capital and the government as the sole owner has different and often unclear expectations compared to private investors holding ownership to commercial financial institutions.

Thus, within the context of what drives profitability in financial institutions, a refocus of the discussion to the specific case state-owned DFIs projects three key factors: 1) the two-pronged objectives; 2) the availability and cost of capital; 3) the implications of state ownership, all of which will have a direct bearing on financial performance.

*The two-pronged objectives:* Economic and social objectives potentially clash when pursued by the same enterprise. Social objectives, in the context of DFIs, are usually accepted to have no commercial return, and is a very broad and potentially vague concept which extends to include job creation, provision of rural infrastructure, supporting education and construction of social facilities and amenities.

*The availability and cost of capital:* Credit quality, determined by the strength of a borrower's balance sheet, portfolio quality, management quality, investment return prospects, among other factors, are key determinants of the ability for a non-banking financial institution to raise optimal finance from the market place.

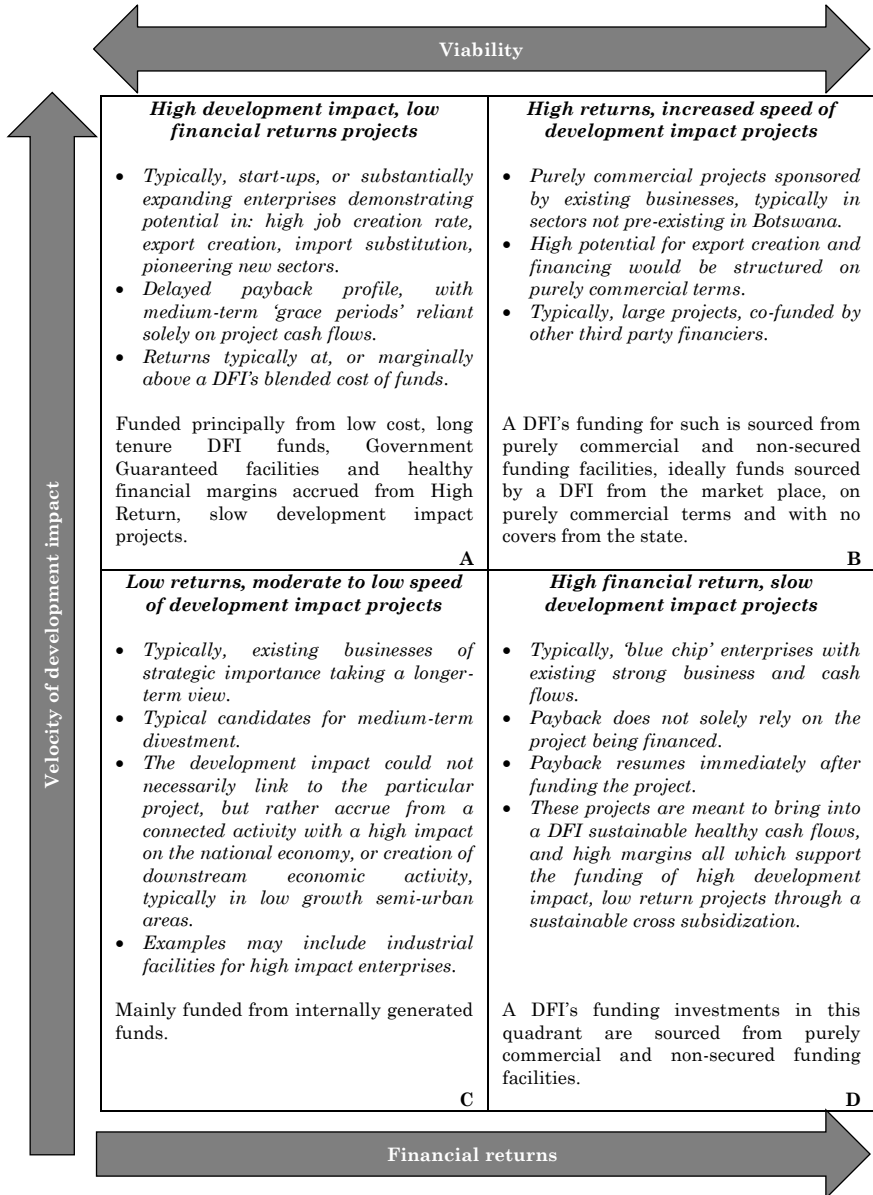
*The implications of state ownership:* Privately owned commercial financial institutions, unlike DFIs, have clearly articulated profit-orientated objectives, attained through purely commercial investments. On the other hand, SOEs are known to be modelled around political cycles (Aharoni, 2000), often faced with ambiguous two-pronged objectives (Shirley, 1998).

### 3. A SUSTAINABLE FRAMEWORK TO FUND DFIS

While state support remains critical for DFIs, state resources are finite, as such state support should be complemented by funds from the credit markets, and profits from commercial investments should support low return investments, in the long run.

Figure 1 below presents a framework on how this needs to be achieved.

**Figure 1.** A proposed framework for DFI sustainable funding



#### 4. THE MODEL EXPLANATION

*Quadrant A:* This represents investments with high and demonstrable development impact, but low financial returns, and would ordinarily carry the tag 'development projects. Examples include infrastructure projects and business start-ups.

*Quadrant B:* These are high return investments, but with demonstrable ability to spur high development impact within a short to medium-term period. Such could take the form of venture capital interventions.

*Quadrant C:* Low return, low development impact would typically be held for strategic reasons. Such include old equity investments that have outlived their time frames and outgrown by the DFI overtime, hence held just for strategic reasons, otherwise ideal for divestment to the private sector.

*Quadrant D:* These are investments with a high financial return, but unlike those in quadrant B, the development impact is minimal. They subsidise those with high development impact with low financial returns.

#### 5. CONCLUSION

This paper explores the two-pronged nature of DFI objectives and the possibility of making profits under state ownership. The paper appraises the importance DFI's despite a generic mandate and highlights a theoretical framework in the context of which the subject needs to be looked at, particularly with the state ownership dynamic in mind. It is evident that state ownership introduces some uniqueness to the type of financial institutions DFIs are, with a direct bearing on their operational models, if sustainability is to be ensured. The type and cost of capital available to a DFI emerge as a fundamental determinant of how effective a DFI becomes, measured from the perspective of the two-pronged nature of their objectives. Consequently, a proportionate mix of investment capital availed to the DFI has to be guided by the targeted mix, by investment type within the DFI's pipeline of investments. The paper proposes a model by which this can be achieved.

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## CONFERENCE FORUM DISCUSSION

**Mbako Mbo:** Development Finance Institutions continue to play a critical gap filler role in developing economies, wherein they supply critical capital for investments governments have no resources for, yet the private sector has no appetite for. Such investments nonetheless are of critical developmental necessity, but in most cases carry a social aspect objective that makes raising adequate finance from the credit markets a daunting task. State ownership often complicates this further, particularly from a governance lens. This paper highlights the intricacies involved and projects a framework for sustainable funding under state ownership.

**Alex Kostyuk:** Hi Mbako, you have outlined for discussion a fundamental issue of corporate governance. What is a more effective type of ownership – private or state? The cost of corporate control is a key issue. My point of view helps me concluding that state-owned enterprises, especially financial companies, should guarantee absolute transparency and accountability to the society, else the SOEs will be distrusted by the public that will make them not effective. What is your vision of how to strengthen transparency and accountability in SOEs in the financial industry by applying corporate governance mechanisms? Are any specifics of the country you investigate?

**Mbako Mbo:** Interesting questions (and insights really). First, private ownership can generally be regarded as more effective and this is assisted by the fact that objectives are clear cut; shareholders are known and have a face, performance targets are clear, stakeholder mapping is relatively easy. Under state ownership it is quite different; the representative shareholders are not necessarily the ultimate, stakeholders are diverse and interests are often in conflict, objectives can be quite vague. So, as you rightly say, transparency and accountability are what can improve governance in a state-owned financial institution. The use of the private credit market is one such tool that brings governance discipline. Just to give a typical example; issuing listed bonds and getting a Moody's rating has come with enormous governance asks that significantly dilute undue political interference that is normally associated with state ownership.

**Alex Kostyuk:** I find your answer very contributive, Mbako. What do you think about the status of directors of the board of such SOEs? I mean those who are independent directors? Do not you think that exactly this mechanism of corporate governance would guarantee proper transparency and accountability? As always, this is a problem for developing countries because of the weak development of the national market for independent directors and as a result, SOEs ask for foreign independent directors? What is your vision of this case?

**Mbako Mbo:** My response will be very similar to a contribution I just made to Joana Andrade Vicente's paper on corporate governance of



SOEs. There are many cases where independent boards are a mere extension of political power, and research has linked such to failure. But where there is a laid down process of appointing boards, and evaluating their performance vs. that of the company – mostly through a specialized entity set up for that, outcomes are good. Even then, though, it remains quite important to accept that there will be political influence so that it can be managed, trying to deny or totally block it often leads to total lack of support from the 'shareholder'.... and we often hear of 'the state having fired well-performing boards'.

**Alex Kostyuk:** I see your way of thinking, Mbako. The final issue we need to fix here is the issue of legislation. Civil law or common law...where is the vision of SOEs governance described above better implemented?

**Mbako Mbo:** In most cases, each SOE has its own piece of legislation establishing it, but provisions are broadly the same, and largely vague, leaving much power to the Board, which get appointed politically. This is what can then be fixed, just have one unified legislation that borrows broadly from company law.

## 2.5. FROM NON-PROFIT ORGANIZATIONS TO MULTI-STAKEHOLDER SOCIAL ENTERPRISES

Ermanno Celeste Tortia \*

\* Department of Economics and Management, University of Trento, Italy

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### Abstract

This paper briefly outlines the main interpretive keys that can be used to understand as traditional non-profit organizations (NPOs) underwent a long-lasting evolutionary process and were transformed step by step into new organizational forms characterized by social orientation like traditional NPOs, but by stronger entrepreneurial propensity. The specialised literature analysed the important cases of entrepreneurial non-profit organizations, of social enterprises (SEs), of social cooperatives and eventually of multi-stakeholder SEs, which can be considered the final stage of this evolutionary process. In the empirical part, the paper strives to describe and discuss the multi-stakeholder characterisation of one specific form of multi-stakeholder SEs in one single country, that is the social cooperative (SC) in Italy. Survey data show how SCs: factor in their entrepreneurial action: 1) the interest and welfare of clients/users and beneficiaries, even when these stakeholder groups do not hold decision making power (do not partake membership rights and do not sit in the board of directors of the organization); 2) explicitly consider clients/users' need satisfaction and quality of services as their most relevant objectives; 3) distribute resources underprice or free of charge to clients, users and beneficiaries.

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## 1. INTRODUCTION

Hansmann (1988, 1996) states that the ownership of enterprise is assigned to the stakeholder group that minimizes the total sum of the costs of transaction attached to the working of the organization, that is the costs of market contracting with all the other patrons (stakeholders) plus the costs of ownership. In this perspective, multi-stakeholder governance faces a double disadvantage in minimizing the total sum of costs because it compounds the costs of interaction between different stakeholders (e.g., the costs of striking agreements between different objectives pursued by different stakeholders) and because it may not be able to select the stakeholder group that is best able to minimize ownership costs (that is, it inflates costs of transactions because it is not able to select the most efficient solution). This viewpoint is coherent with the orthodox idea that, as a rule, the market for capital is characterized by stronger imperfections than the other markets (labour, raw materials, sales, intermediate goods, etc.). Investor ownership is the dominant solution in decentralized market economies because it represents the institutional solution that best protects risky financial investments against the danger of non-investor stakeholders exploiting opportunistically such investments. The strong focus on one market only (the market for capital) and on its failures also results in considering mono-stakeholder solutions (ownership solutions in which only one patron controls the organization and holds residual claims) as the only viable governance solution. The possibility of multi-stakeholder governance is excluded with scant justification, based on the simplistic idea that governance costs in terms of decision-making costs and interaction costs would be inflated relative to a mono-stakeholder solution. On closer scrutiny, however, the possibility that several markets fail at the same time, increasing this way the costs of contracting with different stakeholders (e.g., investors, employees, clients, etc.) can open new room for the development of multi-stakeholder governance, whose relevance is under-estimated and under-researched to date. When multiple markets fail at one and the same time, contractual costs are high in more than one market and mono-stakeholdership may not guarantee efficiency (Borzaga & Sacchetti, 2015; Sacchetti & Borzaga, 2017).

The process of emergence of multi-stakeholder governance, though, is complex and not uncontroversial. As a theoretical starting point, we take Hansmann's (1988, 1996) definition of non-profits as organizations

without owners. The exclusion of property rights in terms of both residual control rights and appropriation rights allows this kind of organization not only to receive charitable donations but also to reduce other potential failures in their relations with other stakeholder groups, especially clients. In this case, the contractual failure relates to asymmetric information in the production of services whose quality cannot be predicted in advance and is not easy to evaluate by clients (Blandi, 2018). Contractual costs are expected to be particularly high in the case of care, health and educational services because of asymmetric information and of the relational and non-standardised nature of such services. Owners would have an incentive to exploit such imperfections to their advantage, to increase profits. The non-profit distribution constraint (NDC), by preventing private appropriation of surpluses, has the additional positive feature of favouring strengthened trust between the organization and its clients (Hansmann, 1988, 1996).

Adding up to Hansmann's approach, in a new perspective envisaging the emergence of multi-stakeholder social enterprises, the governance structure plays a crucial role as it defines the ability of organizations to manage multiple relations with positive outcomes (increasing benefits without exceedingly inflating costs) (Borzaga & Defourny, 2001; Borzaga & Tortia, 2017). Non-profit organizations are led by trustees who are in charge of achieving the organization's goals. Multi-stakeholder social enterprises are run by directors who represent stakeholders' multiple and potentially conflicting objectives. Trustees can be more effective in implementing decision making processes since they mostly represent donors and pursue increased welfare for beneficiaries. Multi-stakeholder governance (MSG) can be effective when it is able to achieve an entrepreneurial synthesis or virtuous compromise between the different values, motivations, objectives, or when it is able to convert (again through virtuous compromises or synthesis) stakeholder objectives into societal goals (e.g., concerning social or environmental sustainability). In this, the imposition of the NDC characterising multi-stakeholder non-profit firms and the emerging form of the multi-stakeholder social enterprise can help to foreclose the pursuit of self-seeking objectives to the detriment of users/clients and beneficiaries. As said, the multi-stakeholder solution can be viable and effective when it is able to reduce contractual failures (reduce contractual costs) by internalizing these failures within the organizational boundaries, while, at the same time, producing a positive surplus by developing dedicated entrepreneurial and organizational patterns. The process of creation of multi-stakeholder social enterprises led, in some countries such as Italy, to an organizational model in which the possibility of active participation of different groups of patrons is explicitly recognised by law, while, at the same time, the non-profit and socially-oriented nature of the organization (in Italy an explicit social objective for social cooperatives and other

forms of social enterprises is required by law) adds further guarantees in favour of those stakeholder-patrons that may not hold decision making power, especially donors, beneficiaries and client/users.

## **2. EMPIRICAL EVIDENCE: MULTI-STAKEHOLDER GOVERNANCE AND CLIENT ORIENTATION**

In order to give an initial and partial confirmation of the pattern of evolution of governance solutions going from traditional non-profit organizations to multi-stakeholder social enterprises, this section presents descriptive qualitative evidence extracted from survey data. We use data on Italian social cooperatives, which are a socially oriented typology of membership based organization. The data are from the 2007 survey on Italian Social Cooperatives (ICSI), as developed by a group of five universities in Italy: Trento, Bergamo, Brescia, Naples and Reggio Calabria. The survey started in 2004 and was concluded in 2007. Questionnaires were compiled in most cases by directors. The data concern a nationally representative sample of 310 SCs, stratified by geographical area (North-West, North-East, Centre, South and Islands), dimension and typology of cooperative (type A and type B social cooperatives). In the ICSI sample, 217 are type A SCs and 93 are type B. The descriptive statistics presented in the following paragraphs refer to type A cooperatives only.

### **2.1. Multi-stakeholder governance**

The possible stakeholder groups that can be present in the membership are 10: paid workers, clients/users; volunteer workers; generic supporters; financial members; private non-profit institutions; private for-profit institutions; public institutions; financial institutions. Paid workers are the most important stakeholder group in the membership, as they are present in 98% of the 192 type A cooperatives for which we have data. Volunteers represent the second most relevant stakeholder after paid workers (present in 54% of organizations). Volunteers are predominantly active workers employed in other enterprises (Marino & Schenkel, 2018). The third most relevant stakeholder group is financial members, who are present in about 1 out of 4 organizations. As required by law, however, they never control the organization. SCs are prevalently multi-stakeholder organizations, even if they have only paid workers in their membership in 32% of cases. Descriptives show that 33% of these cooperatives are mono-stakeholder, while the remaining 66% have two or more groups of patrons in their membership. More specifically, 39.5% of organizations have 2 stakeholder groups in the membership (this is the modal outcome), 17.1% three groups, 7.3% four groups, and 1.6% five groups. No organization has more than 5 groups in its membership (Dapedri, 2007).

## 2.2. Client orientation

The fundamental importance of client orientation can be shown in several ways, but first of all by referring to Law No. 381/1991, whose Article 1 defines SCs as businesses created with the aim of "pursuing the general interest of the community in human promotion and social integration of citizens". The general interest of the community, which must be reflected in their statutory bylaws, can be understood to include the interests of the users of their services.

Furthermore, when asked whether the inclusion of clients/users is a positive thing because it improves social inclusion, on a 1 to 7 Likert scale the average is 5.2, while the modal (highest frequency) score is 7. When asked if the quality of services is one of the important elements in the social mission of the organization, 68.3% answered affirmatively. Especially, when asked if interaction with users/clients is important for the organization in terms of "trust", "quality of relations" and "mutual understanding" on 1 to 7 Likert scales, scores were, respectively, 6.49, 6.61, and 6.43. In all three cases, the modal and median answer is 7. On a 1 to 4 Likert scale, the quality of the services provided receives a score of 3.65, and both the modal and median outcomes are 4. Finally, in terms of outcomes, when asked how they evaluated the results reached by the cooperative concerning its relations with users/clients, on a 1 to 10 Likert scale the average score was 8.17, while both the modal and median scores were 8. In other contributions, users' wellbeing has been shown to be the main determinant of both paid workers' and volunteers' job satisfaction (Michelutti & Schenkel, 2009).

## 2.3. Distributive function

Finally, we analyse the "distributive function" of SCs in the ICSI sample, defined as the amount of resources, in terms on overtime or volunteer labour, and in terms of services delivered below market price or for free, distributed to clients/users and/or beneficiaries (Borzaga, Depedri, & Tortia, 2011). These resources can be though to embody client orientation by increasing the benefits received by non-controlling stakeholders, especially beneficiaries, and clients/users, without any monetary or in kind compensation. A further mechanism allowing distribution of resources in favour of clients/users is price discrimination: the non-profit nature of SCs can induce clients to disclose more truthful information concerning their ability to pay for the service since they do not risk that the organization exploits opportunistically this information to increase its profits. In turn, following a pattern of positive reciprocity, the organization can use this information to set lower prices for individuals or groups characterized by a lower ability to pay (Grillo, 1982). Qualitative results (self-ratings on Likert scales) from the ICSI survey, show that SCs distribute some extra services free of charge to all their

clients in more than 52% of cases, sell their services at less than market price in one-third of cases, and distribute some services free of charge to the poor individuals in 40% of cases. Furthermore, a non-negligible proportion of SCs distributes resources in favour of society in general (35.5%). Finally, a high proportion of SCs states that the services supplied are explicitly developed to protect users/clients and satisfy their needs (50% occasionally, and 33% systematically, 83% in total) (Borzaga, Depedri, & Tortia, 2011). When the origin of additional services delivered free of charge is examined, the most relevant elements appear to be, in decreasing order of importance, resources accumulated to the asset lock or indivisible reserves (34% of cases), voluntary work (23%), other resources obtained thanks to cost savings (19%), overtime or underpaid work (partial work donations, 12.5%). Finally, cooperatives with a stable and significant distributive function more frequently pursue social benefit aims (83 vs 70%) and are characterized by a democratic managerial style (in 53% vs 27% of cases). Hence, the broader the missions, and the more democratic the style of management, the broader the distributive function and the wider the effects on social well-being.

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## CONFERENCE FORUM DISCUSSION

**Alex Kostyuk:** Hi Ermanno, welcome to our conference forum. Any issue related to the term "stakeholder" is important for further research in corporate governance. This could concern even the most solid fundamentals of corporate governance – its models. Do you think that multi-stakeholder social enterprises need a new, or even any sort of hybrid model of corporate governance? A range of stakeholder-based models of corporate governance is wide and spreads from Germany to Japan. At the same time, client-based details are integrated into the models of corporate governance FIRMLY just in Japan where the outside directors of a company are delegated by these groups of clients.

**Dmitriy Govorun:** Ermanno, thank you very much for your ideas. You've mentioned that "the broader the missions, and the more democratic the style of management, the broader the distributive function and the wider the effects on social well-being." I believe you may describe effects or show the model of influencing of distributive function or management style on the social wellbeing. It will strengthen the conclusion and may start further discussion. Multi-stakeholder governance seems to be close to the art of balancing. And the 2/3 (all ICSIs with 2+ stakeholder group in membership) of sample cooperatives managed to handle that in Italy according to the survey results. You've pointed that mostly directors gave responses. May you highlight a bit the governance structure of average ICSI? What is the determinant which helps to find a balance? It is good to see governance model description for multi-stakeholder cooperatives. Maybe we will see the suggestion for further evolution or modifications to maximize benefits for stakeholders. What are your thoughts on that? Finally, have you also gathered



conclusion statements in a separate section of the paper? I would be happy to get introduced with them. Thanks in advance.

**Ermanno Celeste Tortia:** Dmitriy, thank you so much for your message and for the very interesting questions. About your questions, let's start from the first. I think the management in these organizations is very much the expression of their social base, since managers are appointed by directors, who are elected by members. Managers follow most of all directions by the directors in the board. As the organization grows more multi-stakeholder (new stakeholders enter the membership base), managers are quite naturally "forced" to take up a more democratic style of management and to consider the needs of different public. This is never an easy process. It is always difficult and can in some cases be also conflictual, and it can also happen that in some cases managers decide or are forced to resign by the circumstances, because they are not able to cope with such complexities, conflicting demands and scarcity of resources. However, all in all, I think the process is there and shows that it is not impossible to make organization involve different publics and reach results that factor in different needs.

**Ermanno Celeste Tortia:** As for the second question. These organizations are very often created as worker cooperatives, and in some cases are created by volunteer workers. Probably, the reason is simply that this is the easiest way to create this kind of organization, which are cooperatives and, hence, cannot have shareholders. Workers are "insiders" they know the organization well and can run it if they are properly organized. So, it is quite unavoidable that they are almost always the initial and the most prominent stakeholder. The governance is regulated first of all by the national law on cooperatives. The organization has to elect or appoint all the relevant bodies which can run the organization and represent it with third parties. In this, the governance of social cooperatives is quite standard. However, since there are no shareholders and the organization are basically a nonprofit firm with a social objective, I think governance is molded by such elements. Certainly, workers' objectives are important, so there is strong focus on job stability, procedural and interactional fairness. The non-profit nature and the social objective favors the creation of trust relations with customers, in much the same way as in non-profit organizations. This result is not guaranteed though, since workers' objectives can contrast with the objectives of clients and beneficiaries. In this the role of directors and managers and of internal regulation in striking virtuous compromises is crucial.

**Ermanno Celeste Tortia:** The third question you put forward concerns the evolution of multi-stakeholder governance in social cooperatives. In general terms, I think it is an open-ended process that can only be defined in its very general characteristics by legal and statutory requirements. Social cooperatives in Italy can be, but are not required to be multi-stakeholder, so the evolutionary process is very

spontaneous and not forced by the rules. The process of inclusion of new stakeholder groups in the governance is again a complex and lengthy one. The organization recognizes by itself step by step that inclusion by bringing benefits, even if it unavoidably increases complexity and can increase organizational costs and impasses. Eventually, however, as the data show, most organizations recognize the benefits of inclusion and implement it, even if there are always risks (at the very least your share of control is diluted and you can find yourself becoming a minority group) and costs (decision processes become lengthy and costly). In pure economic terms it can mean that there is a positive surplus to inclusion (benefits are higher than costs). In more general terms social benefits are higher than social costs. In this perspective a crucial role is taken up by intrinsic and social motivations. It is not true that motivations are only monetary and private. As long as people are guided by complex and enlarged motivational drives (both private and social) they are able to recognize that the social value produced by multi-stakeholder governance is larger than the one produced by traditional mono-stakeholder forms, and as long as the social value is higher than the cost they can decide to vote for it and choose including governance. This does not mean that they forget private objectives and needs. It is an enlarged perspective, it is not a completely new one.

**Ermanno Celeste Tortia:** To me, it is fundamental that the process of evolution of multi-stakeholder nonprofit governance is an open-ended and free one. The legal rule need only set the stage and then let actors in the system show the solutions that are the best for themselves. As the data show, multi-stakeholder non-profit governance can emerge in a spontaneous way. As for clients' involvement in the comment by Alexander, I think that yes, probably this is too weak in Italian social coops and should be improved, but it is always true that often clients have a very loose relationship with the organization and may not even want to be involved. Unless they explicitly ask to be involved as an active stakeholder, the best solution may be to involve them as information flows and consultation, but not with direct participation in the membership base, which often ends up in very low levels of actual participation.

**Dmitriy Govorun:** Ermanno, thanks for your detailed replies. Of course, let's keep in touch. My email is [dmitriy.govorun@virtusinterpress.org](mailto:dmitriy.govorun@virtusinterpress.org). I will be happy to see an updated version of your paper.

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## 2.6. THE IMPACT OF CORPORATE GOVERNANCE MECHANISMS ON THE FINANCIAL DISTRESS: THE EGYPTIAN CASE

Ghada Gaballa<sup>\*</sup>, Bahaaeldin Samir Allam<sup>\*</sup>,  
Mohamed Antar<sup>\*</sup>

<sup>\*</sup> Business Administration Department, Faculty of Commerce, Cairo University, Egypt

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### Abstract

Using a sample of 93 non-financial firms listed on the Egyptian Exchange over the period 2013-2019, this paper aims at investigating the impact of a corporate governance index (CG-I) on firm financial distress.

The developed index CG-I constitutes three key dimensions: the board of directors, the audit committee and the ownership structure. The board of directors is a key mechanism in CG, it is responsible for guiding, monitoring, and controlling management behaviour, as well as, sustaining a firm's stability. The audit committee and the external auditor are responsible for ensuring the accuracy and fairness of the financial statements' presentation and the internal control systems.

Using the dynamic generalized method of moments (GMM) estimator and panel logistic regression (PLR), the modified Altman Z"-score will be utilized as an inverse indicant of financial distress, the higher the Z"-score, the lower the risk of financial distress. Moreover, a market-based model will be applied to check the robustness of the reported findings.

The findings may be of interest to corporate managers, investors and regulators in the formulation of long-term corporate governance

strategies to manage the financial distress. Furthermore, this study contributes to the existing literature by adding new evidence from developing countries (i.e., Egypt).

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## CONFERENCE FORUM DISCUSSION

**Dmitriy Govorun:** You've pointed out that the aim of the paper is to investigate the influence of CG index on financial distress. "The developed index CG-I constitutes three key dimensions: the board of directors, the audit committee and the ownership structure." May you specify a measurement for those dimensions? Going further it is also interesting how do you weight each index component: is there the same weight for all components/variables?

**Maha Radwan:** I have the same question of Dimitriy, how could the 3 dimensions be measured?

**Ghada Gaballa:** The CGI was constructed on the basis of governance indices developed in previous studies (Black et al., 2006; Varshney et al., 2012; Lima & Sanvicente, 2013). In addition, the best practices revealed in Egypt's set of CG guidelines and standards issued in October 2005 are also considered to ensure compatibility between the constructed index and the Egyptian environment. Accordingly, the CGI consists of 11 elements.

**Ghada Gaballa:** Yes, we adopting the unweighted CGI, each of the index elements earns a score of "1" if the answer is "yes" and "0" otherwise. The total score of CGI for each company (j) can be defined as follows:

$$CGI_j = \frac{\sum_{i=1}^n X_{ij}}{\sum_{i=1}^n M_i}$$

where  $M_i$  is the maximum possible score awarded to any firm for all categories ( $i=1, [ \dots ], 4$ ).  $X_{ij}$  reflects the actual score attained by each firm.

**Maha Radwan:** Yes, it is the same idea of constructing a disclosure index with content analysis.

**Dmitriy Govorun:** Thanks for the clarification. I see an approach for measurement now. Have you also studied the overall committee system adopted in companies? How common for researched companies in Egypt is to have more than one committee with a control and monitoring function (audit committee)? Is it defined somehow in any code?

**Ghada Gaballa:** Thank you so much for your question. If I understand your question correctly board of directors may establish committees from among its non-executive and independent members for different functions. And one of the most important function is a control and monitoring one and this obligation may be required from more than one committee beside audit committee but with the different nature of each of them, for example, risk management committee, governance committee, and executive committee, etc., but in this research, we focus on the role of internal and external auditors represented in the audit committee.

**Sabri Boubaker:** The difficulty in your paper is handling endogeneity due to reverse causality (financial distress) that can affect

the corporate governance quality and omitted variable (e.g., the unobserved monitoring quality).

**Stergios Tasios:** Hi Ghada, your sample includes only firms in financial distress? If not, you could try to use the dependent variable "financial distress" as a dummy variable in your model.

**Ghada Gaballa:** Hello Sabri, thank you for your comment and we will handle reverse causality with panel data which is straightforward: use ML-SEM to estimate both the contemporaneous and the lagged effect of CG on financial distress. Only this approach yields unbiased estimates of both effects even if reverse causality is present, and it allows solving the problem of misspecified lags that plagues other panel models.

**Ghada Gaballa:** Hi Stergios Tasios, I totally agree with you, we will use the financial distress as a dummy variable to classify companies into a distressed group and healthy or non-distressed group.

**Omrane Guedhami:** Hi Ghada, thank you for your effort to compile the governance data for Egyptian firms. My first reaction was why focusing on financial distress. You can link the index to firm performance or the cost of capital. Examining how the components affect valuation would be interesting as well. We need more evidence from MENA region. So, this is an important contribution.

**Sabri Boubaker:** Ghada, you can also divide your sample based on high CG index vs. low GC index and use a PSM (propensity score matching technique). Unfortunately, there is a unique econometric technique that solves endogeneity. This is a thankless exercise and more than one way to solve it is welcomed.

**Ghada Gaballa:** Hi Omrane, thank you for your comment I appreciate that, and our reason to choose financial distress not financial performance because there were many studies already made in this area our contribution is to provide more insight to corporate managers and investors about the association between the quality of corporate governance and the degree of financial distress, with respect to Egyptian firms. Furthermore, this study contributes to the existing literature by adding new evidence from developing countries like Egypt which are helpful for regulatory bodies and policymakers in the formulation of long-term corporate governance strategies to manage financial distress. In addition, we use the firm financial performance as a control variable in our research.

**Omrane Guedhami:** Makes sense. I totally agree with you about the importance of providing evidence from Egypt.

**Rainy Trinh:** Hi, thank you for this paper. I am feeling that your measure of financial distress (Z-score) is the same default risk? If so, I think there are numerous papers testing CG index (with more comprehensive elements) and default risk. So, your contribution seems to be weak. In addition, your empirical model needs to include more controls for firm characteristics. You can also consider the robustness check of propensity score matching method as well as other endogenous treatment approaches. I hope this helps.

**Ghada Gaballa:** Thank you, will be considered.

## SESSION 3: ACCOUNTING, AUDITING AND TAXATION

## 3.1. CORPORATE TAX BEHAVIORS AND FIRM VALUE: THE MODERATING ROLE OF AUDIT CHARACTERISTICS

Andrea Vacca \*, Antonio Iazzi \*, Amedeo Maizza \*

\* Department of Management, Economics, Mathematics and Statistics, University of Salento, Italy

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### Abstract

The purpose of this paper is to analyze the moderating role of audit committee characteristics and audit quality on the relationship between tax aggressiveness and firm value. Our regression results show that the audit committee's size and gender diversity within it do not affect the relationship between tax aggressiveness and firm value. However, the data indicates that audit quality has a positive effect on the relationship between tax aggressiveness and firm value. Therefore, audit quality is an important governance mechanism that incentivizes firms to engage in tax planning strategies to maximize shareholder value, avoiding incurring conflicts of interests between shareholders and managers.

### 1. INTRODUCTION

Tax planning or tax aggressiveness is a managerial practice adopted by a firm to reduce its explicit taxes in compliance with a country's framework (Hanlon & Heitzman, 2010).

This strategy is adopted by a firm to maximize shareholder value and to increase economic means to invest in creating value (Desai & Dharmapala, 2006). However, this practice is also a risky strategy, it could cause reputational costs, compliance costs with tax administration (Hanlon & Heitzman, 2010) and the agency's conflicts between shareholders and managers. Specifically, managers could engage in tax

planning activities led by managerial opportunism to increase their profit in the short-term, causing a decrease in firm value in the long-term because of potential costs of tax aggressiveness (Desai & Dharmapala, 2006).

Part of literature (Richardson, Taylor, & Lanis, 2013; Hsu, Moore, & Neubaum, 2018; Gaaya, Lakhal, & Lakhal, 2017) attributes a pivotal role to the external auditor and audit committee to solve the agency's problems and in defining the level of tax aggressiveness of a firm. These bodies are responsible to safeguard the firm's reputation by exercising a monitoring role on financial reporting and the management, safeguarding shareholder value (Beasley, Carcello, Hermanson, & Neal, 2009).

The aim of this research is to analyze the moderating role of audit characteristics on the relationship between corporate tax planning and firm value. Specifically, this study investigates within a time interval of seven years, whether some audit characteristics such as audit committee size, audit committee's gender, and external auditor's quality have a role in long-term to define an optimum level of tax planning suitable to increase shareholder value, avoiding to incur in agency problems.

## 2. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Part of the literature (Chen, Hu, Wang, & Tang, 2014; Zhang, Cheong, & Rasiah, 2017) analyzed the effects of tax aggressiveness on firm value, showing a negative relationship.

These negative empirical results above mentioned suggest that the potential cost linked to the engagement in a high level of tax aggressiveness could not allow a firm to maximize shareholder value, despite it generates an increase of net profit for a company.

Based on this, the external auditor and audit committee should recognize the costs associated with the engagement in a high level of tax aggressiveness and they should have an influence on the managers' actions to define the optimum level of tax planning suitable to increase firm value.

An audit committee is a critical part of a firm's governance structure. This body has monitoring tasks on the management of a firm in compliance with the legal framework. Specifically, it ensures the quality of financial reporting's disclosure, avoiding fraud that may be caused by employees (Beasley et al., 2009).

An audit committee plays a key role in the decision-making process of adopting a tax strategy (Deloitte, 2013). Pertaining it, Richardson et al. (2013) argue that the independence of the audit committee reduces tax aggressiveness, conversely, other authors (Hsu, 2018) show that the financial expertise of the audit committee increases it. Therefore, it is also likely to predict that the audit committee's size should have an influence in adopting a tax planning, as more members the committee is



made up, the higher the degree of independence and financial expertise of the audit committee. In addition, gender diversity could be another important audit committee's characteristic to act as an effective monitoring function. Indeed, the literature attributes to gender diversity a high monitoring expertise (Zalata, Tauringana, & Tinghani, 2018) and a role in the decision-making process of the adoption of corporate tax planning (Lanis, Richardson, & Taylor, 2017).

Pertaining to the role of the external auditor, the international doctrine on the topic attributes a high quality of audit services provided than other firms on the market to the BIG 4 (KPMG, DELOITTE, PWC, EY). Related to the influence on tax planning by auditor's quality, some researchers (Kanagatnamet, Lee, Lim, & Lobo, 2016; Gaaya et al., 2017) argue that a BIG 4 as an external auditor has a negative influence on corporate tax aggressiveness to avoid incurring in reputational cost.

Based on this, it is likely to expect a moderating role of audit committee's size, audit committee's gender and audit quality on the relationship between tax aggressiveness and firm value.

Thus, the above discussion leads to the following research hypothesis:

*H1a: Audit committee size has a positive impact on the relationship between tax aggressiveness and firm value.*

*H1b: Audit committee's gender has a positive impact on the relationship between tax aggressiveness and firm value.*

*H2: Audit quality has a positive impact on the relationship between tax aggressiveness and firm value.*

### **3. SAMPLE AND EMPIRICAL MODEL**

The population under investigation was extracted from the "AIDA Bureau Van Dijk" database and it is comprised of 168 no-financial listed firms on Milano Stock Exchange.

The analysis was conducted through two different research methodologies. First, to detect the characteristics of the board's structure, document analysis was used through the evaluation of the listed firm's annual report. Second, to test the research hypothesis, a panel data analysis with fixed effects was performed (Stock & Watson, 2015) on a time interval of seven years (2011-2018) with the determination of 1176 observations.

To analyze the moderating role of audit characteristics on the relationship between tax aggressiveness and firm value two different regression models were estimated for each independent variable as a measure of tax aggressiveness such as ETR (Kiesewetter & Manthey, 2017) and CETR (Balakrishnan, Blouin, & Guay, 2019). The regression models were built with the dependent variable TobinQ as a measure of firm value (Nekhili, Nagati, Chtioui, & Rebolledo, 2017) and with control variables and independent variables widely used in previous studies

(Mishra, 2017; Fauver, Hung, Li, & Taboada, 2017; Richardson et al., 2013) on corporate governance, firm value and tax aggressiveness.

**Table 1.** Description of the variables

<i>Code</i>	<i>Variable</i>	<i>Value</i>
<b>Dependent variable</b>		
TobinQ	Measure of firm value	Log
<b>Control variables</b>		
SIZET	Total asset	Log
LEV	Leverage	%
ROA	Return on asset	%
R&D	Research and development costs	%
ACSIZE	Number of audit committee's members	Log
ACDIV	Percentage of female members on audit committee	%
BIG4	External auditor: PWC, Deloitte, KPMG, EY	1 = Yes 0 = No
ETR	Effective Tax Rate	%
CETR	Cash Effective Tax Rate	%
<b>Independent variables</b>		
ACSIZE X ETR/CETR	Interaction effect between <i>ACSIZE</i> and <i>ETR</i> or <i>CETR</i>	
ACDIV X ETR/CETR	Interaction effect between <i>ACDIV</i> and <i>ETR</i> or <i>CETR</i>	
BIG4 X ETR/CETR	Interaction effect between <i>BIG4</i> and <i>ETR</i> or <i>CETR</i>	

Based on the variables reported in Table 1 and to reach the research's aims, the following multivariate regression models were performed for each variable used as a measure of corporate tax planning.

Model 1:

$$\begin{aligned}
 TobinQ_{it} = & \alpha_{it} + \beta_{1t}SIZET_i + \beta_{2t}LEV + \beta_{3t}R\&D + \beta_{4t}ETR + \beta_{5t}ACSIZE \\
 & + \beta_{6t}ACDIV + \beta_{7t}BIG4 \\
 & + \beta_{8t}ACSIZE \times ETR + \beta_{9t}ACDIV \times ETR \\
 & + \beta_{10t}BIG4 \times ETR
 \end{aligned}
 \tag{1}$$

Model 2:

$$\begin{aligned}
 TobinQ_{it} = & \alpha_{it} + \beta_{1t}SIZET_i + \beta_{2t}LEV + \beta_{3t}R\&D + \beta_{4t}CETR + \beta_{5t}ACSIZE \\
 & + \beta_{6t}ACDIV + \beta_{7t}BIG4 \\
 & + \beta_{8t}ACSIZE \times CETR + \beta_{9t}ACDIV \times CETR \\
 & + \beta_{10t}BIG4 \times CETR
 \end{aligned}
 \tag{2}$$

#### 4. FINDINGS

The multivariate regression analysis shows different empirical results reported in Table 2.

**Table 2.** Regression analysis results

<i>Model 1</i>			<i>Model 2</i>		
TobinQ			TobinQ		
Code	Coeff.	Sig.	Code	Coeff.	Sig.
const	-0.4537		const	-0.5464	
SIZET	0.2089	***	SIZET	0.2044	***
LEV	-0.0124		LEV	-0.0122	
R&D	-0.0249	*	R&D	-0.1351	
ETR	-0.0139		CETR	-0.0029	
ACSIZE	1.4184		ACSIZE	1.5523	
ACDIV	0.0037		ACDIV	0.0041	*
BIG4	0.2336		BIG4	0.2660	
ACSIZE X ETR	0.0200		ACSIZE X CETR	0.0064	
ACDIV X ETR	0.0001		ACDIV X CETR	0.0038	
BIG4 X ETR	-0.0146	**	BIG4 X CETR	-0.0163	**
R <sup>2</sup>	0.4554		R <sup>2</sup>	0.4546	
Panel	Fixed effects		Panel	Fixed effects	
Observations	1176		Observations	1176	

Note: \*  $p < 0.10$ ;  $p < 0.05$ ; \*\*\*  $p < 0.01$ .

The data reported in Table 2 show that the audit committee's size does not affect the relationship between tax aggressiveness and firm value, thus *H1a* is rejected. In the same way, audit committee's gender does not influence the relationship between tax aggressiveness and firm value, therefore *H1b* is rejected.

Linked to the role of the external auditor covered by a *BIG4*, the regression analysis shows that audit quality has a positive impact on the relationship between tax aggressiveness and firm value, thus *H2* is accepted.

#### 5. CONCLUSION

This study analyzed the moderating role of audit's characteristics on the relationship between tax aggressiveness and firm value, showing various theoretical contributions and managerial implications on the evaluation of agency problems on the investments.

Specifically, this paper provides evidence that audit committee's size and gender diversity within it do not affect the relationship between tax aggressiveness and firm value. These data give evidence that the audit committee may not represent a means of solving the conflicts of interests between shareholders and managers.

Conversely, the role of external auditor covered by a BIG 4 has a positive influence on the relationship between tax aggressiveness and firm value. Therefore, audit quality could represent a critical governance mechanism to protect shareholder value, do not lead to a conflict of interests.

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## CONFERENCE FORUM DISCUSSION

**Dmitriy Govorun:** You've pointed out in your paper that "...the role of external auditor covered by the BIG 4 has a positive influence on the relationship between tax aggressiveness and firm value." I was wondering if you tried to test models within a sample where external auditors were a) BIG 4+ (like BIG 4 plus well-known international auditors); b) just having independent external auditor (the same binary character of a variable) and compare those findings?

**Andrea Vacca:** Hi Dmitriy, thanks for your comment. I did not try it. It is a good idea that could be tested on a sample made up of non-listed firms. It was not possible to test it in this research, as Italian legislation requires that the financial statement of a listed firm must be audited by an audit firm registered in a special list.

**Hadfi Bilel:** The audit or the quality of audit is a very important mechanism in companies that is to better govern the company, limit internal conflicts in the company, more confidence and transparency. In your article, you are interested in the importance of the auditor on the value of the business in a period of tax aggressiveness and I find it to be a good idea.

**Stergios Tasios:** Hi Andrea, Antonio, and Amedeo. Congratulations on your work. It would be interesting to examine also the impact of governance aspects regarding ownership concentration, family ownership, and CEO duality. You could also try sales as a proxy for firm size.

**Andrea Vacca:** Stergios, thanks for your comment. I agree with you. We would like to extend this study including the composition of corporate board and ownership to carry out a complete analysis based on the agency theory.

**Maxim Dolinsky:** Andrea, how extensive is that list of auditors for Italian firms? Is there a perceived variation in the quality of those auditors?

**Andrea Vacca:** Maxim, thanks for your comment. The list is quite long, the analysis was conducted on 168 Italian listed firms over a 2011-2018 period. In the paper, we have not considered the quality of the auditor perceived by the client. We have discussed on audit quality taking into account the size of an audit firm.

**Omrane Guedhami:** Hi Andrea, I like the topic and idea. I am wondering whether the results on Big 4 and gender diversity are due to low variation in these variables or to multicollinearity. For the latter, you can use split samples instead of interactions. Regarding audit quality, you can consider other proxies employed in the literature. For both issues, you may find the following paper interesting: *El Ghouli, S., Guedhami, O., & Pittman, J. (2016). Cross-country evidence on the importance of Big Four auditors to equity pricing: The mediating role of legal institutions. Accounting, Organizations and Society, 54, 60-81.* Note that for Italy, most of the firms (at least for this sample) appoint a B4 auditor. Hope this helps. I wish you the best in your research.

**Andrea Vacca:** Omrane, thank you very much. I will certainly consider your suggestions for my future research.

**Sabri Boubaker:** Hi Andrea, do all audit committees in Italy are chaired by independent directors? If not, controlling for this specificity is important as you may be capturing it when studying other audit committee characteristics.

**Andrea Vacca:** Sabri, thanks for your comment. Yes, audit committee of an Italian listed firm is made up only of independent members.

## 3.2. THE INTERNAL AUDIT FUNCTIONS IN UAE LAW

Bashar H. Malkawi \*

\* Director of Knowledge Management, Government of Dubai, Legal Affairs Department, UAE

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### Abstract

According to corporate governance standards in the UAE, an annual audit should be conducted by an independent, competent and qualified, auditor in order to provide an external and objective assurance to the board and shareholders that the financial statements fairly represent the financial position and performance of the company in all material respects. The purpose of the internal audit function is to improve the level of corporate governance and provide another layer of assurance to the board of directors on compliance with applicable laws and regulations.

The role of internal audit within a business has undergone dramatic changes in recent years. In order to monitor the accounts of public joint-stock companies, they need specialized accountants to review the company's accounts and books to determine the fact of its financial position and to ensure that its profits are real. Therefore, the UAE legislator obligated every joint-stock company to have one or more auditors.

Article No. 243 of the Commercial Companies Law stipulates how to appoint a company auditor, stating that his/her nomination is made by the company's board of directors and then presented to the general assembly for approval. The founders of the company may, upon incorporation, appoint one or more auditors that are approved by the Securities and Commodities Authority, so that it assumes its duties until the first general meeting is held. The general assembly is the one that assigns one or more auditors to the company for a renewable period of one year, provided that it does not exceed three consecutive years, so that he undertakes his duties from the end of the meeting of that assembly to the end of the next annual general meeting, and the general assembly

shall determine his fees. It may not authorize the company's board of directors in the matter of appointing it or determining its fees. The wisdom behind this prohibition is to guarantee the impartiality of the company's auditor and not to be subject to the influence of the members of the board of directors.

There are several duties for the internal auditor. These duties include checking whether the company is fulfilling the measures laid down by the management in order to achieve the goals and objectives of the company and assessing whether the company is compliant with applicable laws, regulations, policies, and procedures. More recent functions include gauging the influence of a company's operations on the environment and whether the company complies with the laws and regulations pertaining to the environment.

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## CONFERENCE FORUM DISCUSSION

**Dmitriy Govorun:** Thanks for the material and I appreciate your efforts in comparing the UAE and USA approach to internal audit systems. I should note that having a well-designed and substantial corporate governance code is a good signal for companies and I believe investors. This is in line with various strategic programs of country development for many years. But on the other hand, the best code and well-outlined principles seem not to become the only basis for success. Have you looked at external environments that may lead to successful code implementation? Which other mechanisms should be also used/developed to motivate companies to follow UAE Corporate Governance Code (KCGC)? By term "motivate" I mean other motives than the legal obligation to follow the rule.

**Bashar H. Malkawi:** I agree with you as one has to look at the external environment for good corporate governance. However, it is important to have the internal function well defined and designed.

**Oumaima Sadqi:** I fully agree with you that the internal audit function is very useful both for top management and for all stakeholders insofar as it provides them with assurance regarding compliance with procedures and the consideration of their interests in the conduct of the company's business.

**Hadfi Bilel:** The audit or the quality of audit is a very important mechanism in companies that is to better govern the company, limit internal conflicts in the company, more confidence and transparency. Also, it should not be forgotten that UAE and USA belong to two different systems; on the one hand, UAE in a civil law regime where the governance index and shareholder protection is reliable, compared to a system of common law where shareholder protection and the governance index are very important. I hope that Bashar will try to mention this point in their article if it is possible because governance, audit and the system I think are significant.

**Bashar H. Malkawi:** Thanks, Oumaima and Hadfi, for your comments in the civil/common law distinction and this affects the audit function.

### 3.3. COMPETITION BETWEEN ACCOUNTING STANDARDS IN NATIONAL CONTEXTS: DOES FAMILY MATTER?

Mario Daniele \*

\* Università Cattolica del Sacro Cuore, Milan, Italy

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#### Abstract

This study investigates the competition between accounting rules in national contexts. Following the introduction of non-mandatory simplified accounting rules, which are intended to reduce the burden of administrative costs for small and medium companies, competition between national Generally Accepted Accounting Principles (GAAP) has arisen. Generally, SMEs are expected to prefer the simpler and less expensive rules. However, they may voluntarily choose the ordinary ones if the related benefits are perceived to outweigh their costs. Combining agency theory and socioemotional wealth theory, we posit that the choice is influenced by agency relationships and ownership structure. The analysis of a sample of 6.052 Italian SMEs reveals that companies which opted for ordinary rules are less indebted, present a higher number of non-family related directors and operate in complex social environments. These results suggest that SMEs' accounting choices are not directly intended to reduce agency costs, while they reflect both the availability of resources for the preparation of comprehensive financial statements and firms' internal and external complexity. Focusing on SMEs, this study aims to expand existing knowledge about the accounting choice of a type of companies that are still underinvestigated, despite being an important component of the economic system in many countries.

## 1. INTRODUCTION

Do accounting standards compete? When the legal framework allows choosing among different sets of GAAPs for the preparation of financial statements, companies face an economic choice (Bassemir, 2018).

As the benefits and costs associated with different accounting rules may diverge, companies are expected to bear the minimum amount of costs that allows the satisfaction of their users' needs.

This implies that, while small and medium entities (SMEs) could simply comply with legal requirements since financial information is usually carried through private channels (Page, 1984; Hope, Thomas, & Vyas, 2013; Bassemir, 2018), large public firms may significantly benefit from the disclosure of high-quality financial reporting.

Accordingly, both the EU accounting Directive (Dir. 2013/34/EU) and IFRS provide one set of standards applicable to all entities, regardless of their size, and another set of GAAPs specifically aimed at SMEs.

Currently, simplified accounting rules are not mandatory for the companies which meet the relevant dimensional requirements (in terms of assets, revenues and a number of employees).

As a consequence, companies that are expected to benefit from "lighter" accounting rules must make a choice: ordinary or simplified standards?

Generally, small and medium companies are expected to prefer the simpler and less expensive rules. Nevertheless, they may voluntarily choose the ordinary ones if the related benefits are perceived to outweigh their costs. This study aims to investigate the determinants of this choice.

## 2. SIMPLIFIED ACCOUNTING RULES: OVERVIEW AND NATIONAL DIFFERENCES

Following the enforcement of Dir. 2013/34/EU, national regulators consequently adapted their accounting rules. Despite the intention to ensure the harmonisation of these rules throughout the European Union, their practical implementation led to some differences. Indeed, the formulation of simplified accounting rules requires at least:

- the definition of one or more dimensional thresholds for eligible companies;
- the choice of the provisions to disapply or to adapt.

In order to get an overview of those differences, we have analysed current simplified accounting rules in four European countries: France, Germany, Italy, and Spain.

The main characteristics of simplified rules in the four national contexts analysed are summarized in the following table.

**Table 1.** Simplified accounting rules in France, Germany, Italy, and Spain

	<i>France</i>	<i>Germany</i>	<i>Italy</i>	<i>Spain</i>
Simplified BS and IS	Yes	Yes	Yes	Yes
Simplified Notes	Yes	Yes	Yes	Yes
Preparation of CF statement	No	No	No	No
Preparation of management report	No	No	No	No
Different measurement criteria	No	No	Yes	Yes
Dimensional threshold	Tot. assets: 4 Mio Tot. rev.: 8 Mio No. employees: 50	Tot. assets: 6 Mio Tot. rev.: 12 Mio No. employees: 50	Tot. assets: 4,4 Mio Tot. rev.: 8,8 Mio No. employees: 50	Tot. assets: 1 Mio Tot. rev.: 2 Mio No. employees: 10
Source	Code du Commerce (L.123-16) Plan Comptable Général	Handelsgesetzbuch (§267)	Codice Civile (Art. 2435 bis)	Plan General de Contabilidad de Pequeñas y Medianas Empresas

### 3. THEORIES AND HYPOTHESES DEVELOPMENT

Simplified accounting rules are specifically aimed at reducing the burden of administrative costs for SMEs, whose users “have a limited need for supplementary information” (Dir. 2013/34/EU). As a consequence, we should expect all eligible companies to apply those rules. This is not always the case. Even the smallest entities could take advantage of the preparation of extended financial statements and, in fact, simplified rules are not mandatory.

As a result, SMEs will choose between ordinary or simplified rules based on the balance between the benefits and the costs related to each set of rules. Competition has arisen.

In order to develop this analysis, our study combines two theoretical perspectives: agency theory and socioemotional wealth (SEW) theory.

#### 3.1. Agency theory

SMEs are characterized by high levels of asymmetric information and face great agency conflicts associated with debt (Lopez-Gracia & Mestre-Barberá, 2015) and with the presence of non-controlling shareholders (Prencipe, Bar-Yosef, & Dekker, 2014). Accounting standards choices may be intended to reduce the costs arising from Type II (Morck, Wolfenzon, & Yeung, 2005) agency relations. It follows that:

*H1: The probability of choosing the ordinary accounting rules will be positively affected by the level of debt.*

*H2: The probability of choosing the ordinary accounting rules will be positively affected by the presence of non-controlling shareholders.*

### 3.2. Socioemotional wealth theory

Since SMEs are usually family-owned and managed, accounting choices may also be affected by the desire to preserve shareholders' non-economic benefits (Gomez-Mejia, Cruz, & Imperatore, 2014). However, the effect of family ownership and control cannot be signed ex-ante. As a consequence, the following hypotheses are formulated in the null form.

*H3: Family control and influence have no impact on the probability of choosing ordinary accounting rules.*

*H4: The presence of Family directors has no impact on the probability of choosing ordinary accounting rules.*

## 4. SAMPLE SELECTION AND RESEARCH DESIGN

### 4.1. Sample selection

The empirical setting is provided by Italian companies that voluntarily chose the ordinary rules for the preparation of their annual financial reports, even if they met the requirements for the simplified regime.

Among the countries where the enforcement of Dir. 2013/34/EU has given rise to a competition between simplified and ordinary rules, Italy provides an interesting empirical setting for two main reasons:

- the characteristics of the simplified accounting rules, as stated in art. 2435 bis of the Italian civil code significantly diverge from the ordinary ones (as summarized in Table 1);
- due to the ownership structure of Italian companies, the effects of Type II agency relationships and family influence may be clearly observable.

Data were collected from AIDA (Bureau van Dijk database for Italian companies) among private firms that prepared and published financial statements for FY 2018. Table 2 presents the data collection process.

**Table 2.** Data collection process

<i>Firms on AIDA that meet the following selection criteria</i>	<i>Total</i>	<i>Simplified rules</i>	<i>Ordinary rules</i>
Tot assets (min=175 K, max=4,40 Mio) Tot revenues (min=350 K, max. 8,80 Mio) No. employees (min=5, max=50) Active status Unconsolidated Legal form: limited liability companies (S.r.l. or S.p.A.)	153.051	150.001	3.050
Less financial companies that are required to apply the ordinary rules.	(24)	-	(24)
<i>Final population of companies</i>	153.026	150.001	3.026

Companies that prepared financial statements according to the ordinary rules (Group 1) will be compared with a subgroup of the much

larger population of SMEs that prepare financial reports according to the simplified regime (Group 0).

Matching is performed using the propensity score matching technique (Rosenbaum & Rubin, 1983; Shipman, Swanquist, & Whited, 2017). The subgroup will then include the observations with the closest propensity score as estimated on three-dimensional measures (total assets, total revenues, and a number of employees).

#### 4.2. Model and measurement of variables

In order to investigate the factors that influence the probability of voluntary adoption of the ordinary rules, binomial logistic regression will be applied. The independent variables are defined as follows:

**Table 3.** Independent variables

<i>Hypothesis</i>	<i>Construct</i>	<i>Variable</i>	<i>Definition</i>
<i>H1</i>	Level of debt	<i>DA</i>	Ratio of total debt, both short and long term, to total assets.
<i>H2</i>	Presence of non-controlling shareholders	<i>HHI</i>	Herfindahl index (sum of squares of each shareholder's right on equity)
<i>H3</i>	Family control and influence	<i>FAMSHARE</i>	Shares directly owned by the family with the relative majority of property rights.
		<i>MACROREGION</i>	Dummy variables reflecting the macroregion of a settlement of companies
		<i>AGE</i>	Number of years since the foundation
<i>H4</i>	Family directors	<i>NONFAMILYDIR</i>	Percentage of directors that neither own a share of the company nor bear the family name of one shareholder on the total number of directors (excluding auditors).

The definition of the variables related to "Family control and influence" deserves further explanation.

*FAMSHARE*: to identify family firms, the previous study relied on the level of family ownership, which is usually a hand-collected data (Villalonga & Amit, 2006; Cascino, Pugliese, Mussolino, & Sansone, 2010; Arena & Michelon, 2018).

In the context of this research, which is focused on small private firms, data on shareholders' familiar ties are not available. As a consequence, we used a narrow definition of family, which is composed of individuals with the same surname.

Thus, family control is proxied by the shares directly owned by the family (as defined below) with the relative majority of property rights.

*MACROREGION*: since social ties and legitimation are two crucial dimensions of SEW (Berrone, Cruz, & Gomez-Mejia, 2012) and Italian social context is strongly influenced by geographic-contextual factors

(Putnam, Leonardi, & Nonetti, 1993), family choices can be likewise led by the regional environment. Thus, we included two dummy variables (*DUMMY\_CENTRE* and *DUMMY\_SOUTH*) reflecting the macroregion of the settlement of companies (North is the baseline and, thus, omitted).

*AGE*: Family influence depends also on the life cycle of the company (Arena & Michelon, 2018). As a consequence, we included as a variable the number of years since foundation.

## 5. EMPIRICAL ANALYSES

In order to test if the independent observed variables (*DA*, *HHI*, *FAMSHARE*, *DUMMY\_CENTRE*, *DUMMY\_SOUTH*, *AGE*, *NONFAMILYDIR*) have statistical explanatory power on the dependent variable (*SIMORD*) binomial logistic regression has been applied.

Contrarily to expectations (*H1*), *DA* has a strong negative coefficient, significant at the 0.001 level. While, *HHI* has the expected sign (the Herfindahl index increases as ownership concentration decreases), significant at the 0.001 level (*H2*).

As for the variables related to the SEW theory, the results suggest that there is a negative relation between family ownership (*FAMSHARE*) and the probability to choose the ordinary rules (*H3*).

Regarding the contextual geographic variables (*H3*), centre-based companies do not differ from north-based companies (omitted variable), while south-based companies are significantly more willing to choose the ordinary rules.

Furthermore, the variable *AGE* (*H3*) is positively related to the probability of choosing the ordinary rules at the 0.001 level.

Finally, the presence of non-family directors (*H4*) influences significantly (at the 0.001 level) the probability of choosing the ordinary rules.

## 6. CONCLUSION

The research questions of this study could be summarized as follows:

*RQ 1: Do accounting standards compete at the national level?*

*RQ 2: Which factors influence the choice of accounting standards by non-public small and medium companies?*

The introduction of non-mandatory simplified rules in national contexts has given rise to a competition between them and the ordinary rules.

Depending on their cost-benefit assessments, companies eligible for the simplified regime can choose between the two sets of rules.

Although the proportion of firms that voluntarily chose the ordinary rules is low (2%), they could provide useful insights in order to understand which factors influence the accounting choices of private small and medium companies.

The results of our study suggest that at least three factors can materially influence this choice:

- the level of debt (companies with a lower level of debt can allocate more resources on financial reporting);
- the geographical-social context (companies settled in complex social environments can increase their legitimation through the disclosure of more comprehensive financial statements);
- the presence of non-family directors (family directors can easily carry information via private channels, while non-family ones can be incentivized to disclose information through comprehensive public financial statements).

## 7. RESEARCH AND POLICY IMPLICATIONS

This study aims to contribute to the literature about competition between systems of accounting standards. In particular, it posits that SMEs' cost-benefit assessments may be affected by agency relationships and ownership structure.

The expected research contribution is two-fold. First, we aim to expand existing knowledge about the accounting choice of a type of companies that are still underinvestigated, despite being an important component of the economic system in many countries.

Second, we explicitly attempt to comparatively test the predictions stemming from different theories, which are still rather rare, as emphasised by Prencipe et al.'s (2014) call for "comparing theories and explicitly identify convergence and/or diverge in predictions and to empirically test these predictions in a comparative manner".

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## CONFERENCE FORUM DISCUSSION

**Mario Daniele:** I'm Mario Daniele, PhD Student in Management at Catholic University, Milan. My research interests lay in the field of financial accounting. In particular, I am interested in investigating the reasons of differences in SMEs accounting choices. I would like to briefly introduce my conference paper which aims to point out the determinants of the choice of accounting rules by SMEs. In particular, I suggest that the choice between ordinary and simplified rules could be explained by two main factors: the need to reduce agency costs and the desire to preserve shareholders' non-economic benefits. The analysis of a sample of 6.052 Italian SMEs reveals that companies that opted for ordinary rules are less indebted, present a higher number of non-family related directors and operate in non-cooperative social environments. These results suggest that SMEs' accounting choices are not directly intended to reduce agency costs, while they reflect both the availability of resources for the preparation of comprehensive financial statements and firms' internal and external complexity.

**H A R P Madushanka:** Hi Mario, it is a really interesting research area and thank you very much for sharing your findings with us. I have a few comments/queries. Hope you would be kind enough to share your thoughts in these. I am very curious about the variables you used in *H2* and *H3*. Family control and influence and independent vs. family

directors. Aren't these very much interdependent? Even the presence of non-controlling shareholders would be very much related to the family control. I feel like *H3* is almost a sub-theme under *H2*. Hope you can share your thoughts on the reasons to use them as a separate hypothesis? When I read through the findings, it made me realize 'the cost of choice' in this matter. Mostly these SMEs might not be able to afford expertise in financial accounting or any other areas than focusing on surviving in the current business context. Hence the role of regulators seems very significant. I would like to know if you have any ideas to share on that regard.

**Maha Radwan:** Hi Mario, very interesting scope, I have some questions how you define ordinary rules of accounting? Do you mean the domestic Italian one? Also, I would like to ask you if you have analyzed the dimension of the impact of the rules on profitability. As it could be choosing the application of specific rules could be for tax or profit reasons.

**Mario Daniele:** H A R P Madushanka, thank you for your comments. Of course, there is interdependence between *H2* and *H3*. The reason why I included two separate hypotheses is related to a possible difference between the effect of the number of shareholders (both family and non-family related) and the weight of the family with the relative majority on accounting choice. Regarding the findings, I agree with you. The role of regulators is crucial in assuring high-quality financial information even for the smallest entities. It may require the provision of a set of simple but comprehensive rules (including the preparation of basic cash-flow statements) and the involvement of professional accountants to support both managers and shareholders in preparing and understanding financial information.

**Mario Daniele:** Maha Radwan, thank you. The ordinary rules are the Italian GAAP that can be applied by small, medium and large companies. Your suggestion about profitability is very interesting. In this study, I decided to focus only on the determinants of the choice. While I would like to analyze its effect in a second study.

**Maha Radwan:** Do not you think that one of the determinants of the choice would be to high some costs or to overvalue some costs for having at the end higher or lower profitability, taxes and dividends? Also do not you think of applying the measurement of writing items on cost or by using fair value, by having carrying amount or by estimating by net realizable value like in cases of inventories...all of this would not be a determinant of the choice of the CFO?

**Mario Daniele:** Maha Radwan, I see the point. In general, ordinary and simplified rules don't differ in terms of valuations (that is cost-based) or revenues/cost recognition, so I don't expect that the choice is related to profitability or tax purpose. But, since it's a very interesting point to analyze, I will include a variable to test the impact of this factor.

**Maha Radwan:** Those are just some points that could be useful for your study but I like your research so much and the idea deserves to be deeply researched ...very interesting indeed!

**Dmitriy Govorun:** Hi Mario, thanks for the interesting paper and your ideas. Thanks for the slide with simplified accounting rules for some EU countries and the influence of accounting standards inside one particular country. Just one short comment/reply. I would also like to support Maha Radwan. I was also wondering whether you have tested other criteria for choosing the system by SMEs. It seems that they may have additional determinants as the purpose of the existence of such companies may vary. Anyway your findings made me think over the "cost" of choice not only for accounting rules.

**Mario Daniele:** Dmitriy, thank you for your comment. The choice of the variables is based on Bassemir's (2018) study about the determinants of IFRS voluntary adoption by private firms in Germany, that were adapted in order to consider the peculiarities related to small family-owned firms. As there aren't many studies that investigate this type of firms, I adopted the perspectives arising from both Agency Theory and SEW Theory. I would appreciate very much if you can provide me with some examples of determinants to include in the study.

**Mireille Chidiac El Hajj:** Hi Mario, I liked your research. It's very interesting. In response to your above-mentioned question concerning the determinants; I would like to point to the fact that the literature shows that family directors' performance can be less or worse than that of independent or outsiders (Bennedsen & Nielsen, 2010). Comparing both performances can help to find out the cost effects on the one side and the correlation between the variables of the agency theory and those of the SEW theory on the other.

**Mario Daniele:** Mireille, thank you for your interesting suggestion. I will deepen this theme in order to test the effect of directors' performance.

## SESSION 4: CORPORATE GOVERNANCE: GENERAL ISSUES

## 4.1. IMPACT OF THE POLITICAL AND ECONOMIC CSFS ON OTHER CSFS IN THE PPP PROJECTS LIFE CYCLE

Ahmad Almeile<sup>\*</sup>, Maxwell Chipulu<sup>\*</sup>, Ramesh Vahidi<sup>\*</sup>

<sup>\*</sup> School of Business, University of Southampton, the UK

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### Abstract

The public-private partnership (PPP) procurement approach has received attention from more than half of the world's governments as an alternative method of providing public services (Lee & Schaufelberger, 2014) and raising standards of living (Chou, Hsu, Lin, & Chang, 2016) through a long partnership between both the public and private sectors (Bao, Peng, Ablanedo-Rosas, & Gao, 2015; Liu, Love, Smith, Regan, & Palaneeswaran, 2015).

Many researchers have attempted to identify the critical success factors (CSFs) that inform PPP project success, particularly in the construction industry (Askar & Gab-Allah, 2002; Chan, Lam, Chan, Cheung, & Ke, 2010; Cheung, Chan, Lam, Chan, & Ke, 2012; Dulaimi, Alhashemi, Ling, & Kumaraswamy, 2010; Hsueh & Chang, 2017; Ismail, 2013; Jacobson & Choi, 2008; Jefferies, 2006; Li, Akintoye, Edwards, & Hardcastle, 2005; Liu & Wilkinson, 2015; Osei-Kyei, Chan, & Ameyaw, 2017; Salman, Skibniewski, & Basha, 2007; Tang & Shen, 2013; Zhang, 2005). However, researchers have made little effort to identify the issues that influence the CSFs of PPPs, including political and economic conditions. CSFs are known as "those few key areas of activity in which favourable results are absolutely necessary for a particular manager to reach his or her own goals" (Bullen & Rockart, 1981, p. 4).

The related literature highlighted the challenges and failures associated with the implementation or completion of PPP construction projects; most of which stem from CSFs that were influenced by political and economic conditions at the time of those projects (Almeile, Chipulu, & Vahidi, 2019; Cheung et al., 2012; Dulaimi et al., 2010).

This paper aims to determine, from a theoretical point of view, the impact of political and economic CSFs on other CSFs during the life cycle of PPP construction projects.

To achieve the research aim, a comprehensive list of literature published between 2002 and 2017 was analysed to identify the related CSFs for PPP construction projects. In total, 24 CSFs were identified and grouped, based on the Delphi technique, to establish the most relevant political and economic factors. The factors and their groups were then mapped according to the best fit phases in the PPP project life cycle (EIB, 2016; Hueskes, Verhoest, & Block, 2017; Liu et al., 2018; Liu, Love, Smith, Regan, & Sutrisna, 2014; Love, Liu, Matthews, Sing, & Smith, 2015) (see Table 1). Lastly, the relative positions of the critical political and economic variables were identified.

It was found that 14 CSFs might be affected by political and economic issues. All 14 factors appeared in the ten CSFs groups found in this research. However, the ten CSFs groups were only found during three phases of the PPP project life cycle. Therefore, it is evident that the impact of political and economic CSFs can influence: 1) a great number of CSFs; 2) a considerable number of CSFs groups; and 3) most, but not all, of the phases during the PPP project life cycle (see Table 1). Thus, the political and economic CSFs have the possibility and potential to influence a PPP construction project's performance.

Overall, the research aim in this study was successfully addressed, as the impact of political and economic CSFs on a PPP project's life cycle was determined. This work also provides a systematic classification model of the CSFs for PPP construction projects, as well as distinguishes between groups based on their differences. The groups are mapped into the PPP project life cycle to help the public and private sectors appropriately allocate resources, and therefore ensure PPP project success. Therefore, the researchers believe this work contributes to the body of knowledge on the subject of PPPs.

**Table 1.** CSFs for PPP construction projects during the PPP project life cycle

CSFs groups	Financing				Economic environment			Public sector			Effective project management		Legal		Political environment		Procurement		Shared responsibility		Innovation	Private sector	Risk management	Social environment	
	Available financial market	Government guarantees	Realistic financial study	Value for money assessment	Availability and organising resources	Promising economy/ economic growth	Stable economic condition	Engage a team of advisers	Good and effective governance structures	Picking the right project	Project performance monitoring	Understanding and respecting the goals of the main PPP parties	Available policies and regulations	Favourable contracts and agreements	Stable political condition	Well-organised host government	A fair evaluation team	Transparency in the procurement process	Commitment and responsibility of project parties	Open and constant communication among stakeholders	Innovation in delivering public services	A strong and good private consortium	Appropriate risk allocation and risk-sharing	Supportive and understanding community	
Project identification	F-A	F-A	F-A	F-A	F	F	F		F-A					F	F									F-A	F-A
Project detailed preparation								F	F			F	F			F									
Project procurement									F				F			F-A		F-A	F-A	F-A	F				
Project implementation	F-A	F-A			F	F	F	F	F	F	F-A	F-A		F				F-A	F-A	F-A	F-A	F-A	F-A	F-A	F-A

(F) presents the best fit for each CSF in the PPP project life cycle, while (A) presents the CSFs affected by political and economic CSFs from a theoretical point of view.

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## CONFERENCE FORUM DISCUSSION

**Rainy Trinh:** I think you should use the full term in the title to help all audience understand your topic.

**Ahmad Almeile:** Thank you for your suggestion.

**Dilvin Taskin:** This is a very interesting paper. I believe however that in developing economies where political dominance is very high, it might not be possible to find data and the outcomes would be biased. What do you think?

**Ahmad Almeile:** When I started the search, I thought that I will not be able to find any data.

However, I conducted a questionnaire survey in one of the developing economies and I found them very responsive with no significant bias.

**Dilvin Taskin:** So, do you point to any differences for the projects in developed and emerging countries?

**Alex Kostyuk:** Hi Ahmad, my expectations about the outlooks for the public-private partnership projects depend on the major issue that can erode the nature of this partnership – a degree of corruption in the country. Most developing countries still suffer from this problem, and finally, corruption seriously reduces the positive influence of the PPPs. Therefore, the issue of national legislation is extremely important.

**Ahmad Almeile:** Well, this paper did not aim to identify any differences between the developing and developed countries. However, I had a paper on the same topic which has been sent already for publication regarding the differences between the developing and developed countries.

**Dilvin Taskin:** Sure, but the question is because I am curious that political impacts in emerging countries might not be explained so the findings might be different. I will check out your other paper as well.

**Ahmad Almeile:** Alex, I totally agree with you. I'm working at the moment on a third paper focusing on the national political and economic issues and their role in PPP project success in developing countries. I, therefore, will try to identify if this image exists in some developing countries via empirical study.

## 4.2. CORPORATE GOVERNANCE IN AGILE ORGANIZATIONS: A PATH DEPENDENCY SCHEME OR A SOURCE FOR GROWTH

Iliana Evangelina Haro Leon \*

\* School of Business and Management, California Southern University, USA;  
Kooperativer HFU-Promotionskolleg, Hochschule Furtwangen University, Germany

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**JEL Classification:** D2, G3, K2, L1, L2

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### Abstract

This paper explores how formal institutionalized corporate governance frameworks are better suitable for conventional hierarchical organizations with a mental infrastructure that seeks control and stability, empower vertical management decision lines and is developed under the paradigms of mistrust and risk control while at the same time; they foster path dependencies through the management decisions that come with their implementation. In contrast, people-centered enablement organizations also known as agile organizations and whose corporate values and culture are not only based on open collaboration, adaptability, flexibility and resilience but among everything on trust may need a different set of corporate governance practices, one that has emerged not as a preventive control measure, but as fomenting strategy for development. Therefore, it is imperative to explore these aspects particularly in light of the escalated presence and strength of agile organizations. This study aims to present theoretical research that describes the general context of hierarchical vs. agile organizations in terms of corporate governance by discussing their mental infrastructures and path dependencies and the problems associated with them. These

elements together should help to evaluate the extent to which the conclusions drawn from this research are transferable.

## 1. INTRODUCTION

Corporate governance systems main purpose is to control business malpractices, effectively distribute capital and diversify risks and liabilities (Fauver & Fuerst, 2006) they are devised to structure authority, develop communication, balance responsibility and, depending on the system, to provide accountability to shareholders and stakeholders at all levels (OECD, 2015; Nestor & Thompson, 2020). However, due to new information technology, the growing power of the customer, the relevance to capture and retain talent (Denning, 2018) and a complex and dynamic business environment new forms of organization that enable people's responsibility and accountability have evolved recently, while the corporate governance practices reflection of traditional management systems that regulate them have remained the same. So, one question arises: Is corporate governance helping to strengthen the performance of people-centered enablement organizations or, on the contrary, it is becoming the barrier that prevents them from achieving their full potential?

Under this context, this paper aims to present theoretical research sustained on an inductive approach to describe the present circumstances of agile vs. hierarchical organizations in terms of corporate governance. These elements together may help to evaluate the extent to which the conclusions drawn from this research are transferable to other times, companies, industries and people.

## 2. LITERATURE REVIEW

Since the Cadbury report on corporate governance has been acknowledged as a system of control (The Committee on the Financial Aspects of Corporate Governance and Gee and Co. Ltd., 1992), or as a set of processes by which an organization is directed and controlled ("Corporate Governance", 2004), in addition, the agency theory perspective of corporate governance, accentuates the monitoring and control scopes of governance (Homayoun & Homayoun, 2015). Two different determinants set the lane for corporate governance with a controlling scope: 1) the theoretical assumptions of management; 2) the historical events and changes in the business environment. These determinants do not operate in isolation, neither in a specific order, while both enhance the effects of each other.

The theoretical assumptions of management find its roots in Theory X and Y of Douglas McGregor. Theory X considers that people shall be controlled and directed in order to get them to achieve organizational objectives (McGregor & Cutcher-Gershenfeld, 2006). Hierarchical or

traditional organizations are institutionalized in rules, structures and management systems like corporate governance. Decisions are taken by the top management and board of directors. Personal responsibility is substituted by rules and the division of labour, the authority of command, hierarchy and compliance regulate the organization. Power is delegated vertically and access to the organization's information for decision-making, strategy design and implementation is made through management systems (Trost, 2019). This determinant constitutes the fundament of a mental infrastructure of mistrust and the need for control. Mental infrastructures are mental models that endorse previous decisions and support our actions, thoughts and beliefs. They influence our perception over time, adopt the appearance of a fact and common sense and direct the creation of social and tangible infrastructures. Mental infrastructures hide gaps, shortcomings and inconsistencies in our thinking, and under their influence we act with a certainty that favors overlooking biases, self-interests and negative consequences (Austen, 2014).

The influence of historical events is accentuated by mental infrastructures. Examples of this determinant in corporate governance are the lack of investors' confidence in the integrity and accountability of listed companies (Cadbury, 2014) the global financial crisis of 2008, the increase in cross-border ownership, the changes in the functioning of stock markets and complex investment chains (OECD, 2015). As a consequence of the mental infrastructure of the first determinant and to some extent the success of corporate governance systems, corporate governance is not only formed but repeatedly justified for hierarchical organizations (Welzer, 2011; Korine & Gomez, 2014), evolving into complex bodies of rules and structures, increasing costs and decision flexibility reductions (Durden & Pech, 2006). This, in turn, fosters path dependencies, which are "historical decisions, events, actions and successes" that develop through three phases – preformation, formation and lock-in – that impact the organization's strategy, leadership and collaboration and technology. At the preformation phase, the organization chooses how to incorporate corporate governance practices influenced by its mental infrastructure. At the formation phase, corporate governance is implemented in line with previous choices. Lastly, at the lock-in phase old and new decisions that should be reconsidered are locked into the first decision (Wang, Hedman, & Tuunainen, 2016), this lock-in effect increases when earlier decisions were directed to the investment of resources (Thomsen & Vinten, 2014), and even though this phase does not inhibit the possibility of making different choices, it distorts the decision-making process (Lynch, 2015).

On the other hand, people-centered enablement organizations are explained by Theory Y (McGregor & Cutcher-Gershenfeld, 2006). They leave as much responsibility as possible to their talent. They are colleagues, teams, customers and sharing knowledge orientated and have

overlapping roles, clusters and projects that adapt to given requirements over time and which strategy depends entirely on their teams' involvement (Trost, 2019). Trust is the mental infrastructure that prevails for these organizations (Bandsuch, Pate, & Thies, 2008). But while these organizations have become rather common in the business context (De Smet, Lurie, & St. George, 2018) corporate governance practices have remained the same, becoming a bumper block for their development because they do not recognize people's self-direction and self-control neither allow the development of strategies from down to top. In consequence, the inflexibility of corporate governance frameworks has led to inefficiencies and low job satisfaction (Hathaway, 2001; Nmai & Delle, 2014). Furthermore, patterns of operation in corporate governance strengthen the path dependency that constrains the production and integration of new knowledge (Coombs & Hull, 1998) which is a major output of people-centered organizations (Pérez-Bustamante, 1999) and the input for strategy formation (Takeuchi, 2013) and innovation (Bertoni, Colombo, & Croce, 2013). To avoid the negative effects of path dependencies derived from traditional corporate governance new frameworks need to be allowed and developed, frameworks that reflect the mindset of trust, the multiple levels of leadership, transparency and communication of people-centered organizations.

### 3. CONCLUSION

Mental infrastructures are the starting point not only for legislation of corporate governance frameworks but also for the implementation by organizations of those frameworks. Meanwhile, these mental infrastructures shape path dependencies that can lead to deficiencies in strategy, leadership and human resources management, use of technology and external collaboration, which in exchange can bring identifiable costs, loss of profits and inefficient corporate strategies. Defying existing mental infrastructures, like the ones that work at hierarchical organizations is a huge challenge for organizations and policymakers, because they provide arguments, as to why corporate governance frameworks shall be designed in one way or another. Nevertheless, while implementing a traditional corporate governance system it should not be forgotten that each decision, long-term investment and technology acquisition to comply with corporate governance play a relevant role for path dependencies. The remaining question is to determine if those deficiencies are sufficiently meaningful to justify a change of orientation in corporate governance that supports self-direction and self-control and allows the emergence of corporate strategies from the down to the top.

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## CONFERENCE FORUM DISCUSSION

**Iliana Haro:** I am a PhD candidate at California Southern University and Hochschule Furtwangen University. My research explores how formal institutionalized corporate governance frameworks are better suitable for conventional hierarchical organizations that strive for control and stability and whose social values are developed under the paradigm of predictability and risk control while, on the other hand, people-centered enablement organizations also known as agile and whose corporate values and culture are not only based on open collaboration, adaptability, flexibility and resilience but among everything on trust may need a different set of corporate governance practices, one that has emerged not as a preventive control measure, but as fomenting strategy for development. This is a work in process, it is theoretical research and it is sustained on an inductive approach to describe the present circumstances of agile vs. hierarchical organizations in terms of corporate governance efficacy.

**L-F Pau:** A well-known problem (or not). The paper neglects two functions: HR strategy in selecting leaders, and board strategy in selecting inside its rank challengers.

**Iliana Haro:** Thanks for your contribution, L-F Pau, the paper does not intend to neglect those functions indeed. Studying and analyzing agile organizations it is a very broad and fascinating topic, in which strategic HR management plays a relevant role. But as you know we need to focus our question in one aspect.

**L-F Pau:** It is far from only hierarchical vs. agile: seen as such it is only the internalized view. You have hierarchical organizations that adapt well and fast to external shocks, and you have "agile" organizations that do not as the agility is mostly an internal power fighting reason (as at Apple).

**Iliana Haro:** Furthermore, the process of HR in agile organizations to select leaders it is precisely by allowing teams to select their own leaders, HR does not select them, that would be exactly hierarchy and control, it must be the people who select who they follow.

**L-F Pau:** People selecting who they follow... Well fine in unchallenged static businesses or administrations, but not otherwise.

**Iliana Haro:** It is the challenging, uncertain and extremely dynamic context on which agile organizations perform which foster that people select their own leaders, according to their projects and needs. In control orientated, with high power distance and focus to control, leaders are formally appointed.

**L-F Pau:** I suggest that you reduce the importance of reporting structures and more that of dynamics. See, for example, *Vervest, P., van Heck, E., Preiss, K., & Pau, L.-F. (Eds.). (2005). Smart business networks. Berlin, Germany: Springer (ISBN: 3-540-22840-3); and Pau, L.-F. (2007). Discovering the dynamics of smart business networks (ERIM Working*



paper); and Pau, L.-F. (2014). *Discovering the dynamics of smart business networks. Computational Management Science, 11(4), 445-458, <https://doi.org/10.1007/s10287-013-0162-x>.*

**Dean Blomson:** I think there are some really important angles (to agile boards) to explore: 1) What does agile mean for board processes/systems/structures/behaviour? 2) When is agile more likely to work well/not well? 3) In a COVID environment how have boards demonstrated agile traits and what can be learned from that for the future? 4) In a VUCA world why may agile be a more effective option than a more rigid set of disciplines? 5) In which areas/activities by a board can agile be reasonably safely applied? And in which areas may it add more risk to board duties?

**Iliana Haro:** Dear Dean, I am so happy that my research got your attention because I am actually also really interested in yours I liked your sentence "This paper is constructed as a provocation and call to arms", I think we are more or less on the same page but let's see, I will try to answer question by question.

**Iliana Haro:** 1) What does agile mean for board processes/systems /structures/behaviour? This is very important, it is necessary to understand first that there are different understandings about the agile organizations "concept". From the broadest and let's say lay understanding "agile" organizations are those ones software-development orientated organizations that work under processes like agile and scrum, getting the name of "agile" precisely from here, that would refer to process and systems. But when we are talking about structures and behavior we are talking from the strategic management perspective, that goes beyond a scrum and agile, it goes beyond only software-development organizations. We are talking about a different mindset one that influences the behavior of organizations.

**Iliana Haro:** 2) When is agile more likely to work well/not well? This is a very difficult question to answer without having a context to analyze. Our context is going to be confirmed by the business environment, its complexity; by the strategy and corporate strategic goals of the company and very important by the mental infrastructure of the founder or the CEO because they set the basis for the corporate culture and mindset of the members of the organization. As an example, let's suppose we have a consulting organization whose corporate goal is to provide state of the art solutions to their clients, with a founder with flat hierarchy mindset, whom search to empower its team, trust the team, and listen to the team because they are the ones who are in direct daily contact with their clients, and therefore they design directly what is the strategy to follow in the organization.

**Iliana Haro:** 3) In a COVID environment how have boards demonstrated agile traits and what can be learned from that for the future? This is something I was wondering myself yesterday, I was searching in LinkedIn, the New York Times, and Forbes for specific news

that would mention specific "board actions" that were demonstrating agile traits. I did not find many that were clearly stated as that, my guess is that since boards are still embedded in traditional and stable CG practices that do not allow fast decision making processes neither disclosure of their decisions. However, one case could be the liquor brand 58 Gin, who changed from producing Gin to hand sanitizer. I do not want to mention here the speed by which some organizations closed or suspended their operations because in many cases that was governmental decision and mandate.

**Iliana Haro:** 4) In a VUCA world why may agile be a more effective option than a more rigid set of disciplines? In a VUCA world like the one that the Coronavirus has propelled some organizations have had to make faster decision making processes, to know and change according to the needs of clients and stakeholders, to become flexible, to develop a higher tolerance for mistake, to reduce the aversion for risk-taking, or at least accept that risk will be always there, and above everything organizations have had to trust (doing home office is a clear case of trust as no other alternative). All these characteristics are part of the agile mindset.

**Iliana Haro:** 5) In which areas/activities by a board can agile be reasonably safely applied? And in which areas may it add more risk to board duties? On this regard, we would come back to the context and the strategy of the organization, what are the strategic aspects that the board of directors is dealing with? Where do you need the most of the characteristics of agile? My point is that there is no one fits all solution, and traditional CG assumes that there is. Now it is important to consider that while agile could be reasonable in some cases it could be not in others, similarly with traditional CG.

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## 4.3. HUMAN CAPITAL'S IMPORTANCE IN ICOS SUCCESS

José Campino \*, Ana Brochado \*, Álvaro Rosa \*

\* ISCTE-IUL, Lisbon, Portugal

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### Abstract

Initial coin offerings (ICOs) are an alternative investment form offering the possibility of direct financing from worldwide investors and contribute to the democratization of entrepreneurship and access to capital markets. The ICOs are based on the blockchain technology and offer the chance to invest in a project's initial phase through the acquisition of a token (Brochado, 2018). It also allows tokens' transaction on the secondary market which is essential to their success (Chen, 2018). There are three main types of token which vary according to their purpose and investors' rights: 1) currency token: used as a means of exchange and store such as a cryptocurrency; 2) security token: used as conventional security but recorded and exchanged on a blockchain; the underlying of this token type can range from corporate equity (typical share) to commodities, real estate or even currencies; 3) utility token: is the most common token type and provides to the buyer consumptive rights to access a product or service (Howell, Niessner, & Yermack, 2018). Since the first ICO of MasterCoin in 2013 proposed by J. R. Willett the interest on this topic has been increasing and reached a peak between the years of 2017-2018. This is confirmed by an analysis of Google trends for the word "ICO" at a worldwide level (Google, 2020). This increase in popularity goes hand in hand with the appreciation of cryptocurrencies during the same period. Indeed, the market capitalization of cryptocurrencies influences the amounts raised by ICOs (Masiak, Block, Masiak, Neuenkirch, & Pielen, 2018; OECD, 2019; Fisch, 2019). The literature has been following this tendency and several studies have focused on ICOs although there are still several literature

gaps due to the novelty, different and complex interaction of an ICO process. The studies' focus has also been on the success factors of ICOs (An, Duan, Hou, & Xu, 2019; Fisch, 2019; Goergen & Rondi, 2019; Giudici & Adhami, 2019; OECD, 2019). The current paper intends to focus particularly on human capital which is considered to be an essential factor in a successful venture (An et al., 2019). The common measure for asserting an ICO's success has been the amount raised in the campaign (Fisch, 2019). ICOs propose to achieve both soft-cap (least amount the funders will accept to proceed with the project) and hard-cap (maximum amount the founders will accept) thresholds. Therefore, the time elapsed until achieving one of these limits is also a measure of ICOs' success along with the amount raised (An et al., 2019). In terms of human capital, the characteristics of the founding team can be considered the following: 1) experience in the financial sector; 2) experience in computer science; 3) experience in blockchain projects; 4) entrepreneur's profile; 5) number of founders; 6) existence of social media accounts (Brochado, 2018).

In the current study, the authors propose to analyze human capital as an ICO's success factor using a database collected from ICObench<sup>1</sup> via its API through computer programming. The database was filtered in order to comprise 556 ICOs in the banking/financial sector. The database also included information on the founders' profile who the current paper will study. It was possible to complement the information on the database with public information available on the LinkedIn profiles. The result was extra information of 4552 founders' profiles.

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## CONFERENCE FORUM DISCUSSION

**Iliana Haro:** Dear José, Ana and Álvaro, thanks for sharing your research. I venture to say that you are quite pioneers on this topic so congratulations. In your presentation, you mention that you want to tackle human capital's importance and later you also mention that the objective is to understand the impact the team's characteristics have on the success of an ICO project and you also pay attention to innovative board positions. So, I wonder, are you also considering analyzing the dynamics that need to be fostered among working teams, for example, the innovative board? And do you think that the innovative board position plays a relevant role in the ICO's strategy?

**José Campino:** Dear all, I hope to find you well on these special circumstances which pose so many challenges to our creativity and also urge innovative solutions as the current way to meet and share ideas. I look forward to receiving your feedback on the research and will be very glad to clarify any topics you may find interesting. Thank you and talk to you soon.

**José Campino:** Thank you very much for your comment, very much appreciated. Indeed, this is a very new topic that has been explored due to its expansion, due to its innovative characteristics, due to the challenges posed to regulators and also due to the significant money amounts involved. Therefore, there is a large gap in the literature to explore and in which any of us could be a contributor. The main objective of the study will be to explore the teams' importance as a determinant of the projects' success, in other words, we are developing a correspondence analysis and an econometric model to measure certain teams' characteristics, such as location, networks or education. As you speak, I thought that it could be interesting to include a variable related to the board composition and check for its significance. Concerning the board, we have been verifying that although there are traditional board positions there are also so many others which we consider as innovative (slide 21). Besides, the board might not have the traditional composition and strict division of roles and hierarchy. These are usually

technological, highly innovative and highly risky companies that adopt a much more flexible model. Replying now directly to your question, the composition of the board should, as all the company's organization, contribute to its strategy much more comparable to a start-up or a venture capital project than to a traditional company.

**José Campino:** Dear all, dear Iliana, would you have in mind a variable that could measure the board's impact on the project's success (given the circumstances)? What do you think about the impact on a company's strategy of this lean model of companies which will most likely start with the founders and eventually develop into a risky project? Do you find these companies interesting to study as they could be a very innovative way to obtain financing (comparable to a digital IPO)?

**Iliana Haro:** Hi José, thanks for answering my questions I appreciate it. And yes, I completely agree with you, there is more than ever a need for a flexible model, and if I understood you correctly this should include new board composition, or at least a new role, one that fosters creativity and innovation. In my opinion, that new model should also include a board that recognizes leadership, talent and capabilities in "lower ranks in terms of written structure" but who are not at all low in terms of potential for organizations. What is your perspective on it?

**Iliana Haro:** Thanks for asking back, José. "Would you have in mind a variable that could measure the board's impact on the project's success (given the circumstances)?" I think that whenever we want to measure the behavior of group, like in this case the board's impact in project success, and then we want to extract the variables off to measure it, we face a bigger problem: "Human behavior" which is affected by their context, by the people themselves and by how the behavior itself affects again the context itself and the people, here we are talking about reciprocal determinism. Therefore, I would not focus on a specific variable, because it may not exist, or better to say, there may be so many variables to consider that it would become impossible to measure. I would rather focus on analyzing what are the conditions, what is the context that need to be allowed or created to enable all the participants of the organization to contribute an achieve the goals of the organization.

**Iliana Haro:** "What do you think about the impact on a company's strategy of this lean model of companies which will most likely start with the founders and eventually develop to a risky project?" I am of the opinion that the impact on the strategy of lean companies can only be determined depending on the strategy itself. For example, if the strategy is focused on creativity, innovation and flexibility, lean companies may benefit from the presence of a founder that fosters networking, resilience, tolerance for error and risk. But again it depends. I truly believe that we cannot play anymore with a one fits it all model. What do you think on this regard, it is very interesting?

**Iliana Haro:** "Do you find these companies interesting to study as they could be a very innovative way to obtain financing (comparable to

a digital IPO)?" I feel very humble with this question, but I venture once again to say that YES, this indeed may be the future. Just look at the entire world right now with the Coronavirus. Are we spending our normal currencies? At least in Germany no, we cannot even pay with cash because we have to touch it. Stores are accepting only credit and debit cards because in that way their employees do not have to expose themselves to the virus, and this is just the beginning!!!! I am not saying that we will change everything in one year, but we never know. I am convinced you are on the right path, what do you think?

**José Campino:** Iliana, I couldn't agree more with you. Yes, indeed the ICOs' board composition should be innovative in structure and also in terms of positions. In my opinion, when we meet the corporate world in most of the cases, particularly multinational companies, we find such a division of tasks and so many departments with strict hierarchies which might not allow at all "lower ranks" to shine, prove their value and be recognized. I guess this is can be a price to pay when having great growth. In a start-up or in such innovative projects such as ICOs a "lower rank" might most likely have contact with high-rank positions and many more chances to be seen as valuable for the organization. I think these companies are much more adapted to innovate in terms of work, (e.g., much more prepared for remote working, flexible offices, and flexible schedules) and could be of value to understand how they promote employee satisfaction and recognition. A position at the board which would have a function of promoting employee recognition would be innovative and of tremendous impact, I think.

**José Campino:** Thank you for replying. It is very important to me to receive feedback and learn from it, it is for sure a determinant of success in this case I agree it is very hard to measure that. I should reflect a while more on the subject and try to find a good way to include this.

**José Campino:** I think that the future is not at all the one fits all, which I think has proven to not foster innovation or by itself promote employee satisfaction and recognition. I guess also that in these cases the strategy will be, at least in the beginning, the vision of the founders. I mean, the founders will determine if the company is prone to innovate, the way it does and growth paths to follow. But yes, I believe the companies' organization models should follow a much more flexible structure and as tailor-made the employees as possible to allow them to be productive in their own way keeping the company together. This is a great challenge which I think these companies may reply to.

**José Campino:** This is a topic that interests me a lot. I have also been looking at Fintech companies and the revolution they are forcing on traditional banking systems. The value of currency exists because each one of us believes it exists. For example, why is our euro valuable? Is it because it is backed by the European Central Bank because it is tradable in several economies in an entire continent? It is for sure not because we

can assign a specific value to it, for example, a value in gold. So, cryptos are the same thing backstopped by a blockchain system but not as tradable as the traditional currencies. If they were, for sure they would have much bigger importance. I think, as you said, this is the future. I think the future will most likely depend on traditional institutions to reply to these challenges, for example, there are central banks issuing cryptos (e.g., China). The future is for sure digital and there are so many solutions adopting traditional currencies but overcoming much of the physical barriers and physical exchanges (e.g., Revolut, N26). Here in Portugal, we have a platform that basically works as an ATM in your phone and allows creating disposable cards for safe internet purchases without fees for example (i.e., MBWay). Germany is a very interesting country, innovative in these aspects and headquarter of many Fintech. Do you think people and companies are adapting and willing these innovations?

**Iliana Haro:** Absolutely, it is the founder who sets the corporate culture that, at the end, will allow innovation and creativity, and now that you mention, I think that we also have a broad field to explore in terms of corporate culture and corporate governance or not? People and companies adapting and willing these innovations? That is hard to answer. There is something going on definitely, we are moving in that direction, but I am afraid that not at the speed that the historical moment is requesting from us and not at the level that organizations and people inside them also need. For example, in this conference, I have only detected other 2 colleagues besides you and me who are discussing more or less the same "new governance" if we want to name it somehow, while the rest is still focusing on the traditional structures and even claiming for additional regulations and more hierarchy. It is going to be a tough path indeed, but the truth is that we cannot fight evolution, the traditional corporate governance model is based on hierarchy and control, and that structure comes from a mental infrastructure developed during the industrial revolution when people use to work with their hands. We are not in that stage anymore, we are mental workers!!! Once again just look at cryptocurrency, is not possible that a constructed concept like money has already developed, while corporate governance is still embedded in an idea of the power of control from the 18th century. But what we know for sure is that evolution always wins... sooner or later.

**José Campino:** Absolutely yes. These projects, specifically the ICOs, are almost unknown to most of the people and to the academy. Therefore, there are so many topics one can explore. I did not found studies on ICOs' corporate governance or culture but as we have been speaking, they can propose disruptive ideas that can be applied to other realities. So, there is a lot to study on this field, for example, how are the boards composed, by whom and the hierarchies proposed (or their inexistence). How tends to be the corporate culture of these companies,



how are they organized in terms of CSR? For example, Fintech companies do not have the burden of heavy crises such as banks, promote the employee's satisfaction and benefits and can be more prone to CSR initiatives. For example, as the target market of these companies and their internal composition is much younger in terms of people's age, they are eventually more eager to tackle environmental CSR strategies? This is just an idea.

**José Campino:** It has been wonderful to discuss this with you. I completely share this idea. I would be very happy if more people start dedicating more time to these issues and start exploring more future trends and less on past experiences. For sure today we have new and disruptive necessities which are much clearer in terms of crisis such as the one of today. Hence, corporate governance should for sure keep up the pace at all levels to adapt to this new reality we are living in.

**Alex Kostyuk:** Hi Jose, I went through both your paper and the comments of my colleagues above. My vision of your innovative ideas is about the possibility to integrate all the transformations the board should experience after your suggestions, into the existing infrastructure of corporate governance and regulation worldwide. First – stock exchanges should modify their listing requirements (related to the boards). Second – regulators (various commissions, like the SEC in the USA) should accept a need for these innovations. Third – shareholder activists should pick up these good ideas and promote it to their companies. Your contribution is very important as you outlined your innovative ideas and put it in the profile of the new board structure and probably functions. Recently, you and the community of scholars should promote these ideas to the market participants mentioned above in the way of scholarly papers, market reports, social networks, blogs, and surely conferences. You have just fixed the first stone into the wall, Jose.

**Iliana Haro:** I agree with you Alex, indeed. In terms of regulators, my personal belief is that that is still a long shot since there are a lot of political and economic individual interests involved, but I may be wrong. Maybe for now we could be content by trying to integrate this transformation in organizations that even though are not public and are not subject to specific legal frameworks are self-regulating themselves by incorporating corporate governance frameworks, maybe, that could be the first step in this long path. What do you think?

**José Campino:** Hello Alex. Thank you so much for your comments. It is a very good point and very good insight. I completely agree with you on this and you touched a crucial point here, the regulators and regulations. Indeed, for a company to adapt it also needs so much adaptation to regulations that can block innovation and a cutting hedge decision-making process. This type of companies (Fintech, ICO projects) has much less regulation (sometimes none) and that can be a competitive advantage. They are trying to adapt though. For example, the Whitepaper works for these companies as a prospectus of a fund. The

difference is the regulation once in the Whitepaper almost no regulator will have a role to play. Nevertheless, there are places where this is changing and regulators are looking more closely on the topic.

**Alex Kostyuk:** I see your vision, Iliana. Yes, I think that scholars and scholarly research are drivers of the transformations you meant. My experience tells me that very often scholars are seriously disordered (mainly by politicians) what scholars should do and what incentives should be fixed for us. They forget that scholars are entirely, naturally independent, so my point of view is about the scholarly activism that should have certain outcomes (ideas) and promote it actively through the public.

**José Campino:** If I may complement somehow what was said by Alex, I would say that the regulators were created to regulate the traditional institutions which have (sometimes) tremendous power and influence. Imagine the disruption caused in banks by the appearance of a competitor which completely changes their business model and offers the same but refined product with much lower costs. Sometimes this innovation will likely disappear and be integrated into the usual business model once a traditional institution has the power to buy the new incumbent. Studies have also highlighted the slowness of the regulators adapting to new realities. Regulation can be for sure a safe harbor but at the same time jeopardize innovation if it does not adapt quickly. Besides, today a question appears: what regulators can in fact do to avoid tremendous crisis as the last financial crisis?

**José Campino:** That is a very interesting insight. Alex, may I ask: in your opinion which qualities should a scholar have in order to remain independent despite all the interests surrounding? What are the most effective ways for academics to reach the global public and attract institutions' attention (e.g., regulators, companies)?

**Iliana Haro:** Following your idea Alex, I just came across a concept from psychology that supports exactly what you say, the concept is "availability heuristic", probably you already know it, but for me it was novelty, it refers to "how we tend to judge how likely an event is by how easily we can retrieve an example of it", the relevance of this concept in terms of policy making, according to the author is that, policy makers judge rare events (like Enron & WorldCom) as being much more common, because they can remember them more easily, and therefore they spend larger amounts in them in policy making to combat threats that are not actually the standard in the context, which makes harder and more expensive more regular good behaved organizations to comply with the rules. So, exactly as you say it will correspond the scholarly activism to help policy makers to open their minds to new solutions for old problems.

## 4.4. A MULTI-COUNTRY ANALYSIS OF THE SHAREHOLDER EFFECTS OF CYBER BREACHES

Karen M. Hogan \*

\* St. Joseph's University, Philadelphia, the USA

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### Abstract

This study analyzes global cyber activity for five major non-US countries and compares their descriptive characteristics and cyber-related shareholder value effects to that of US corporations experiencing cyber events during the 1990 to 2019 timeframe. Results for shareholder effects of US based corporations show significant short-term and long-term negative results for all timeframes in all event windows. Unlike their US counterparts, the five major non-US countries used in this study do not exhibit any short-term effects on stock prices from cyber breaches, even though all non-US companies used in this sample also trade on the same US exchanges. Global long-term results are present for only one window. These results allude to a difference in the way the cyber breach information is perceived in the market depending on the country of domicile.

### 1. INTRODUCTION

Historically, most of the publically announced cyber data breaches have occurred in North America, but cyber risk is a growing threat to all companies worldwide regardless of size or country of incorporation. A 2020 study from Allianz Corporation, found that cyber incidents for the first time in history ranked as the number one corporate risk globally with 39% of the 2,700 global risk managers representing over 100 countries in the survey choosing it (Allianz Global Corporate and

Specialty, 2020). The survey highlights the fact that the risk of global cyber incidents has grown exponentially during the past 15 years, along with the dependence on data analytics and IT infrastructure. According to a Ponemon Institute (2019) study, the average cost of a data breach in the US increased from \$7.91 million in 2018 to \$8.19 million in 2019, which is the highest cost globally when compared to other regions. Worldwide, the average cost of a data breach has increased to \$3.92 million.

Key changes in regulation both in the US and abroad, such as Europe's General Data Protection Regulation (GDPR), are increasing both the financial and operational stakes for firms doing business. As a result, cyber risk is important to all countries regardless of their corporate domicile.

This paper will add to the current cyber risk literature by analyzing the short-term and long-term shareholder effects of a comparative set of global cyber events. To the author's knowledge, this is the first paper that has done a global comparative analysis of the shareholder effects of cyber breaches. First, this research will do a descriptive analysis of country-specific characteristics. Next, an event study analysis is conducted to identify short-term and long-term return differences that may exist between US based companies and their global counterparts.

The results highlight some major differences that exist when comparing cyber events in the US to other major countries around the world. While the US still makes up at least 95% of the known breaches, the risks among other major countries are growing. The absolute number of yearly events differs significantly between the US and other major non-US countries, but the relative distribution of events appears to follow a similar pattern around the world with publicized global cyber events peaking in 2017. An industry breakout by country highlights major industry differences between the US and some non-service dominated countries. Current cyber risk frequency and severity indices show similar results for many of the countries with the exception of Japan, which has significantly higher current frequency and severity results associated mainly with the manufacturing industry. Event study analysis highlights major differences that exist with respect to the CARs for the short-term and long-term analysis between the US and other global countries. Analyzing the long-term results with event windows inclusive of (-1 to 90 days) between the US and major non-US firms' elucidates differences there as well. These results support differing patterns of shareholder value effects in both short-term and long-term event windows to cyber breaches for the major non-US corporations than is traditionally seen with the US counterparts.

## 2. LITERATURE REVIEW

Studies on historical stock price changes to cyber breaches have been limited due to the difficulty with data collection. The lack of global and the US federal standardized reporting requirements has also limited the sample size due to low rates for firm self-reporting. Prior research, looking at mostly the US corporations, has found either no change or negative change in firm value as the result of a breach (Campbell, Gordon, Loeb, & Zhou, 2003; Kannan, Rees, & Sridhar, 2007; Gordon, Loeb, & Sohail, 2010; Gatzlaff & McCullough, 2010; Gordon, Loeb, & Zhou, 2011; Amir, Levi, & Livne, 2018; Hogan, Olson, & Angelina, 2019).

Most of the studies are short-term in nature or focus on specific forms of breaches such as loss of confidential data, unauthorized malicious breach, or IT data input errors. In addition, distributed denial of service (DDOS), which denies access to a firm's own computers and servers usually until a ransom is paid are also popular forms of cyber activity (Ettredge & Richardson, 2003; Gordon, et al., 2011; Cavusoglu, Mishra, & Raghunathan, 2004). Other authors, such as Amir et al. (2018), investigate the probability of disclosure. While Sinanaj and Muntermann (2013) and Tanimura and Wehrly (2015) focus on reputation effects.

## 3. DATA AND RESULTS

Cyber breach data was collected using the first notice date from 1990 to 2019 from Advisen Ltd's standard loss feed data for all global cyber events. The first notice date is the public first notification of the event regarding the breach. Cyber events with 100 or more affected individuals per event were organized along with their GVkey and IID and subsequently paired with Permnos gathered from the Center for Research in Securities Prices (CRSP). An event study analysis was done using the first notice date to calculate cumulative abnormal returns (CARs). Any non-trading day was converted to the next trading day. An equal weight index was used to calculate the market abnormal returns. All nonparametric tests were recalculated using the bootstrap method.

Table 1 shows the annual distribution of cyber breaches across the world. The results support the market knowledge that historically the majority of all cyber breaches have occurred in North America, with about 95% of them occurring in the US alone. The annual patterns between the US and the rest of the world do support increases in frequency over time; regardless of country of origin. Both markets show a peak for cyber activity in 2017, which coincides to the widespread growing knowledge of the need for cyber risk management. These results are in line with historical buying habits of global cyber policies with fewer policies written in the global markets. According to experts in the

field, this could be a result of the historical lack of regulation regarding privacy in the global markets. With the recent addition of GDPR in Europe and similar regulations in Australia, there has been an increase in activity for cyber products, along with a growing awareness of the extended negative financial ramifications that can result from cyber breaches (Morkroft, 2019).

Table 2 represents the industry breakout of cyber breaches by country and looks at the current frequency and severity by industry. The data highlights historically popular target companies, regardless of country origin, have personal identifying information, personal financial information, and personal medical information. Other countries such as France and Japan show different cyber breach patterns centered on the manufacturing (MAN) and transportation, communication and utility (TCU) industries, respectively. The current frequency and severity scores by industry show that most countries' current frequency and severity of attack scores range between 50 to 60 out of 100.

Table 3 shows the CARs for the US, and major non-US firms for event windows including (-1 to +5) days. The US companies show an increasing negative short-term CAR in each window from the day (0 to 1, 3, and 5). When looking from the day ( $t = -1$  to 1, 3, and 5) the CARs are slightly more negative for the US firms, suggesting information leakage by the bad actors, insiders with company knowledge, or both. The magnitude of the CARs is relatively small ranging from -17 basis points with the window (0, 1) to -25 basis points with the window (-1, 5). These results support more recent studies, such as Amir et al. (2018) and Hogan et al. (2019), highlighting the possible desensitization of the short-term market reactions to cyberattacks. It is also difficult in the short-term to distinguish significant financial breaches, as very little information is available to the market.

The short-term results for the major non-US firms follow a very different pattern. All windows of the aggregated data for non-US companies show no significant CARs for any windows, implying that on average firms outside the US do not see abnormal negative price reactions to the news of a breach. This result is interesting in that these firms also trade on US exchanges and presumably have some of the same investors purchasing them. Some of the differences might be explained by the differences in cyber breach industry break out for countries like Japan and France that don't follow the traditional US services/FIRE heavy cyber activity. However, that would not explain the differences for the countries that do have similar industry patterns to the US. These patterns might be better explained by a historical difference in regulation. These results are consistent with the individual country data not shown here but analyzed by the author.

Table 4 breaks out longer-term results for non-US CARs compared to that of the US. The results used a buy and hold strategy with results adjusted for bootstrapping. The US results for windows up to 90 days

from the first notice date also show highly significant negative results in each window with a maximum shareholder value change of -1.06 percent associated with the event window (-1, +90). Long-term results for non-US firms show significance only at the window (0, +30) days of -1.59%. Again, it shows that non-US firms historically have not been penalized with decreases in shareholder value resulting from cyber breaches. Results by country, not included here, show some significant windows, but no discernable trends overall.

#### 4. CONCLUSION

The instances of global cyber breaches have been increasing steadily over the past 15 years. Cyber risk is currently the number one risk worldwide. This paper compares the characteristics and shareholder value effects of cyber breaches between the US and five major non-US countries. The results highlight some commonalities and differences between the US and other major countries with regard to cyber breach characteristics. Major differences between US and non-US price reactions to cyber events exist, with US firms having a significant small negative price effect regardless of event window and non-US firms showing little if any significant reactions overall.

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## APPENDIX

**Table 1.** Break out of US breach activity compared to the rest of the world

<i>Year</i>	<i>USA</i>	<i>% to total</i>	<i>Major non-US</i>	<i>% to total</i>
1990s	5	0.14%	0	0.00%
2000	2	0.06%	1	0.62%
2001	3	0.08%	0	0.00%
2002	5	0.14%	0	0.00%
2003	15	0.42%	0	0.00%
2004	5	0.14%	0	0.00%
2005	25	0.69%	0	0.00%
2006	84	2.33%	2	1.23%
2007	94	2.61%	3	1.85%
2008	124	3.44%	7	4.32%
2009	101	2.81%	6	3.70%
2010	97	2.69%	4	2.47%
2011	146	4.06%	6	3.70%
2012	173	4.81%	10	6.17%
2013	287	7.97%	6	3.70%
2014	391	10.86%	27	16.67%
2015	541	15.03%	15	9.26%
2016	595	16.53%	27	16.67%
2017	644	17.89%	33	20.37%
2018	239	6.64%	14	8.64%
2019	24	0.67%	1	0.62%
<b>Total</b>	<b>3600</b>	<b>100.00%</b>	<b>162</b>	<b>100.00%</b>



**Table 2.** Industry breakout of major cyber activity

Country	MAN	TCU	RET	FIR	SER	OTH	TOTAL	FREQ	SEV
Canada	3	3	0	9	21	1	37	56.4	44.2
France	2	24	0	2	0	0	28	60.0	50.1
Great Britain	3	9	0	16	4	0	32	58.8	51.6
Japan	31	1	0	2	2	0	36	76.7	70.7
Netherlands	3	3	0	0	23	0	29	61.6	50.7
United States	377	318	433	591	1801	80	3600	63.5	58.9
<b>Total</b>	<b>419</b>	<b>358</b>	<b>433</b>	<b>620</b>	<b>1851</b>	<b>81</b>	<b>3762</b>		

**Table 3.** Short-term global CARs for companies experiencing cyber events (1990–2019)

US						
Days	N	CAR	Patell Z	p-value	Gen Sign Z	p-value
(0, +1)	2914	-0.17%	-2.688	0.0036	-1.454	0.0730
(0, +3)	2914	-0.20%	-1.800	0.0360	-0.601	0.2738
(0, +5)	2914	-0.22%	-1.427	0.0768	-0.675	0.2497
(-1, +1)	2914	-0.20%	-2.935	0.0017	-2.381	0.0086
(-1, +3)	2914	-0.23%	-2.183	0.0145	-0.156	0.4378
(-1, +5)	2914	-0.25%	-1.806	0.0355	-0.564	0.2863
Major non-US						
Days	N	CAR	Patell Z	p-value	Gen Sign Z	p-value
(0, +1)	141	-0.04%	-0.075	0.5030	0.472	0.3185
(0, +3)	141	0.00%	-0.286	0.4090	0.135	0.4465
(0, +5)	141	0.20%	0.305	0.3200	0.64	0.2610
(-1, +1)	141	-0.02%	0.097	0.4130	0.809	0.2093
(-1, +3)	141	0.02%	-0.127	0.4960	1.483	0.0690
(-1, +5)	141	0.22%	0.394	0.2860	0.978	0.1641

**Table 4.** Long-term global CARs for companies experiencing cyber events (1990–2019)

US						
Days	N	CAR	Patell Z	p-value	C Sect Error t	p-value
(0, +30)	2914	-0.05%	7.049	< .001	-0.196	0.422
(0, +60)	2914	-0.59%	10.257	< .001	-1.639	0.045
(0, +90)	2914	-1.00%	12.937	< .001	-2.083	0.013
(-1, +30)	2914	-0.09%	6.888	< .001	-0.341	0.373
(-1, +60)	2914	-0.64%	10.159	< .001	-1.753	0.039
(-1, +90)	2914	-1.06%	12.869	< .001	-2.17	0.01
Major non-US						
Days	N	CAR	Patell Z	p-value	C Sect Error t	p-value
(0, +30)	141	-1.59%	-1.590	0.0950	-1.51	0.0620
(0, +60)	141	-1.49%	-0.134	0.4580	-1.066	0.1420
(0, +90)	141	-2.67%	-0.399	0.3670	-1.524	0.0660
(-1, +30)	141	-1.59%	-1.199	0.1340	-1.484	0.0690
(-1, +60)	141	-1.51%	-0.052	0.4860	-1.079	0.1440
(-1, +90)	141	-2.68%	-0.325	0.4000	-1.532	0.0660

## CONFERENCE FORUM DISCUSSION

**Alex Kostyuk:** Hi Karen, it is great to read your paper. It is very interesting and outlining many critical issues toward corporate governance practices recently. I saw that as mentioned in your paper “A 2020 study from Allianz Corporation, found that cyber incidents for the first time in history ranked as the number one corporate risk globally with 39% of the 2,700 global risk managers representing over 100 countries in the survey choosing it. The survey highlights the fact that the risk of global cyber incidents has grown exponentially during the past 15 years, along with the dependence on data analytics and IT infrastructure”. It is a serious challenge to the corporate world. Do not you think that corporate governance models, mainly related to the structure of the board of directors, should be transformed accordingly to respond?

**L-F Pau:** Interesting issue to investigate. But the methodology has to be adapted to the combination of national financial market regulations, and of security regulations in those countries which have an oversight agency (btw the EU has one common one in Creta). The point is on several delays: internal discovery of breach, reporting to security/information agency with a mandatory blackout period needed to track/find source of breach, reporting to investors (if any). Regarding the company boards, it is also complicated; normally CEO or COE will be advised first by internal security or CTO/CIO. But normally not any others on board to avoid leaks by external board members; they learn in board meetings held after end of the blackout period. What some companies have done is for some board members to impose government clearances on CEO, COE, CTO/CIO.

**Stergios Tasios:** Hi Karen, interesting presentation. The announcement of a security breach is negative news and therefore the share price is expected to go down (investors are expected to sell their shares). I noticed in the tables some cases with positive cumulative abnormal returns. Do you think that these positive abnormal returns to the shareholders during the notice date or the prior date is an indication of insider trading?

**L-F Pau:** No insider trading, but again a timing issue (see the previous message). Boards release some public info in conjunction with positive financial results say for the quarter, to dilute the effect, thus positives. The problem is with some outsourcing security companies working for the listed one's who also claim victories or increased turnover due to the breaches...

**Stergios Tasios:** Thank you for the clarification, L-F Pau. The time lag is an explanation for the positive abnormal return.

**Dilvin Taskin:** May the CARs differ according to the different type of industry? Probably investors may respond more to the cyber breaches in the financial industry than others.

**L-F Pau:** Absolutely wrong ...I except from this remark the famous insider trading abuses which were not cyberbreaches.

**Karen Hogan:** Hi Alex, thank you for your question. Yes, it is a complicated issue. From the heads of boards that I have talked to they all have their own take on what should be done. Some have regular quarterly briefings from the CIO and some include the CIO/CISO on the board. Others really look at it as a risk management problem that just requires updates to the board. The problem is that more and more class action law suits are being brought against the boards regarding cyber related issues. I don't have any percentages, but I know that the percent of CIOs on boards is growing so I would assume we will continue to see a growing requirement for deep knowledge of information technology as a pre requisite for at least one person on the board.

**Alex Kostyuk:** Your vision of the issue is very clear for me, Karen. You wrote, "I don't have any percentages, but I know that the percent of CIOs on boards is growing". That is great. Is this trend a reason of the generally accepted wisdom by companies? What is the role of regulation? Is the US SEC silent about it? What about the rules on the boards to be transformed accordingly, by the NYSE?

**Karen Hogan:** Hi L-F Pau, thank you for your comments. Yes, there are other country-specific regulations. Just to be clear the announcement date which was used is not the accident date. The average announcement in the database is done months after the initial discovery of the breach. As you noted this could be due to lots of issues and many of them could be regulatory or out of necessity to facilitate the internal discovery and validate that the bad actor was shut down and all sources of infection removed. I do agree with you that all countries would have different regulatory issues. However, the lack of historical demand for a market in cyber insurance in the foreign countries when it existed in the US markets suggests that the breaches which were occurring in those countries were not from a cost/benefit analysis significant to require transfer of the risk. As we have increased the regulations of the companies I believe this will change and I am curious to see if these new return patterns move closer to those seen in the US markets.

**Karen Hogan:** Stergios, I do believe there could be an element of insider trading going on here in addition to some of the other information releases as suggest by L-F Pau. There are documented cases where insider trading has occurred by both company insiders and as likely by bad actors or those paying the hackers. Many of the original small studies did adjust for other positive news announcements and still found significant results.

**Karen Hogan:** Hi Dilvin, I have looked at some industry differences and there are no clear patterns here. It appears some have positive and some have negative returns, but I haven't yet picked apart other possible announcements that could have had an effect on those returns. Industries like the securities industries and the health-related

industries have historically more regulations associated with them and thus could give investors the impression that their data should be safer, but that might not be the reality.

**Dilvin Taskin:** Thank you very much, Karen, for the information and for your wonderful presentation.

**L-F Pau:** There are no sector specifics. Don't forget that, on average, many attacks are from...employees alone or with outside help. That is why CIO's (which have direct or indirect oversight over IT/coms) are usually NOT the proper party on the boards. I see that all the time talking with direct experience.

**Karen Hogan:** Hi Alex, I think each company is looking at it based on what they think the actual cyber risk is. Those that are in the more traditional cyber targeted companies seem to have more of a representation. It would be interesting to see what kinds of surveys have been done. In the US there is no comprehensive federal law dealing with cyber security. However, there are some federal and state regulations that companies do have to abide and some depend on the industry and type of data that is kept. Companies are supposed to many states have enacted breach notification laws especially for PII data. An organization may be required to send a breach notification only to the affected persons, or it may also have to inform state enforcement organizations and/or consumer or credit agencies, depending on local laws. Alternatively, some states require notification only if the breach will cause harm or appears to pose a risk of identity theft to individuals affected by the breach. So, all in all it is a patchwork of rules and regulations. The NYSE really just says that you need to acknowledge that there is a risk and you need to plan for it with "state of the art" standards. I hope this helps as it is ever evolving.

## 4.5. TERRITORIAL FOOD HERITAGE. IS IT POSSIBLE TO VALORIZE AND TO REPORT IT TO LOCAL STAKEHOLDERS?

Nadia Cipullo \*

\* Link Campus University, Rome, Italy

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### Abstract

Food is an expression of the cultural identity of a social group from the cultivation phase of the raw material to that of consumption, passing through the choice of what to put on the plate. The relevance of the cultural aspect connected to food and foodways and to the culinary traditions of a territory is underlined by UNESCO, which recognized "The traditional art of Neapolitan pizza" as an intangible heritage of humanity in 2017, after the "Mediterranean Diet" in 2013. The preservation of healthy and traditional diets such as the Mediterranean one as well as the promotion and protection of food diversity are key components of the global strategy for achieving sustainable development goals. These principles were recently reiterated on the occasion of the fourth UNESCO World Forum on "Culture and Food", at the end of which the Parma Declaration was presented. Among others, the following recommendations contained in the Declaration are relevant for the purposes of this work:

- strengthen the link between culture, food and education;
- guarantee food consumption and production models that place communities and their cultural and environmental resources at the center of sustainable development, to respond to the challenges of the scarcity of natural resources;
- promote, through education, awareness of the value attributable to traditional knowledge.

From a strictly accounting point of view, the cultural aspect of food takes on the connotation of heritage asset, with its own value. The latter is composed of a "use-value", expressed in economic/financial terms, to which it should be added a "non-use value", understood as an intrinsic cultural, historical and religious value, deriving from the simple existence of the good and independent of its use.

This form of heritage asset can be considered a living heritage or "knowledge in action" and, as such, "owned" by an entire community. It, therefore, requires continuous use by the population to last over time and to be preserved for future generations. The commitment of the interested parties and the sharing of knowledge of traditional culture can guarantee the continuous identification of new opportunities for economic, social, environmental and cultural development deriving from the food and foodways.

This project intends to answer the research questions presented below.

1. *What are the territorial communities and organizations that better than others can guarantee the enhancement of food cultural heritage?*

It is believed that mainly three communities/organizations can be identified:

1. *Slow Food Presidia*. The Presidia sustain quality productions at risk of extinction, protect unique regions and ecosystems, recover traditional processing methods and safeguard local breeds and plant varieties. Their goal is to guarantee a viable future for traditional foods by stabilizing production techniques and promoting local consumption.

2. *Bio-districts*. A bio-district is a geographical area where farmers, citizens, tourist operators, associations and public authorities enter into an agreement for the sustainable management of local resources, based on organic principles and practices, aiming at the fulfilment of the economic and socio-cultural potential of the territory. Each bio-district is marked by lifestyle, nutrition, human relations and nature. It results that agricultural productions are more valuable and typically characterized, hence more appreciated by the market.

3. *Ethnographic food museums*. Ethnographic museums are cultural places that have the task of collecting, preserving and enhancing the anthropological evidence of the territory they represent, thus creating a valuable center of culture and research. Thus, each territory can decide to preserve and to interpret its typical products and knowledge related to the world of gastronomy in museums, to testify once again that cooking is an integral part of our culture. The small ethnographic museums, which speak of folklore and popular traditions, are the memory of our culture.

In all the three cases, the link with the territory and its culinary traditions is strong and, therefore, they are natural custodians of the food cultural heritage.

2. *What is the current awareness at the territorial level of the value (cultural, economic and nutraceutical) of food cultural heritage characterizing the territory/community?*

Elicitation techniques of opinions and of the traditional knowledge related to food and foodways can be used – mainly ethnobotanical/ethnographic research techniques, based on surveys. At the same time, the information about methods and tools used for the management, protection and enhancement of this cultural heritage should be collected. Then the data should be analyzed through quantitative and qualitative methods.

3. *How can the values attributable to food cultural heritage be identified?*

This question involves the identification of the "use-value" and the "non-use value" of the assets deriving from the food cultural heritage. For the purpose of determining the "use value", methods of economic and financial analysis (such as the discounted cash flow analysis) can be used for the flows deriving from cultural or ecotourism-related uses of the asset, entrance tickets to the museums, revenue streams for farmers and their agribusiness activities involving the active use of the territorial heritage, etc. On the other hand, the non-use value should be estimated mainly through economic analysis methods since these are values relating to goods that are not traded or acquired on the markets, and therefore difficult to express in terms of price. For example, many of the socio-cultural qualities associated with food are also non-use values. They derive from the qualities of the public good of the cultural heritage, identifiable in the non-rivalry and non-excludability. In order to appreciate these values, preferred techniques and, in particular, contingent analysis methodologies (contingent valuation methods - CVM) will be used. CVM is an investigative approach that creates a hypothetical market for the heritage considered as a public good, determining what people would be willing to pay for certain changes in the quantity or quality of those assets or what they would be willing to accept as compensation for well-specified reductions in the supply of such goods.

4. *How can the identified values be reported?*

The most appropriate reporting technique should be based on the concept of responsibility. The community/territory report must contain economic/financial values, as well as values that represent the expression of the socio-cultural component of food and foodways. The report will, therefore, be characterized by a financial and a non-financial component, in an integrated sustainability reporting logic. The current indications of the Global Reporting Initiative (GRI) and, in particular for the public sector, the IPSASB (International Public Sector Accounting Standard Board), aim to closely combine the two souls in a report in which the narrative component has a significant weight and relevance. The report will identify specific performance indicators for the territory (KPI) and

risk indicators (KRI), which illustrate and monitor the objectives to be achieved, as well as the challenges and corrective actions, implemented to address the risk of loss of cultural biodiversity.

In addition, the valorization also passes through the use of digital technologies, among which the use of QR codes and narrative labels (in the case of slow food) and the innovative blockchain technology for the agri-food sector take on particular relevance and they should work alongside the integrated report.

*5. What are the expected outcomes of the valorization of food cultural heritage and of its reporting?*

The active involvement of the local population in the collection and dissemination of data in a bottom-up logic can be the basis for the creation of *territorial living heritage labs* for the identification of new opportunities for economic, social, environmental and cultural development.

*6. Can the enhancement of food cultural heritage contribute to sustainable development?*

The territories and communities/organizations that value their food heritage economically, socially and from an environmental point of view can contribute to the achievement, among others, of the following sustainable development objectives of the 2030 Agenda of the United Nations:

- 2) end of hunger;
- 3) improve health and well-being;
- 8) promote inclusive and sustainable economic growth;
- 12) guarantee sustainable production and consumption models;
- 15) promote sustainable use of the terrestrial ecosystem.

It is also believed that the integration of traditional food-related knowledge into the policies and strategies of territorial actors guarantees sustainable food production, conservation of natural resources and resilient agriculture.

The expected results of this research are represented:

- by the identification of a set of assessment methodologies for the "use value" and the "non-use value" attributable to food and foodways. In fact, it is believed that the classic accounting and financial reporting methodologies must be integrated with other methods typical of the general economy, such as the contingent valuation method.

- by the preparation of an integrated sustainability report model, which also makes use of smart and innovative technologies in order to generate a digital cultural heritage, replicable in other private and public entities. This report will consist of a financial and a non-financial part and will constitute a real "territorial report".

- by the active involvement of the local population in a bottom-up logic. This form of the heritage asset, in fact, can be considered as a living heritage. It, therefore, requires continuous use by the population to last over time and to be preserved for future generations. The



stakeholder engagement during the data collection, preparation and dissemination of the integrated report will, in fact, represent the basis for the creation of *territorial living heritage labs*, within which the open and multi-stakeholder approach to innovation and knowledge sharing of traditional culture can guarantee the continuous identification of new opportunities for economic, social, environmental and cultural development deriving from the use, promotion and protection of the food cultural heritage. This result is in line with the Sustainable Development Goals of the 2030 Agenda and with the "Council of Europe Framework Convention on the Value of Cultural Heritage for Society" (Faro Convention). As a matter of fact, culture is the fourth pillar of sustainability and cultural heritage must be protected not only for its intrinsic value but also as a resource for socio-economic growth. In this context, the "*heritage communities*", that is the local communities choosing to attribute value to the cultural resources that they inherit from the past and that they consider as their identity values, play a pivotal role in protecting and passing on these resources to future generations.

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## CONFERENCE FORUM DISCUSSION

**Dmitriy Govorun:** Hi Nadia! Thank you very much for sharing the project and key research questions as to the project. I like the idea to look at the cultural aspect of food as "Heritage Asset". You've pointed out Slow Food Presidia, Bio-districts, Ethnographic Food Museums as structures which better than others may guarantee the enhancement of food cultural heritage. How should they have been governed – new governance model or existing one but modified? How should it look like to your opinion – all these organizations should have been governed one by one or through one system? It should be noted that integration of classic accounting and financial reporting methodologies with other qualitative ones sounds like a reasonable suggestion. However, it is much better to see in detail proposed methodologies and their combinations. One concern should be also noted here. It is preferable to outline possible ways of solutions on how to calibrate and validate results for such integrated hybrid methodologies.

I see that you have stated a report as a result of the project. Of course, stakeholders are expected to assist in collecting the data for further information usage. It will be quite good to have information regarding the costs of such reporting for stakeholders.

## 4.6. ENABLING FACTORS IN INNOVATION GOVERNANCE: A BUSINESS POLICY APPROACH

Pedro B. Água<sup>\*</sup>, Anacleto Correia<sup>\*</sup>

<sup>\*</sup> CINAV, Portuguese Naval Academy, Almada, Portugal

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### Abstract

Innovation governance is a key for competitiveness, process improvement and organizational sustainability. Even in the public sector, a lack of organizational innovation may affect the organization in very different ways, ranging from lost opportunities for more efficient and innovative processes, up to staff morale; staff that embeds organizational knowledge, values and culture, which organizations wish to retain. Innovation can also provide new ways of doing things aimed at strengthening competitiveness. A more innovative organization can also make people jobs more fulfilling, help them overcome challenges and ultimately make the world a better place. There are not many authors linking organizing for innovation to corporate governance. Board directors have a considerable contribution to give in organizing for innovation, and policies that direct the organization towards a more innovative culture, oftentimes in face of organizational difficulties and scarce resources. We take a business policy approach to organizations, considering four critical governance areas. The followed methodology brings a logical thinking approach to organizational governance, with a focus on causality. It ends with suggestions on key steps towards better innovation governance, alerting for some dangers.

### 1. INTRODUCTION

Currently, board directors have a much broader scope, than just ensuring compliance with regulations, playing more active roles (Charan, 2005;

Nueno, 2016). This demands board directors to step into matters as strategy shaping, risk supervision and guidance, and supporting management in organizational development, of which organizing for innovation is one facet (Lorsch, 2012; Hill & Davis, 2017).

Innovation architecture is defined, within the scope of this text, as *an arrangement through people that makes other people innovate by changing the environment they work in* (Miller & Wedell-Wedellsborg, 2013). Innovative organizations own a highly sought-after competitive edge, with several benefits beyond direct growth potential. As organizations are systems, a suitable approach in dealing with them shall be a systems approach as well.

This text proposes an approach that connects three frameworks, into a single systems approach, to support innovation governance. It starts by considering the main reasons for change, then questioning what to change; what to change to; and how to cause the change. In order to do so it needs the identification of critical success factors for attaining the desired future organizational innovation paradigm; starting by assessing the current stage; creating needed transformations to fill the gaps, providing for the design of a "future reality tree" – a cause-and-effect logical tree, which shows how selected actions enable a more innovative organization. The framework ends with two additional kinds of trees; one aimed at identifying organizational obstacles to change and another one focusing on strategy deployment. Finally, some key remarks are made concerning models, their validity and usefulness.

## 2. A HOLISTIC APPROACH TO ORGANIZATIONS

Senior managers choose and act in order to achieve a desired future situation for the organization. Architecting and creating a desirable new organizational culture – a culture of innovation – demands, approaching the organization in a holistic way to ensure that unintended consequences are minimized.

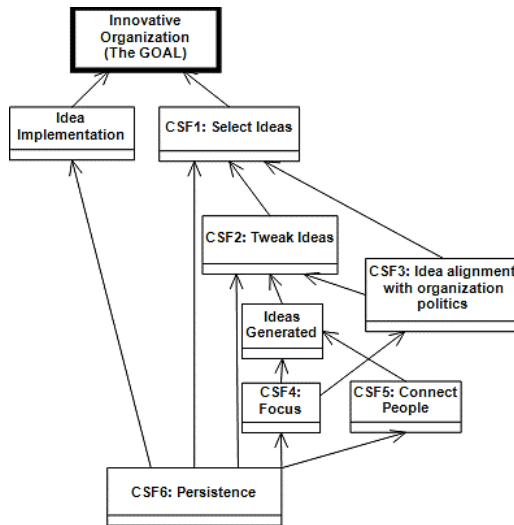
Among several possible approaches, Christensen, Andrews, and Bower (1978) did set up the early roots of a holistic organizational approach – the *business policy approach*. Later on, Vicente and Tomas (1991) developed the *business policy model*, building on the previous works, and conceived senior leadership work as including four main areas of governance, together with the development of specific procedures that provide detailed steps for the analysis, choice and implementation of the organization's desired future. These governing areas are: 1) the business; 2) the directing structure; 3) professional commitment (incentive systems); and 4) the institutional configuration.

The business policy model suggests that management may be more humanistic, and practical, being a good alternative to the traditional school of thought that promotes a narrow approach to strategic management, focusing almost exclusively on short term indicators.

### 3. TOWARDS A MORE INNOVATIVE ORGANIZATION

A considerable effort has been made in order to understand the governance of innovation and how to make an organisation more innovative. The usefulness of a model is oftentimes at odds with its comprehensiveness, which makes us look for simpler but useful models. Miller and Wedell-Wedellsborg (2013) suggested a model supported by six critical success factors (CSF), which are crucial when considering an innovation strategy aiming at attaining a better innovation culture. These key components are: 1) focus; 2) connect; 3) tweak; 4) select; 5) stealthstorm; 6) persist. These authors suggest that ideas on their original form are rarely ready for deployment, and need to be "tweaked" in order to improve. Figure 1 illustrates how the mentioned six critical success factors, CSF1-6, supports the main goal – getting an *innovative organization*. As suggested by Miller and Wedell-Wedellsborg (2013) having good ideas is a "necessary condition", however "not sufficient".

**Figure 1.** The strategic intermediate objectives map



The movement towards a more innovative organization is a governance process that demands a "change strategy", which by itself demands a suitable strategy development approach. The term "development" suggests the strategy process does not end with the strategy formulation but actually shall continue with the strategy deployment in the field, together with the "normalization of innovation" (Vilà, 2011). Among several possible approaches, theory of constraints (TOC) thinking processes (Goldratt, 1994) is a possible one, as it allows

for a robust establishment of cause and effect relationships, allowing for fast recognition of the strategic problem and root causes identification.

#### **4. LOGICAL THINKING PROCESS APPROACH TO INNOVATION STRATEGY**

Governing innovation demands attention to change management and expected resistance to change. Traditional organizations, like the ones found across aged forms of organization (e.g., public service departments), are typically more resistant to change. This is probably due to organizational learning and the establishment of many negative feedback loops alongside such learning. When change is needed, a policy or set of policies are needed in order to change the system – the organization. Such may be the case when we try to change an organization with many strong negative feedback loops into a more innovative one, which needs some “freedom” to change. Many examples exist across organizations, from the case of (potentially outdated) written procedures to cultural constraints, as the typical “that’s not the way things work around here”. If negative feedback loops are the ‘brakes’ of organizations, then positive feedback loops are the ‘accelerators’ and change drivers.

Proper governance of innovation is imperative and *change is of the essence*. The TOC thinking processes (Goldratt, 1994) suggests one possible comprehensive approach to problem-solving, bounded by the four questions: 1) Why change? 2) What to change? 3) What to change to? 4) How to cause the change?

While the answer to the first question – *Why change?* – seems obvious, the remaining three questions need addressing, which is progressively done below by making use of logical trees.

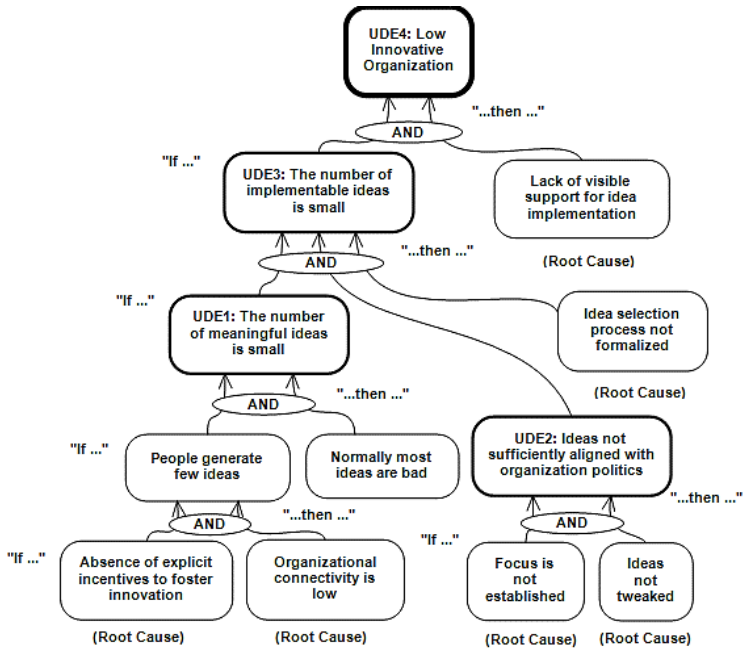
The process starts by forcing the organization to rethink its desirable innovation paradigm; then comparing it with its current paradigm in order to analyse the differences. After these stages, the process demands the creation of a transformation and design of a suitable strategy, after which comes the planning, execution and deployment stages.

The next stage encompasses the drawing of a “strategic current reality tree”, in order to clarify what is wrong with the current paradigm. Such a tree develops from the bottom up (Figure 2). The terminating statements reading undesirable effects (UDE) are the unwanted effects triggered by the precedent chains of cause-and-effect. Also salient in the tree are “root causes” that shall be addressed in later stages of the process.

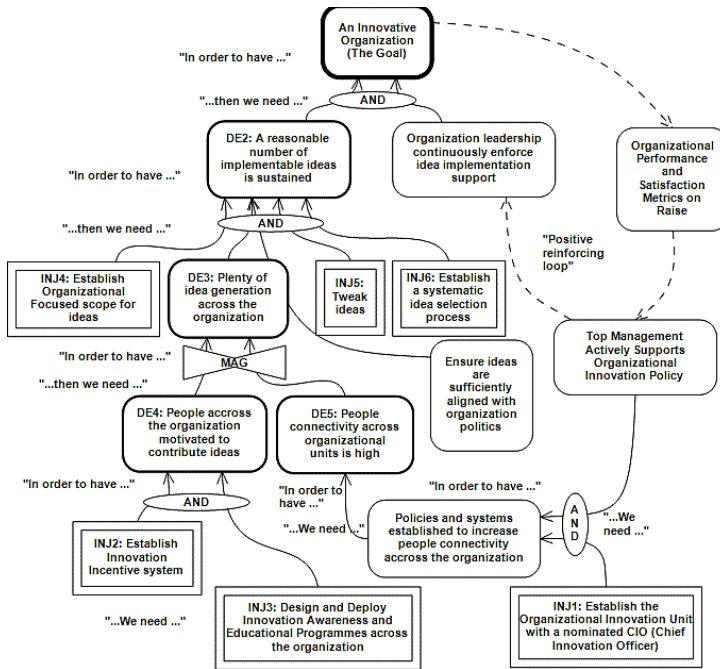
Next, taking the concept of “evaporated clouds” into account – a process of creative problem solving (Goldratt, 1994) – and focusing on the identified root causes, progress will be towards “*What to change to?*” in each of the four business policy model governance areas in order to

eliminate the undesirable effects and end up at a strategic future reality tree (S-FRT). This calls for addressing the root causes of problems as well as assumptions on how the whole organization functions. Figure 3 shows the future reality tree with several “injections” (INJ#) in order to change the whole innovation architecture towards a better paradigm, thus approaching the whole organization to its goal – becoming a more *innovative organization*. The S-FRT conveys a narrative where the “injections” (INJ#) are enabling actions that will drive the organizational system towards the desired goal. With the visible desired effects (DE1-5), the S-FRT answers the third question (*What to change to?*). Hence the last question – *How to cause the change?* – or how to deploy the formulated strategy to make an organization more innovative, is addressed by the *prerequisite trees* and *transition trees* (Mabin & Davies, 2010).

Figure 2. Strategic current reality tree

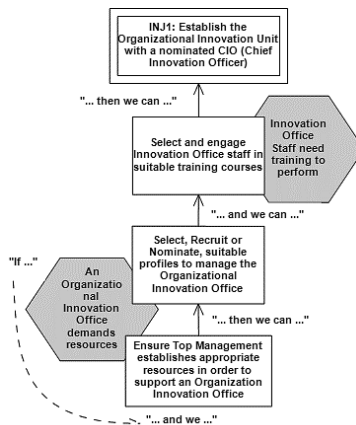


**Figure 3.** Strategic future reality tree



Prerequisite trees are built to ensure the ‘strategic injections’ are implemented in practice and obstacles to implementation are removed. Figure 4, illustrates a sample of the identified injection actions.

**Figure 4.** A sample of the strategic prerequisites tree

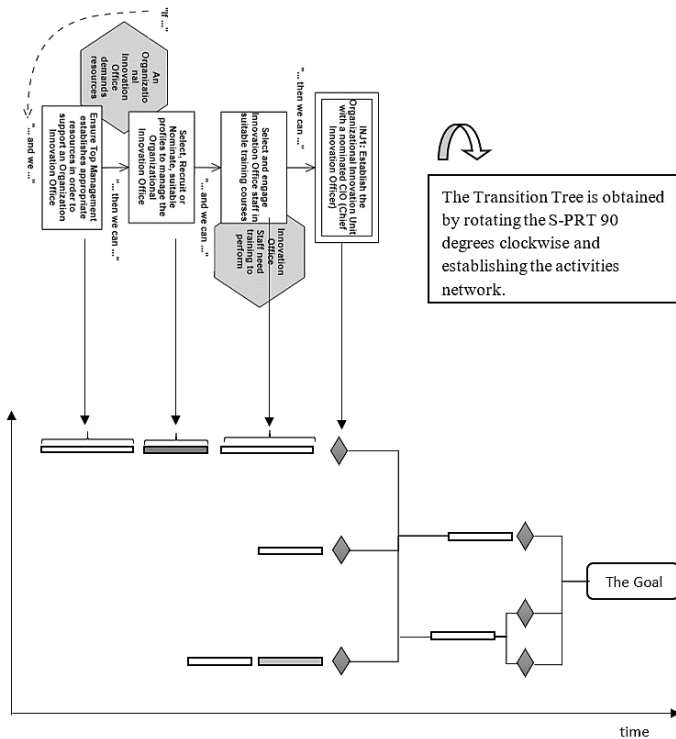




The strategic prerequisite trees and the due connections into the main strategic future reality tree mean halfway to answer the fourth question (*How to cause the change?*). The hexagons signal obstacles that must be overcome in order to implement the changes.

The prerequisites tree address such potential obstacles in the way of organizing for innovation. In order to deploy such a strategy, the TOC thinking processes includes the sixth kind of tree – the transition tree (TT) – which bridges into the world of project management, providing activity networks, and allowing for scheduling aimed at implementation (Figure 5).

Figure 5. Transition tree



## 5. CONCLUSION

This model provides several tangible measures that if taken in the correct sequence improve organizational performance in what innovation governance concerns, such governing measures ensure the organization will progress on an innovation maturity curve from initial stages towards

a better innovation culture. The model is useful enough in providing strategic guidance, by identifying several key areas where to focus attention; as well as the following suggested measures: 1) the need to design and deliver innovation short programmes across the several organizational units and echelons in order to create a proper level of awareness on the importance, possibilities and mechanisms of organizational innovation; 2) to progress towards a higher maturity level, a tailor-made in-company programme may provide a considerable thrust toward the organizational innovation goal; 3) once the enabling conditions are in place, the creation of an “organizational innovation unit”, headed by a senior officer with direct report to top management; 4) several programmes can be launched, as would be the case of an “idea platform” and “innovation selection and steering committees”; and 5) an innovation incentive system shall be put in place in order to make innovation systematic. As motivation is always a factor in shaping people’s mindset, such an incentive system can benefit from the creation of “innovation awards” and making innovation a key appraisal criterion for promotion advancement.

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## CONFERENCE FORUM DISCUSSION

**Rainy Trinh:** Hi, thank you for this effort. Yet it is still not quite clear for me what innovative governance is. How can you define it and measure it? And what is your specific context?

**Pedro Agua:** Dear Rainy Trinh, thanks for your comment. However, it's not about "innovative governance" but "innovation governance". A considerable amount of literature existed for years on the importance of innovation at a more executive level (Clayton Christensen among the most known). What is more recent is perhaps the concept of "organizing for innovation", a subject that may dictate the sustainability of organizations. In the same sense that strategy, and even risk management (beyond the mere financial one) is ultimately a responsibility of the board in this "post rubber stamp" age, the same is true for innovation as a philosophy and overall organization architecture. The paper doesn't focus only on Sophia, but phronesis, i.e., how to do it from a practical wisdom perspective, bringing together the business policy approach (Kenneth Andrews, HBS) as an adequate framework for board directors to frame proper governance. The paper further develops the "how to do it". As someone said, "the future is not a question of optimization, but initiative". So, boards have no chance but to step into a progressive board mode (Ram Charan in *Boards that Deliver*).

**Iliana Haro:** Dear Pedro and Anacleto, thanks for sharing your work and perspective. I really enjoyed going through your presentation and later on, reading your paper, particularly when you mention the importance of intrinsic and extrinsic motivation and the demand of "connect" as a key factor for innovation governance, I completely agree with you. So, in your opinion, do you think that HR should begin to play a strategic role in corporate governance? You may find useful the literature and research by Armin Trost on agility and strategies; he discusses a lot the roles of intrinsic and extrinsic motivation, locus of control, self-efficacy and self-regulation, and the implications of feedback. Is this the final paper? Will you extend your research on this topic?

**Alex Kostyuk:** Hi Pedro, I picked up a few interesting issues from your paper and comments above. The first – you fixed a medicine for a well-known disease of corporate governance that is "rubber stamp" boards. This is "innovation governance". What is your vision on how to put this conceptual vision into the empirical context? The second – you refer above to the well-grounded statement that "the future is not a question of optimization, but initiative". Does it mean that the future of corporate governance is not about the structure of corporate governance institutes (like the board of directors) but rather this is the issue of corporate governance leadership?

**Juliet Wakaisuka:** Recent research has shown that the majority of the organizations have embraced innovation models to build a competitive advantage; most seem to consider internal factors,

including your study, Pedro and Anacleto. Don't you think another examination of data focusing on external factors in innovation governance, would be good?

**Dilvin Taskin:** My question is about the possible empirical analysis of your model. What would be the relevant variables in order to test your approach?

**Pedro Agua:** Dear Juliet, thank you very much for your comments and question. Indeed, data shall be sought when appropriate, and if available. Studies of the board under operation are difficult as we know. But being at the beginning of this line of research we are "hunting" for more data and structured knowledge. However, any model is a simplification of reality as we all know – so, not only can't we solve complex systems with such mechanistic approaches, as we create potentially a lot of unintended consequences ("The pathway to hell is paved with a lot of well-intended actions"). In this sense the line of thought we started is in the beginning and we are dealing with case study analysis (or perhaps "quali-quant" approaches), as pure empirical approaches (also a model of reality) seems less appropriate. But being in the beginning of this line of research we are "hunting" for more data and structured knowledge.

**Pedro Agua:** Dear Dilvin, thank you very much for your comments and question. At this moment case study research (qualitative approach) seems more relevant as it allows the building of understanding in a more systemic way. Organizations are systems (in fact the whole world is a system and we only split it into subsystems to build understanding... but at a cost), and systems thinking methodologies and case study research is our starting points, however, we are not sure where we will be ending (as in any long-term research).

**Pedro Agua:** Dear Alex Kostyuk, thank you very much for your comments and question. It is indeed a question of both structure and leadership. In our perspective, the world has got too much of "compliance structures", as it could solve the problems. We shall recall that most of the big corporate scandals happened in the presence of codes&regulations. Compliance codes and regulations ensure the "minimums", but it's "phronesis" and ethics that aspire to the maximums and organization can perform. Phronesis, the very big study subject of Aristotle, is beyond "Sophia" (where Plato and Socrates were positioned). In my perspective the world is growing in the number of codes and regulations (not only for corporate governance, but beyond) because world's complexity increased and we (generally speaking) believe we can reduce everything to such frames. From the beginning of XX century up to 1980's as mentioned the business policy with roots in Harvard Business School, ad a strong focus on ethics and Kenneth Andrews himself also included the corporate governance as a "Continuum" from top management to ownership or constituencies. This more than 50 years "Business Policy Scholl of Thought" was lost for the more "sexy" strategic

management current, where again the mechanistic approach, promising simplicity was though – but where not much is considered about the humanistic side of organizations, ethics and ultimately the “practical wisdom” so intrinsic to the business policy current of thought. Also, the world of organizations’ and it governing doesn’t seem go well, otherwise, we would not be gathered here in this event. So, perhaps we have to return to some frameworks of the past, blend it with new knowledge developed since then, (also, “imperfect models of reality”) and advance not only our knowledge (Sophia) on organizational governance but more importantly, our practical wisdom (phronesis) as that is what would make tomorrow better than today. Moreover, might be an opportunity to reduce the well-known gap between academics and practitioners. Having system thinking and modeling backgrounds, we will try to further formalize a systems approach into this line of research. But you touched the point when you called attention to leadership. Is that just leadership is not one size fits all. Leading boards and its dynamics is (our opinion) a special case of leadership. Getting more involved with an “organization’s culture” shaping does belong (also) to the board agenda. And innovation governance is one faced of such desirable culture, which demands governance, otherwise might fall of the executive management agenda’s then other priorities raise (cutting costs for example).

**Pedro Agua:** Dear Iliana, thank you very much for your comments and question. Indeed, HR shall be involved, perhaps not only in a “minor” role (as traditionally compared with finance and auditing folks) but as an equal. Organizations are systems – “a set of parts interconnected for a purpose”. One may find two main features within systems: 1) leverage points and 2) constraining points. In this sense it is not people or functions that command systems performance (organizational performance) but the joint effect of all them. Your question reminded me of Kenny’s and Gennard’s book *Power and Influence in the Boardroom: The Role of the Personnel/HR Director*. Moreover, this is just the initial paper. More is being developed, including specifying organizations, in order to provide more examples and foster thinking.

**Alex Kostyuk:** Pedro, I expect that when this quarantine will be over, universities and institutes will start outlining their budgets for 2021 and....I would only dream that the possibility to arrange "at place" conference come back. Scholarly communications will transform, as for my expectations, and will become more hybrid. The only issue that is absolutely clear recently – the scholars cannot be stopped by any pandemic and quarantine in their intention to establish scholarly network. We need to recognize this wisdom and move forward altogether.

**L-F Pau:** Alex is absolutely right and this subject is on T. Breton's restart plan agenda (being on the team).

**Pedro Agua:** Those are nice comments Alex, and I’m sympathetic with your point. I have a long career as senior manager in national and

multinational organizations, before I joined academia. My aim is to help bridge the gap, that was once broken (not sure when), in order to bring a more "applicable" sort of research. That's why my focus is on practical wisdom. I find myself going sometimes to Aristotle, St. Aquinas, St. Agustin (even King Solomon for some inspiration :0), when it comes to link decision making, leadership and ethics on corporate governance matters. An interesting book I just start reading and take the opportunity to share with whom may be interested in these subjects: *Phronesis and Quiddity in Management: A School of Knowledge Approach*, by Kimio Kase. Thanks for your questions. In the end, it's the questions that make knowledge (and wisdom) advance, not the answer.

**Mireille Chidiac El Hajj:** Hello. Interesting article yet confusing methodology. Is it qualitative? Or a grounded methodology? How did you build all the assumptions? The proposal is nice but what are the fundamentals or the basis of the study?

**Pedro Agua:** Hi Mireille, certainly lean towards grounding. As for methodology, there is a recombination of three main frameworks, but with a solid cause-and-effect methodology (systems thinking tools), not statistics. That's why above I mentioned that even if it may evolve for a quali-quant approach, at this moment we are working with logic trees, taking Goldratt's logical thinking process as a basis to fill the gaps. (I doubt real board could go beyond that in terms of formalism. Logical thinking process is a language accessible for any board-level person, in principle. And these are the ones we intend to reach). As for fundamentals, I would suggest looking into the works of Paddy Miller and Joaquin Vilà at IESE Business School, especially the ones on cultures that foster innovation across the organization (and as such promotes the seeds of future competitiveness – a point that should be in any board agenda).

## 4.7. CHARACTERISTICS OF FIRMS ELIGIBLE TO GO INTO "EXTRAORDINARY ADMINISTRATION" IN ITALY

Pierluigi Santosuosso \*

\* Faculty of Economics, Sapienza University of Rome, Italy

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### Abstract

Large financially distressed firms are admitted to "Extraordinary Administration" (EA) in order to preserve corporate assets, through the continuation or reconversion of entrepreneurial activities pursuant to the Legislative Decree 270/99. One or three judicial commissioners appointed by the Minister of Industry are engaged to manage the company admitted to EA. However, not all financially distressed firms are eligible to go into EA. First, firms are admitted to the procedure if there is a prospect of preserving the business as a going concern. Second, admission to the EA is restricted to large and highly leveraged firms. In more detail, two quantitative limits are required: 1) no less than two hundred employees in the last financial year; 2) debts not less than two-thirds both of revenues and of total assets in the last financial year.

The present study examines the scope of the admission requirements 1) and 2) by analysing firm characteristics that differentiate companies eligible to go into EA from those that are not admitted. More specifically, a sample of firms with at least two hundred employees and debts not less than two-thirds both of total assets and revenues was compared with a sample of firms with more than two hundred employees and debts less than two-thirds of the aforementioned amounts.

The logistic regression model was used for more than 1,500 Italian manufacturing firms. Proxy variables of firm size, cost of debt, firm leverage, asset composition and firm profitability were used as explanatory variables. Average values of the explanatory variables used in the logistic regression model were calculated for the three-year period 2015-2017.

Research findings revealed that the probability of having firms with an amount of debts greater than two-thirds of both total assets and revenues increases as the cost of debt, long-term debts and accounts payable increase. The analysis revealed a negative relationship with the percentage of fixed assets. A statistically significant negative relationship also emerges with firm profitability as measured by the ratio of operating income to total assets. In short, the most leveraged firms that are admitted to the procedure are more exposed to suppliers, have a higher average cost of debt, are less profitable and have a lower amount of fixed assets as compared to total assets.

Overall, the results of the present study enhance our understanding of the scope of the objective requirements of the Decree by exploring several firm characteristics. Policymakers should be particularly interested in this issue, together with creditors, workers and shareholders of firms. However, the research findings should be interpreted with caution since only manufacturing firms were considered, with the exclusion of banks and other financial companies.

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## CONFERENCE FORUM DISCUSSION

**Dmitriy Govorun:** Dear Pierluigi, thanks for your material and the topic. We always prefer to discuss active companies and businesses with high performance, governance principles, etc. However, poor governance or critical biases in risk management, control function, or just strategy of the companies lead them to financial distress.

Thanks for the consideration that only manufacturing firms were studied, and further studies should be done. Of course, financial companies have different structures of capital and so they should be analyzed in additional papers. I also expect that there might be additional specifics defined by regulators as to the "extraordinary administration" (EA) in financial companies and banks.

I would also try to model samples of companies around criteria defined by Legislative Decree 270/99. So, it may be an expanded number of employees plus modified limits for the level of debt. This is just to compare the data received in both samples. Conclusions regarding the changes for such criteria may be outlined in this case (either to expand the threshold or leave it as is). We may also see that the Decree has been issued many years ago. This means that we may have data for more than a 3-year period 2015-2017. It is good to see the background for a selected number of years for modeling (available data, statutory claims period etc.). Thanks in advance.

## 4.8. DIFFERENCES IN CULTURAL-REFERENCED AND SELF-REFERENCED VALUES AND THEIR ROLE IN CULTURE IDENTIFICATION

Salman Saleem \*

\* School of Business, JAMK University of Applied Sciences, Finland

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### Abstract

In literature, there is a heated debate on the various conceptualization of culture (Zolfaghari, Möllering, Clark, & Dietz, 2016). Literature in management and cross-cultural psychology suggests that scholars have used a variety of conceptualization to operationalize the culture (Sun, D'Alessandro, Johnson, & Winzar, 2014; Kirkman, Lowe, & Gibson, 2017). Some scholars have argued that the culture multifaced phenomenon as it may be measured by social norms, values, practices to mention a few (Fischer, 2009). However, scholars seem undecided which construct, such as self-reported values, cultural referenced practice, the social norm to mention a few, form culture. Thus, culture is regarded and elusive concept as the existing ways of operationalizing culture does have limitations. In the cross-cultural psychology the self-reported values, where the individual is asked to report the importance of values in their individual behavioural preference. For instance, Hofstede, G., Hofstede, G. J., and Minkov (2010) six cultural dimensions become dominant method to identify culture in various domains such as international and cross-cultural management (Kirkman et al., 2006; Kirkman, Lowe & Gibson, 2017), international and global advertising (Saleem & Larimo, 2017) to mention a few. However self-referenced approach to measure the culture has been criticized quite heavily on several grounds. For instance, self-referenced values vary more significantly within a culture

than across cultures (Fischer & Schwartz, 2011; Schwartz, 2014). There is a very weak overlap between self-referenced and culturally referenced values (Fischer, 2006). Also, the self-referenced approach lack in capturing several aspects of culture namely, social cynicism, power distance (Sun et al., 2014) and norms are better in predicting intentions and behaviour across cultures than self-reported values (Fischer, Karl, & Fischer, 2019) to mention a few.

Some scholars have chosen another approach namely group-referenced to measure the culture, where they shift the referent and asked the individual to report on the typical values of their group and society (House, Hanges, Javidan, Dorfman, & Gupta, 2004; Fischer, 2009). In doing so they have asked the people to report on the descriptive norm of society their societies. For instance, a large-scale cross-cultural study by GLOBE scholars has measured descriptive norms of their societies by asking people from 62 societies to report social practices concerning the nine values (House et al., 2004; Javidan, House, Dorfman, Hanges, & de Luque, 2006). Several scholars have emphasized the significance of cultural-referenced approach to measuring the culture (House et al., 2004; Wan, Chiu, Peng, & Tam, 2007; Fischer et al., 2009; Sun et al., 2014). Also, studies have shown the usefulness of the cultural-referenced approach in understanding cross-cultural economic development, competitiveness, communication studies, social health (Javidan et al., 2006).

This study addressed an interesting and important question of whether self-reported cultural values and/or cultural-referenced values identify culture. Thus the study has contributed to the current debate on the significance of cultural referenced values over self-reported in the identification of culture (Oyserman, Coon, & Kimmelmeier, 2002; Fischer, 2006; Fischer & Schwartz, 2011; Schwartz, 2014). More specifically the study has examined whether there is a difference in the self-referenced versus cultural-referenced masculinity and power distance values. Also which facet of masculinity and power distance self-referenced and/or cultural referenced ratings predict the manifestation of such values in the culture.

Using self-reported approach Hofstede et al. (2010) have measured masculinity versus femininity and have asked respondents to report on the extent to which their personal life is driven by achievement, competition, assertiveness, and quality of life. Hofstede et al. (2010) aggregated the self-reported masculinity at a country level and ranked approximately 100 societies on a femininity-masculinity continuum. In the same vein Schwartz's (1992) mastery versus harmony dimension measure people preference of achievement versus peace with everyone. More recently the GLOBE used assertiveness labels to measure to what extent societies differ on assertiveness in relationship with others. To sum up, the above mentioned three scholars have tried to address the core issue of achievement and success over harmony and peace. However,

a study shows that there is no correspondence between Schwartz's (1992) mastery's self-reported and culturally referenced ratings (Fischer, 2006).

The study by GLOBE shows, even more, sever results as they found a significant negative correlation ( $\gamma = -0.26$ ,  $p < 0.05$ ) between assertiveness orientation values and cultural-referenced practices (Quigley, de Luque, & House, 2012). Other GLOBE studies have shown that people from 61 societies have experience greater assertiveness in their cultural practices and they wish it to be lower. Based on the above the study proposes that self-reported masculinity differs significantly from cultural-referenced masculinity. Also, self-reported masculinity may not predict the reflection of masculinity in culture rather cultural-referenced masculinity may predict the manifestation of masculinity in the culture.

Also, Hofstede et al. (2010) have used the self-referenced approach to measure the extent to which people accept power and its equal distribution to measure power distance. However, scholars have emphasized that self-reported power distance may not reflect the actual culture (Fischer, 2006; Sun et al., 2014). Chirkov, Ryan, and Willness (2005) have argued that power distance practices such as respect of authority, unquestionable adherence of norms are not well internalized because they are against the human being fundamental needs of autonomy. Also people in modern and democratic may incline to report low power distance in their personal life (Schwartz, 2004). A study by Fischer (2006) confirms above scholar's arguments as the study found no correlation between self-reported and culture referenced rating of Schwartz (1992) egalitarian values. GLOBE study shows a power distance paradox as they found that self-reported power distance is negatively correlated ( $\gamma = -0.43$ ,  $p < 0.01$ ) to power distance culture practices. Based on the above the study proposes that self-reported power distance ratings differ significantly from cultural-referenced power distance. Also, self-reported power distance may not predict the reflection of power distance in the culture rather cultural-referenced power distance may predict the manifestation of power distance in the culture.

The study has used a survey method and asked respondents to report masculinity and power distance in their individual behavioural preference and in their social context. 200 respondents have participated in the survey. Specifically, the respondents were asked to report on their self-referenced and culture-referenced masculinity and power distance values. Also, respondents were asked to report the manifestation of masculinity and power distance in advertising of their country. Statistical techniques of dependent t-test were used to check whether there are differences in the self/cultural-referenced masculinity and power distance. Moreover, linear regression models were used to examine whether self/culture-referenced masculinity and power distance predict the manifestation of masculinity and power distance respectively, in popular media advertising. The results show that for both cultural

dimensions, i.e. masculinity and power distance, the self-referenced rating and the cultural-referenced differ significantly. This suggests that respondents have experienced greater masculinity and power distance in social norms than in their self-reported behaviour. Moreover, the regression analysis shows that self-referenced masculinity and power distance lack in predicting the manifestations of respective values in their culture. Instead, a cultural-referenced rating of masculinity and power distance predicts the manifestations of such values in their society. To sum up, the study advances the current knowledge of the current debate on the significance of various facets to operationalize the culture. The study adds evidence to the literature that self-referenced masculinity and power distance not only differ from cultural-referenced ratings of such values but also the culture-referenced rating of masculinity and power distance predict the manifestation such values in the culture.

In summary, the culture-referenced approach may provide a better understanding of society that self-reported values. As the cultural-referenced rating, by asking accepted rules in society, provide information about the social norms (Cialdini & Trost, 1998) and society in general (House et al., 2004). Whereas self-reported values, asking individual behavioural preference, may provide information about individuals and individuals may differ within society so such an approach may not provide an accurate picture of culture. A cross-cultural study by Wan et al. (2007) also shows that self-reported values do not correspond with the group-referenced values, and group-referenced values provide a better understanding of society. A meta-analysis of cross-cultural studies by Fischer et al. (2019) culture-referenced approach, which measures the norms, is better than the self-referenced approach in predicting the attitudes and behaviours across culture. In this study, the conceptualization of the cultural-reference rating is similar to that of House et al. (2004) cultural practices. Therefore future researchers may use GLOBE cultural practices indices in their cross-cultural studies.

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## CONFERENCE FORUM DISCUSSION

**L-F Pau:** This is rather an abstract paper and comparison of different concepts. But in which context? Sociology? Board governance? Projects or businesses? And how do you combine the attributes. See much more detailed methodology and metrics, as well as cases in *Pau, L.-F., Langeland, A., & Njaa, O. (2016). Assessing cultural influences in megaproject practices. IEEE Engineering Management Review, 44*(2), 56-73.

**Salman Saleem:** Dear L-F Pau, I will try to answer one by one. First and foremost thing is that given globalized word every organization has to deal with the culture. In this paper, I have tried to explain the significance of different facets of culture to identify the culture. For many decades the self-referenced approach is prevalent but this approach lacks in identifying the culture. In this particular paper, I have empirically demonstrated that that self-reference approach differs from the culture-reference approach. Which means that individual values differ from actual cultural practices. Moreover, the data analysis shows that the cultural referenced approach predicts the advertising practices while no such effect for the self-referenced approach of culture were found. These findings are very important for business specifically implications for marketing or advertising manager is that the culture-referenced approach is very useful for designing advertising message or appeal strategy in a different culture. Also, the findings are very useful in a variety of organizational context such as HR, governance to mention a few where managers have to deal with the cultural issue. Based on the obtained result I can say that managers should focus on the normative aspect of culture, instead of self-reported values, for determining the appropriateness of practices and business strategies.

**L-F Pau:** Test your findings against those on work regarding multinational/multicultural organizations and boards.



## 4.9. ENVIRONMENTAL DISCLOSURE IN EUROPEAN BANKS: THE ROLE OF RELIGIOUS SOCIAL NORMS

Simone Terzani <sup>\*</sup>, Teresa Turzo <sup>\*</sup>

<sup>\*</sup> Department of Economics, University of Perugia, Italy

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M14, Q56, Z12

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### Abstract

Green themes are every day at the attention of public opinion. A number of initiatives are taking place in the world. In 2015, the global community issued the 2030 Agenda for Sustainable Development, which includes 17 sustainable development goals (SDGs) and 169 targets that countries have to include in their policies. The European Commission is programming new relevant actions for the next years to incentive environmentally sustainable behavior in Europe (Calza, Profumo, & Tutore, 2017). Besides, the Directive 2014/95/EU, a recent legislative initiative, requires that large public-interest companies, among which banks, include non-financial information in their annual reports.

Environmental responsibility and disclosure are fundamental in improving banks' reputation (Gelmini, 2017), recording higher operating performance (Gallejo-Álvarez & Pucheta-Martínez, 2020), and getting a superior competitive advantage (Carnevale & Mazzuca, 2014).

Our study focuses on the role played by religious social norms in explaining different levels of environmental disclosure of banks within the European Union. More precisely, in the light of social norms theory, we propose that the strength of religiosity in the country influences the extent of the environmental disclosure, and this relationship varies among the cognitive, affective, and behavioral dimensions of religiosity.

The analysis is carried out using an unbalanced panel sample of listed European banks for the period 2004-2017. Following prior literature (Barro & McCleary, 2003; McGuire, Omer, & Sharp, 2012;

Kanagaretnam, Lobo, & Wang, 2015; Mari, Terzani, & Turzo, 2019), we employ the World Value Survey (WVS) to develop a measure of Religiosity and its three sub-dimensions. The cognitive dimension includes religious knowledge and beliefs (Parboteeah, Hoegl, & Cullen, 2008). The question selected from WVS for the measurement of this dimension is: "Would you say that you are a religious person?". The affective dimension relates to the emotions of persons toward religion (Parboteeah et al., 2008). In this case, the proper WVS question is: "How important is religion in your life?". The behavioral dimension focuses on church attendance, believers' donations, and personal prayer (Parboteeah et al., 2008). The suitable question from WVS is: "How often do you attend religious services?". We elaborate a score for each dimension of religiosity, gathering responses from the abovementioned questions. We later apply principal component analysis to obtain an overall measure of religiosity for each country in the sample.

Our expectation relates to two main findings. First, we expect a considerable impact of religious norms on environmental disclosure, so that firms based in high religious countries present a better environmental disclosure than firms placed in countries where religiosity is lower. Second, we expect that each sub-dimension of religiosity affects the environmental disclosure with a different intensity, even in different directions.

The expected results of our study have twice implications. On the one hand, current and potential shareholders concerned with environmental issues and religious beliefs may find our research useful to make decisions regarding investing in given banks. On the other hand, banks should demonstrate their sensitivity to the environmental theme and religious beliefs, avoiding financing polluting companies.

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## CONFERENCE FORUM DISCUSSION

**Vikash Ramiah:** I look at the model specification and you have religion and almost immediately multicollinearity comes up. I guess religion has something to same about debt and hence this variable is the correlation with leverage? Should we try to find IV etc. in this case? If you explore this in other areas, you will see there is a need for more variables. A long time ago, I thought about the aspect of religion in the financial markets and I came up with ten different variables. I think it is a good topic to research.

**Guadalupe Briano:** Hi to all! This paper addresses an interesting topic on informal factors as religion. My question is which is the theory or theories that support the study?

**H A R P Madushanka:** Hi, very interesting paper. I am not sure how we can narrow down religiosity to the number of religious services a person attends though? What is your definition of "religiosity"?

**Maha Radwan:** An interesting topic and interesting perspective which is religiosity, I would like to know the sample of how many banks have you analyzed and in your question related to the religion part to whom have you directed it and how can you define a country high religious or less religious?

**Stergios Tasios:** Hi Simone and Teresa. This is a very interesting topic. How is *ENV\_Disclosure* calculated? Is it based on an index constructed and scored by the researchers?

**Omrane Guedhami:** Hi Vikash. Is the paper about E-disclosure or E-performance? In my view, it is the latter as the data is from ASSET4. Also, can you consider examining the consequences of E-disclosure or performance on risk-taking and performance?

**Teresa Turzo:** Guadalupe, thank you for asking. We apply social norm theory.

**Teresa Turzo:** H A R P Madushanka, religiosity is composed of three dimensions in our work that are the importance of religion, the

recognition of the religious status, and the frequency of using religious services by people.

**Teresa Turzo:** Maha Radwan, we apply the World Value Survey.

**Teresa Turzo:** Stergios Tasios, Omrane Guedhami, you are right. Our data are from Asset4.

**Stergios Tasios:** Did you follow a dichotomous approach (1 for disclosure and 0 for non-disclosure) or you weighted the index?

**Teresa Turzo:** We employ the weighted index.

**Dmitriy Govorun:** Hi all, hi Teresa Turzo, thanks for the chance to get introduced with your paper and the concept. You stated in your presentation file that "...we expect a considerable impact of religious norms on environmental disclosure so that firms based in high religious countries present a better environmental disclosure than firms placed in countries where religiosity is lower." I guess this may be a signal that the company (bank) follows environmental care more. Does better environmental disclosure mean better "green" performance, or it is only related to information signals for stakeholders? Thanks in advance.

**Teresa Turzo:** Hi Dmitriy Govorun, thanks for the question. The answer is both. In the case of banks, we have to consider their commitment to financing polluting companies also.

**Lindrianasari:** The topic of environmental disclosure is very interesting. Decades of all environmentalists discuss and find the best model for how to make the environment better. Surprisingly, only 5 months after Corona was present, world carbon emissions were reduced significantly. Returning to the issue of environmental disclosure, I am one of the many researchers who focus on this issue. From the results of my research, and at the end of 2020 I try to conclude that environmental disclosure is sometimes made merely to fulfill public legitimacy. In fact, since there is no attempt to test the truth of the disclosures made by the company, it is very possible that disclosures made by the company use misleading mode. Therefore, I try to analyze not only disclosure items, but also analyze environmental costs, R&D costs, and environmental assets, which inevitably lead to "environmentally friendly" efforts. Because if we only observe and test disclosure items, the results of our research can be misleading.

**Teresa Turzo:** Hi Lindrianasari, I agree with you regarding the legitimacy power of the environmental disclosure. It is also true that companies may use environmental reporting in a misleading mode. Still, we should remember it is often the only instrument that companies have to communicate their environmental initiatives to external stakeholders. Thanks for the suggestions about additional variables. We will consider them according to the financial sector peculiarities.

**Lucrezia Fattobene:** Hi Teresa, which db did you use for firm-year observations for the European banks?

## 4.10. RISK AND RETURN PROFILE OF INVESTMENTS IN THE PROTECTED TECH-INDUSTRY IN CHINA: A STOCK MARKET'S PERSPECTIVE ON VARIABLE INTEREST ENTITIES (VIE)<sup>o</sup>

Philipp Prigge<sup>\*</sup>, Marc Schroedter<sup>\*</sup>, Mark Mietzner<sup>\*\*</sup>

<sup>\*</sup> Zeppelin University, Germany

<sup>\*\*</sup> Leipzig University for Applied Sciences, Germany

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### CONFERENCE FORUM DISCUSSION

**L-F Pau:** Interesting statistical analysis, but missing out on naming the companies in the sample, and defining exactly what you mean by "protected tech companies". Do you mean majority state control (like many Chinese army companies), or from a selected list set by CN Ministry of Industry, or defined as such by markets?

**Philipp Prigge:** Using the Special Management Measures (Negative List) for Foreign Investment Access in Pilot Free Trade Zones, published by the Ministry of Commerce (MOFCOM) of the People's Republic of China (PRC), the PRC defines business sectors with limited and even prohibited access for foreign investors. This applies not only to security companies, but also to technology and, in some part, to Internet companies. The new revision of the catalogue is much more open. The old version had completely prohibited foreign investors from accessing the Internet, telecommunications, and Internet services.

**Alex Kostyuk:** Hi Philip, I come with some interests related to the regulation. You mentioned that "The Ministry of Commerce of the PRC is continuously adjusting the foreign investments laws". How do you consider these adjustments? Is it effective and how does it influence the investment behaviour in and from China?

**Dmitriy Govorun:** Philipp, thanks for the update and research regarding instrument (VIEs) for forcing foreign investments in a quite strict regulatory environment and complex information access like in China. It was interesting to know more about the organizational approach on how to bypass regulatory restrictions and still keep the ability to have an access on capital markets. And I believe more efforts

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<sup>o</sup> The material has been presented at the conference and was being discussed within the conference forum. The authors preferred not to publish the material in the conference proceedings.

need to be done from regulators to protect foreign investors as risks are substantial for them. What are the key changes which may influence the risk profiles of Chinese companies to your mind? You have identified the company's specific variables which are good to follow while investing in an uncertain environment. Your regression conclusions may be useful for investors. Which variables would you recommend an investor to look at while thinking over IPOs from China?

**L-F Pau:** The strategies of CN foreign investments are much more complicated than just summarized. MOC has not the same role and weight as MITI had in JP. The PRC Party committee guidelines when public or summarized are much more important. You will also note that CN IPO's abroad are almost all with state influenced bank guarantees. So, the variables are non-quantitative.

## 4.11. A NEW PERSPECTIVE IN CREDIT RATIONING FOR EUROPEAN SMES

Christos Kallandranis<sup>\*</sup>, Petros Kalantonis<sup>\*\*</sup>

<sup>\*</sup> Regent's University London, U.K.

<sup>\*\*</sup> University of West Attica; Department of Tourism Management, Athens, Greece

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C25, G10, G30

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### Abstract

Within a severe global financial crisis with its roots in the banking sector and the subsequent sovereign debt crisis, a debate was triggered about the factors underlying the distribution of credit to enterprises. The importance of liquidity comes to the centre stage, especially, when the traditional transmission channels of monetary policy were disrupted putting severe pressure on firms in need of external finance. On the one side, within a tight economic environment banks are tighter in their credit granting, considering the increased risk they face. On the other side, it may also be explained by negative sentiments of economic agents with a direct result of decreased investment and cash flow, creating an amplification mechanism of economic dis-activity.

This conflicting situation becomes even more important when small and medium-sized enterprises (SMEs) considered as the focus group. Actually, SMEs who account for a substantial part of the job and value-added creation in modern market economies (Haltiwanger & Krizan, 1999) depend heavily on bank credit which is among the crucial determinants for their survival and growth (Berger & Udell, 1998; Beck & Demirguc-Kunt, 2006; Banerjee & Duflo, 2014).

Despite that bank credit is so vital there is a large proportion of SMEs who choose not to apply for a bank loan, even if they need it. The relevant literature calls this group of firms discouraged borrowers, which are formally defined as the firms who need bank credit but do not apply for it due to fear of rejection (Jappelli, 1990; Cox & Jappelli, 1993; Mushinski, 1999; Piga & Atzeni, 2007). Following Kon and Storey (2003)

discouraged or self-rationed type of borrowers exist because of both imperfect information and positive application costs.

Formally speaking, discouragement is nothing more than the dark side of the moon. Although you are aware of its existence, it's not visible to the naked eye. Discouraged, or actually, self-rationed borrowers do not fill a loan application, hence there is no action taken or they are not recorded as a direct outcome of a formal process. What is recorded in the system as a transaction is successful or turned down submitted applications. However, the existence of this type of borrowers cannot be neglected. Its prevalence has been documented empirically; with Levenson and Willard (2000) and Freel, Carter, Tagg, and Mason (2012) reporting that there are twice as many discouraged borrowers as rejected borrowers in the US and the UK, respectively. Ferrando and Mulier (2014) focusing on Eurozone SMEs report that the discouragement rate is on average about 15%, and discouraged firms are about twice as many as rejected firms.

It becomes apparent then that there is in the market a clear distinction between the traditional credit rationing in the Stiglitz and Weiss (1981) notion and the self-rationing process. In particular, Stiglitz and Weiss describe a credit market outcome where a firm in credit need has applied for a bank loan and its demand is not met by the bank, which rejects the loan application. However, discouraged borrowers opt themselves for not applying for a bank loan due to possible rejection, driven either by their personal generic negative perception or because an undesirable outcome is grounded on their firm's fundamentals. Although this situation was always known, the scarcity of data was always a barrier in addressing empirically the significance of this type of borrowers leading the literature treating both rationed and self-rationed borrowers as almost identical.

This present study is planning to shed light on the structure of these two different credit market outcomes, focusing on European SMEs by making use of the Survey on Access to Finance of small and medium-sized enterprises (SAFE) for the period of the financial crisis. In particular, we are researching potential non-uniformities of both market outcomes with respect to firm specific characteristics that are related to the level of information along with the cost of capital. Our results provide empirical support for the presence of these uniformities based on the firm characteristics of size and age.

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## CONFERENCE FORUM DISCUSSION

**Dmitriy Govorun:** Dear Christos and Petros! Thanks for your paper and ideas shared on ratings and micro crediting. My first question will be the following: what is the key source of financing for those who are in the "discouraged" group of SME borrowers? Have you discovered this in your sample?

**Dmitriy Govorun:** The second one is the following. You've mentioned also in your presentation that banks probably ask "too many" (due to regulation requirements and risk profiles) and we have a higher rate of rejections. So, the question is who (which structure) may become an easy provider of financial resources for SMEs if they are too small and opaque for traditional banking?

## 4.12. CORPORATE GOVERNANCE PRACTICES IN MOROCCAN LISTED COMPANIES: STATE OF PLAY AND INTERNATIONAL COMPARISON

Oumaima Sadqi \*

\* National School of Business and Management, Hassan First University, Settat, Morocco

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### Abstract

Improving corporate governance practices is today a major requirement and an indispensable condition, for access to capital on international financial markets by Moroccan listed companies.

Moreover, it has been proven that a good governance system contributes to the improvement of investment, which is an essential factor of economic growth.

Aware of this fact, Morocco has carried out a series of reforms over the last ten years concerning corporate governance framework of its listed companies, in order to align it with international standards, mainly those of the Organization for Economic Co-operation and Development (OECD).

The importance of these practices to the robustness of business ecosystems is so crucial that they require monitoring by the World Bank and the International Monetary Fund. This is done through the Reports on Observance of Standards and Codes (ROSC) program, which focuses in particular on the evaluation of governance practices in listed companies (World Bank, 2010).

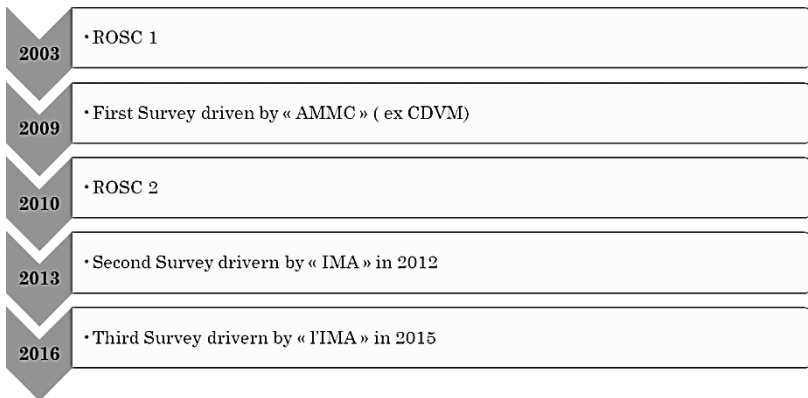
In addition, Moroccan listed companies must meet today the best international standards to support this development, *particularly in terms of corporate governance*.

To this end, Moroccan Capital Markets Authority (AMMC) has conducted since 2009 several surveys of Casablanca Stock Exchange

listed companies, in order to study the evolution of corporate governance practices among these players (AMMC, 2010).

This regulatory agent mandated then the Moroccan Institute of Directors (IMA) to conduct this survey and make it a regular triennial meeting, to measure and understand the evolution of the principles of corporate governance in Moroccan listed companies Moroccan Institute of Administrators, 2013, 2015).

**Figure 1.** Evolution of reports and surveys on corporate governance practices in Moroccan listed companies



This paper aims to analyze these various investigations and surveys, in order to expose the possible gaps that exist between those practices and the international standards of corporate governance.

Our analysis focuses on:

1. The regulatory framework of corporate governance in Moroccan listed companies.
2. Recommendation's role of Moroccan's corporate governance practices code (CMBPGE).
3. Board of Directors:
  - Board of Directors structures;
  - the presence of independent directors on the board of directors;
  - the criteria for selecting directors;
  - Board of Directors Committees.
4. The evolution of financial information's quality.
5. Processing of non-financial information.
6. The fundamental rights of shareholders:
  - the right of information and the imposition of fair treatment of shareholders concerning participation in the company's profits;
  - the right to vote at general meetings and the obligation to publish vote's results.

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## CONFERENCE FORUM DISCUSSION

**Oumaima Sadqi:** My conference paper aims to analyze the various investigations and surveys that have focused on corporate governance practices in Moroccan listed companies, in order to expose the possible gaps that exist between those practices and international standards, particularly those of the Organization for Economic Co-operation and Development (OECD).

**Alex Kostyuk:** Hi Oumaima, we expect the most intensive discussion of your paper during the third day of the conference (according to the conference program) but I would like to take responsibility to ask you, after reading your paper, several questions about CG in Morocco. First, I found in your paper that "the monistic structure is still the leading one among these players and amounts to 83%, with 38% separating the functions of chief executive officer and chairman". What do you think about this dominance of the unitary board model in Morocco? Second, I think that independent directors, as a category, needs a list of certain criteria of independence of directors. What is this list of criteria in Morocco?

**Oumaima Sadqi:** Hello Alex. Thank you for the question. Certainly, I'm looking forward to discussing all these issues during the third day of the conference.

**Dmitriy Govorun:** Dear Oumaima, thanks for your participation and material you've shared with us. It was rather interesting for me to overview the development of corporate governance in Morocco. Nice to see the improvements made by institutions to follow good practices. I also believe that there will be more studies showing empirically that CG practice development goes in the right way which means higher performance, better rights protection and growing interest from the side of international capital. One should be noted regarding research. I believe that paper will have a much stronger effect if you may outline core issues of CG in Morocco as a result of your research and focus on resolving several of them. Following this statement, I would like to ask whether there is any additional plan for reforming CG: what is the most crucial gap in Morocco at the moment?

**Oumaima Sadqi:** Moroccan Code of Corporate Governance Practices indicates that the choice to maintain the cumulation of the

functions of chairman and chief executive officer or to dissociate them belongs to each company which will take an option according to its considerations of corporate governance. The code recommends that companies opt for a dual structure or separate the functions of chairman and chief executive officer. However, most listed companies are characterized by a concentration of capital with a dominance of one or two shareholders, a family or an institutional concentration. That's why we still find that the dualist structure with a management and supervisory board remains less popular than the monistic one. However, according to the latest study conducted by the Moroccan Institute of Directors, 55% of listed companies separate these two functions with (38% in monistic structures and 17% in dualist structures). Secondly, about independent directors, we do have a list of criteria in Morocco due to the last amendments (April 2019) of Law No. 17-95 relating to limited companies:

- not being, during the three years preceding his appointment, an employee or member of the administrative, supervisory or management bodies of the company;

- not being, during the last three years, a permanent representative, employee or member of the administrative, supervisory or management body of a shareholder or of a company consolidated by the latter;

- not being, during the last three years, a member of the administrative, supervisory or management body of a company in which the company holds a shareholding, regardless of its percentage;

- not being, a member of the administrative, supervisory or management body of a company in which the company holds a mandate within the administrative or supervisory body, or in which a member of the administrative, supervisory or management bodies of the company, in-office or having been in office for less than three years, holds a mandate within its administrative, supervisory or management body;

- not being represented, during the last three years, by a commercial or financial partner or a consultant to the company;

- not having a family relationship up to the second degree with a shareholder or a member of the board of directors of the company or his/her spouse;

- and finally, they must not have been statutory auditors of the company during the six years prior to their appointment.

**Maria Guedes:** Hi, does your code have recommendations about gender diversity?

**Oumaima Sadqi:** Hi Maria, thank you for your question, no but the directive of Bank Al Maghrib (Moroccan central bank) recommends that "the administrative body (...) should ensure the implementation of a policy aimed at ensuring better representation of women among its members".



**Maria Guedes:** What about fit and proper mechanisms? How does that work?

**Oumaima Sadqi:** I think that the country should make a greater effort to improve the production of non-financial information disseminated to shareholders and the financial community (specifically, internal control and risk management systems, and the remuneration policy for executives and directors, which remain the subjects least covered in the information disseminated to shareholders, because this is a criterion of transparency and corporate governance. In Morocco, the production of this information remains just a recommendation, and I think that it would be better for the legislator to introduce a law to this effect. The regulatory framework and the Moroccan code of corporate governance practices provide laws and recommendations relating to the size of the board of directors, its duality, its independence and the presence of specialized committees.

**Maria Guedes:** How does the central bank evaluates that board members are a fit for the banks?

**Oumaima Sadqi:** The regulatory framework establishes measures for the fair treatment of shareholders regarding timely access to information, the free use of their voting rights, and the distribution of company earnings. The central bank carries out regular surveys and investigations directed by Moroccan capital market authority in this regard.

**Maria Guedes:** Have you got any idea about a share of women on boards in banks?

**Oumaima Sadqi:** I support the idea that the country needs to introduce legislation to ensure that there is a minimum number of women in the governing structures.

**Maria Guedes:** What is a share of exec or NED positions?

**Oumaima Sadqi:** According to Sbai Hicham, *Governance mechanisms and performance of Moroccan banks* (Conference Paper, May 2017), in his survey on six listed Moroccan commercial banks, the percentage of female directors averaged 4.99 percent.

**Max Alberto Galarza Hernandez:** The results of the paper suggested by Oumaima from Sbai Hicham are quite intriguing: "The results show that the size of the board of directors, the presence of the foreign administrators as well as the Chairman/CEO duality influence *negatively* the performance of these banks". Particularly, the presence of foreign administrators. Most of the CG literature in their recommendations suggests foreign auditors to less corruption and biases. Why in Morocco did not work out?

**Oumaima Sadqi:** Indeed, these results are not in line with CG practices. This was explained by the difficulty that these foreign directors may experience in terms of adapting to the environment of these banks, which implies less in-depth knowledge compared to other executive



directors. However, he points out that the sample is poorly representative (6 listed commercial banks).

**Oumaima Sadqi:** Concerning the appointment of independent directors in Moroccan listed companies, according to the latest amendment to Law No. 17-95, one or more independent directors must be appointed as members of the board of directors of publicly traded companies, and their numbers should not exceed one-third of the total number of directors.

**Max Alberto Galarza Hernandez:** I have just read the brief of your paper and it states "The object of our conference paper is to analyze this various investigations and surveys that have focused on corporate governance practices in Moroccan listed companies, in order to expose the possible gaps that exist between those practices and international standards" obviously you found that GAP congratulations! How many listed Moroccan banks your research analyzed?

**Oumaima Sadqi:** Unlike Sbai Hicham I work on *non-financial listed* companies and for governance mechanisms, I am particularly concerned with internal mechanisms, both disciplinary (agency theory) and cognitive (analyzed by the resource-based view model). My sample consists of 44 listed companies (the total number of listed companies in morocco is 75). Moroccan Capital Markets Authority (AMMC) has conducted several surveys of Casablanca Stock Exchange listed companies, in order to study the evolution of corporate governance practices among these players. This regulatory agent mandated then the Moroccan Institute of Directors to conduct this survey and make it a regular triennial meeting. Also, CG practices are monitored by the World Bank and the International Monetary Fund. This is done through the Reports on Observance of Standards and Codes (ROSC) program, this was done in Morocco 2010 (the most updated version). I analyzed all these surveys and produced this paper. I also analyzed the evolution of the regulatory framework of CG in Morocco and the recommendations of Moroccan Code of Corporate Governance Practices which is inspired by OECD recommendations.

**Max Alberto Galarza Hernandez:** I noticed that your research data is solid 44 out of 75, but I am afraid the comparison with Mr Sbai Hicham's research is not valid, since you worked with different samples (commercial/non-financial).

**Oumaima Sadqi:** Actually, it was an answer to this question and not a comparison. That will facilitate access to capital on international financial markets by Moroccan listed companies.

## 4.13. UNDERSTANDING THE RELATIONSHIP BETWEEN CORPORATE GOVERNANCE PERFORMANCE AND CORPORATE SUSTAINABILITY<sup>°</sup>

H A R P Madushanka<sup>\*</sup>, Ajantha S. Dharmasiri<sup>\*</sup>

<sup>\*</sup> Postgraduate Institute of Management, University of Sri Jayewardenepura, Sri Lanka

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### CONFERENCE FORUM DISCUSSION

**L-F Pau:** Many relevant concepts, but what are the measures (and the verification/certification) tools/agents for social and environmental sustainability? Most annual reports, or board minutes, claim figures and facts, or initiatives, which far too often are just communication exercises and not real.

**H A R P Madushanka:** Hi Pau, thank you very much for your comments and queries. In my research, the main instrument used is a structured questionnaire developed based on Global Reporting Initiative based parameters relevant to social and environmental sustainability. And the information collected through interviewing top executives of companies is used to the thematic analysis. There were instances, where some of the executives spoke beyond what's in their annual reports and some instances where contradictory information was observed. As you have said, the information provided in the annual reports could be "not real", but unfortunately that's the best source of publicly available information we could access with regards to these aspects. Also, most of the sustainability reports are required to be audited by an independent auditor (by GRI and some regulators). So, I do not believe that the companies could "green-wash" their non-financial performance-related indicators as they used to do years ago.

**L-F Pau:** You should also note that boards of bigger companies in environmental conscious countries, like in Scandinavia and France, don't trust their internal people's environmental compliance reports as appearing in the annual reports. So, they have independent verifications by the like of Bureau Veritas, or technical-social auditing companies; they are often taken more seriously by boards than the "green communications" exercises.

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<sup>°</sup> The material has been presented at the conference and was being discussed within the conference forum. The authors preferred not to publish the material in the conference proceedings.

**H A R P Madushanka:** Hi L-F Pau, thanks for your comments, and that's exactly what I meant by third party independent verification.

**Dmitriy Govorun:** H A R P Madushanka, thanks for sharing your ideas with us. I believe a bigger sample of cases/data will add more strength to the research. I see you focused your research on stakeholders. What is the overall approach for the researched country in terms of CG? How does the stakeholder approach be supported on a regulatory level?

**L-F Pau:** Dmitriy, your point is linked to national policies, i.e., priorities given. For example, Poland and Australia ignore environmental issues at board levels, even if quite different board cultures.

**Dmitriy Govorun:** Thanks for your comment. Very valuable for analysis consideration and supporting the idea of evaluation by the third party. Reports of boards agree may be very often just a part of communication policy.

**Hadfi Bilel:** The author has tried after his article to investigate the importance of good governance on the sustainability of companies. The more companies are well-governed, the more profit they make and have comfortable internal and external environments.

**L-F Pau:** Adding to my earlier comments on third party evaluation for boards... For environmental and social issues (both), boards decide sometimes of donations to charities/foundations which cannot be subject to third party verification and do not fall into environmental and social accounts! Case in point these days: huge donations by LVMH & Air Liquide of machinery, new products, and manpower going to social and health. They don't even know how to put these into accounts, according to administrations who just see them as free goods.

**H A R P Madushanka:** Hi Dmitriy, thank you very much for your comments. Yes, of course, extending the research adding more organization would definitely add value as you suggested. In Sri Lanka, the majority of the listed companies are focused on stakeholders including society at large and environment without just focusing on shareholders at least at a reporting sense. Most of the boards do spend significant time on topics such as diversity, social responsibility and environmental footprint. At a regulatory level still it's at a primitive level, where CG disclosures are mandatory but no rating system is established. In terms of reporting the nation has reached heights with a significant number of integrated reports and sustainability reports published.

**H A R P Madushanka:** L-F Pau, thanks for your comments. Of course, totally agree. But it's up to the stakeholders to scrutinize the board and make sure they are on the right track in terms of social and environmental responsibility. Donations would not do any impactful good most of the times as you mentioned. But it's our responsibility to call on it if companies are reporting linking these good for nothing donations in their sustainability reports green washing their dirty. Also, I would like

to also highlight the important of global frameworks such as SDGs in reporting which would standardize the approach limiting any organizations' ability to report anything they want. There's more work to be done in this regard. As researchers, we have a great platform to contribute to this dialogue.

**Guadalupe Briano:** Very interesting topic in corporate governance. I would like to know more in detail how you validate your instrument. Why only two companies? Who responds to the survey? Is there much difference between the information contained in annual reports versus the obtained information?

## 4.14. CORPORATE GOVERNANCE: HOW SOCIAL NORMS AND CULTURAL VALUES CHANGED IN THE LABOUR MARKET?

Francesco Di Tommaso \*, Arturo Gulinelli \*

\* Studio Asse Commercialisti Associati, Rome, Italy

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### Abstract

At an international level, we are witnessing a process of rapprochement between the company and society generated by the increasing attention to the issues of ethics and social responsibility. The company must adopt ethical behavior which means not only to comply with the law but also to establish a correct relationship with the environment, adopt policies that respect the individual and more generally play a positive role in the economic and social context in which it operates. The corporate mission itself is no longer based on a static vision of profit, understood as the sole purpose of social activity, but by evolving it interprets not only economic but also social and environmental objectives. It is of fundamental importance for the company to meet not only the short-term objectives of those who have contributed risk capital but the expectations of the various stakeholders who in the company become the protagonists in the foreground of each phase of social activity. The responsibility of the company is therefore concretized in the creation of value for all stakeholders in the awareness that their satisfaction favors a relaxed and serene atmosphere allowing establishing a relationship of mutual trust and collaboration essential for the pursuit of the common good. In short, a socially responsible company is the one that transfers its goal from the pursuit of maximum profit to that of maximum value. It is consequent and logical therefore that company management also wishes to account for how it has operated towards the company's mission so that there is congruence between what the company offers and what it receives in return from the social system and therefore to ensure that the choices and values adopted internally can have the right visibility outside.

## 1. INTRODUCTION

This social communication process has the aim to:

- set up a systematic measurement and collection system, organization and communication of relevant data relating to the impact of business activities on the well-being of various stakeholders;
- evaluate the consistency between the results achieved and the objectives deriving from the mission, from values and the Code of Ethics; business management models able to identify and classify future events, opportunities and above all potential threats.

Social reporting is an attempt to "measure" what traditional reporting fails to bring out, that is, the "value generated by the investment", since it makes clear the effect that the company has produced on the main categories of stakeholders.

As happens in the political economy, where GDP is no longer accepted as the only measure of the wealth and well-being of a country, so in the business economy alongside the financial statements, which contains only one economic-financial and patrimonial representation of the company reality, other tools are sought to give a more complete representation of the company reality.

As the management of the company has undergone the effects of industrialization and the financial activity has taken on increasing weight, the balance sheet has started to experience the first difficulties in giving the right relevance to the business facts.

The financial statements, having a rigid structure, have not been able to give a correct location to some corporate facts, so much so that it has even reached the current paradox that "off-balance sheet items weigh more than those in the balance sheet". There is also the need to account for intangible factors, in the past not properly assessed, such as the reputation and trust that contribute to conquering and maintaining the consent of the social interlocutors.

### 1.1. What is the sustainability report?

The financial statements have been accompanied by another communication document: the social report. The term "sustainability report", which entered the company vocabulary only between the late sixties and the early seventies in the USA when the first social accounting systems were born, does not mean that it accepts data and balancing values, as well as he teaches us the accounting technique, but indicates that it is a summary document to be drawn up periodically, even if with tones other than the financial statements, based on pre-established rules and procedures. Even if it is placed alongside the financial statements, the social one is an autonomous document that is able to provide qualitative and quantitative information on the effects of the company activity. The information contained therein comes from

reliable and verifiable sources and responds to well-defined procedures to prevent them from appearing as mere declarations of intent and as such escape any verification process.

The social report is a final and periodic document in which the planning lines for the future are indicated: it is, therefore, necessary to specify whether the objectives formulated have been achieved and also indicate the proposals for future programs. The recipients of the social report are all the stakeholders who are directly or indirectly involved in the exercise of the activity. The social information, as it happens for the economic information, has different relevance for the different subjects in relation to the contributions made and the consequent expectations that derive from them. The social report aims to provide stakeholders with a complete picture of the company's performance and thus becomes a means of analytically describing the reasons why some costs have been incurred or incurred, far from the typical management but capable of producing advantages for some categories of social interlocutors. Therefore, the document does not show a global utility but a series of utilities, each for each target audience. It is a prospectus, that of the social report, not completely neutral as is the financial statements but it is clear that it must be as verifiable and objective as possible, otherwise, the interest that the most relevant stakeholders would show would be scarce, making unsuccessful recourse to reporting of social facts. It is of fundamental importance, in the social report, to give relevance to the corporate identity and to the system of reference values assumed by the company, to expose the improvement objectives that the company undertakes to pursue and to provide indications on the interaction between the company and the environment in which it operates, as well as representing added value and its distribution among social forces.

## 1.2. Sustainability report principles

The principles of drafting the social report – according to the model prepared by the Study Group for the Social Report (GBS) – refer to the ethics, legal doctrine and practice of the accounting profession.

These principles can then be customized by the various companies by referring to more specific ethical, regulatory or professional areas. However, these particularities should observe explicit, shared and recurring criteria as they arise.

The quality level of the information contained in the social report is guaranteed by compliance with the following principles:

- responsibility: consists of identifying in advance all the categories of stakeholders to which the company must account for its activities;
- identification: it is expressed in the explanation not only of the government and the ownership of the company in order to give clear information to third parties about the related responsibilities but also of

the set of principles and values that the company pursues with its work (mission);

- transparency: the process of detecting, reclassifying and forming what is contained in the financial statements must be made known to all stakeholders;
- inclusion: means giving voice to all identified stakeholders by explaining the investigation and reporting methodology used;
- consistency: the congruence between management policies and choices and the objectives pursued must be emphasized;
- neutrality: refers to the need for the budget to be impartial and independent of partisan interests and coalitions;
- competence: it means that the facts relevant for the preparation of the financial statements are those that produced social effects during the year;
- prudence: means assessing the positive and negative effects that arise from them in relation to significant and verifiable events, taking care not to overestimate the corporate situation;
- comparability: it must be understood as the possibility of making comparisons between the social budgets of the same company, referring to multiple businesses and different companies operating in the same sector, for the same business. The comparisons are of fundamental importance and take on meaning only if data are homogeneous, if they refer to periods of equal duration, if they are verifiable and if they have been collected according to the same principles.

### 1.3. Identity values

The identity values include:

- clarity and intelligibility: the information contained in the social report must be clear and understandable and the content of the financial statements must strike a fair balance between form and substance;
- periodicity and recurrence: since the social report is a completion of the financial statements, two documents must have the same periodicity and be drawn up for the same period administrative;
- homogeneity: the quantitative monetary data must be expressed in the same accounting currency;
- usefulness: the data shown in the financial statements must be useful to satisfy the needs of the stakeholders in terms of completeness and reliability;
- significance and relevance: the actual impact that events, social and not, produced in the surrounding reality;
- verifiability of information: all information, even additional information, must be verifiable through the collection and reporting process;



- **reliability:** the information in the financial statements must represent truthfully and correctly the object to which they refer to provide a faithful picture of the stakeholders of the business;
- **autonomy of third parties:** if third parties are involved in creating specific parts of the social report or in guaranteeing the quality of the process, they must respect the most absolute impartiality of judgment.

The social report is made up of three fundamental areas, which are distinct and at the same time interdependent parts of the document. The first area concerns "corporate identity", the second the "calculation and distribution of added value" which forms the bridge connecting the financial statements, making clear the economic impact that the company's activity has produced on stakeholders; the latter consists of the "relationship", which refers to the relationships that the company has with stakeholders.

This is the minimum content that the social report must have, as these fundamental areas can also be joined by others and the choice whether to provide additional complementary content is practically free as there is currently no mandatory content to be respected.

The elements that define this identity are: the institutional set-up, the reference values, the mission, the strategies and the policies.

The information on the institutional structure clarifies how the share capital is distributed, to whom the shareholdings compete, who is the economic entity and therefore how the majority is formed, what are the characteristics of the management and what role the employees play in the corporate bodies. This news certainly does not appear in the financial statements and is often hidden from the same stakeholders.

The corporate values that underlie the strategic choices and operational behavior of those who contribute to management decisions in the company must also be clarified.

Of fundamental importance is also the identification of the mission of the company or of the main purposes to which the entire activity is aimed; medium-long term objectives and plans to achieve them and, lastly, the policies, that is, the choices of intervention to be followed.

#### **1.4. The social value added**

The added value measures the wealth produced by the company in that administrative year and is used to anchor the social report to accounting data which, in this way, also acquires social value.

The added value is represented by two distinct statements: the statement of determination of the added value identified by the juxtaposition of revenues and intermediate costs and the statement of allocation of the added value formed by the sum of the remuneration received.

By the internal interlocutors of the company and external donations the two elevations are balanced. The added value can assume the

characteristic, ordinary and global configuration according to the aggregation level of the income components. The chosen configuration is the global one which can be either gross or net of depreciation. A theoretical and practical analysis of the determination of the area of added value and its implications in the accounting aspect will be analysed in the future researches.

## **2. LITERATURE REVIEW: SOCIAL RELATIONS**

This area reports the results related to the business activity which are viewed in three dimensions: what the company intended to do, what it achieved and what the recipients of the results believe they have achieved. Through this comparison, the consistency of corporate behavior can be highlighted. The report, like the other areas, has a minimum content that can be personalized and therefore expanded. It has two sections: one general and one particular.

The first section lists the objectives that the company sets itself to achieve, the reference stakeholders to whom the social report is addressed and which ones have a significant weight since not all of them are on the same level and it is, therefore, necessary to distinguish them. Other information that appears in the first section refers to the criteria followed for the collection of the various pieces of qualitative and quantitative information that do not derive from the accounting.

The second section takes into consideration the individual stakeholder groups for which a minimum content of information is expected, which is also likely to be expanded but not reduced. With reference to each group, the company must describe the policies it has followed, linking them to the results it wanted to achieve, the values it inspires, its mission and its strategies. Furthermore, the process of gathering information regarding the expectations they perceive and the degree of satisfaction expressed by them must be communicated. In this way, the various stakeholders are voiced so that they can pronounce on their expectations and their degree of satisfaction. The involvement is generally extended to all stakeholders and, in any case, cannot be separated from those that are considered priorities for the company. Stakeholder satisfaction can also be inferred indirectly, think of the relationship with the financial administration, in this case, the lack of receipt of assessment notices and more generally of disputes can already be an indication of a good level of satisfaction of the reference stakeholder.

## **3. RESEARCH METHODOLOGY: ETHICAL CODE**

It is in the USA, starting from the seventies, that the code of ethics begins to spread as an operational tool for business management with the aim of channeling the efforts of management and the rest of the staff

to respect ethical principles. After the end of the seventies and the early eighties, the increased attention of the media to the crimes of the so-called "white-collar workers", and the orientation of the Reagan administration to combat the phenomenon of corruption, have highlighted the economic importance of defending ethical values. The diffusion of the document has been encouraged, also in the United States, by the US Sentencing Guidelines which since 1991 provide for substantial reductions in penalties for those companies that have adopted a series of internal preventive programs (self-regulation volunteers) if managers are held responsible for offenses. The disclosure of the code of ethics, in Europe, took place only later than the United States and in Italy, there is a further delay since currently the ethical codes are applied more by large companies unlike the social report which instead is actually present even more small and medium-sized.

In July 2002 the European Commission ruled on the importance of the code of ethics in the Union scenario, defining it: "an innovative and important tool to promote fundamental human, labor and local rights and a good policy against corruption".

The code of ethics is the company's "Constitutional Charter", that is, a charter of moral rights and duties, which defines the ethical-social responsibility of each participant in the corporate organization. Given that it acts as a real practical guide of entrepreneurial action since it defines the moral standards of conduct for all those who work in the company, it assumes a strategic role for the company. The code of ethics becomes a tool to prevent irresponsible or illegal behaviour by those who work in the name and on behalf of the company. The document must, therefore, specify the values on which the production activity is based, the responsibilities towards each category of stakeholders with which the company is willing to assume moral obligations, the specification of the company directives on the conduct of ethics in the business and real rules of conduct for employees.

Generally, the code of ethics is elaborated by senior managers together with external expert staff able to resolve issues that require particular skills. Once prepared, it must then be disclosed within the structure generally through a "cascade" process, that is, it starts from the top and then reaches all the lower levels. Then there is the management phase, carried out by internal staff, in particular by legal offices or by administrative staff, which consists of preventing, ascertaining alleged incorrect behaviour, identifying infringements and punishing them.

For the code of ethics, the problem arises of being understood as a mere tool of the company's social image and therefore of not having its concrete utility.

The conditions for its effectiveness require that:

- the rules of conduct are the result of an ethical choice rooted in the corporate mission and which are therefore communicated to all in order

to create a spirit of sincere adhesion of social forces to the creation of the common good;

- the code of ethics, inserted in a larger project that involves the same corporate culture, is a suitable tool to contrast incorrect behavior and corrupt practices;
- duties and responsibilities for managing the code of conduct must be clearly defined and it must also be related to the selection of personnel and the inspection and control system;
- the rules set out should not be too detailed as this would create an excessive fear among employees who would avoid taking initiatives to avoid incurring criticism and punishment, much less should they be too general because their interpretation would be hindered.

#### 4. RESULTS AND CONCLUSION

The social report and the code of ethics are fundamental documents, not competing but complementary, able to spread both ethically and internally that ethical commitment that the company is ready to assume in relation to the fiduciary relationship with all the social partners.

To underline the complementarity of the instruments, suffice it to say that the larger companies that have adopted an ethical code within the company usually also prepare the social report to give concrete visibility to the principles adopted internally.

The code of ethics is, in fact, the other side of the social report and integrates it. In fact, two control activities arise from the corporate mission: one more general, which involves company policies and which is fully implemented in the social report and the other relating to the monitoring of corporate behavior carried out by the code of ethics.

These documents must be less and less marketing tools and more constructive since mere façade behaviors do not help the company in the short or long term, rather they weaken the corporate image itself, compromising in the long run also the fiduciary relationship with the social partners and therefore the possibility of having their cooperation in the creation of value.

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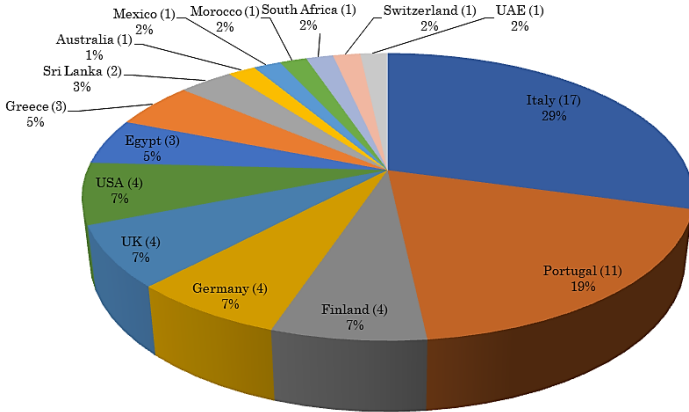
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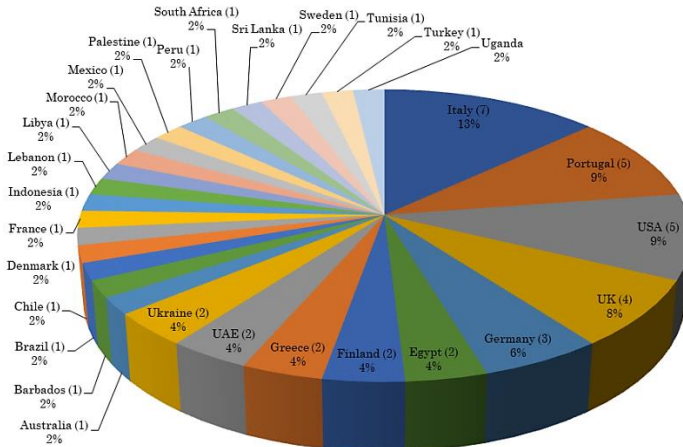
# CONFERENCE INFOGRAPHICS

## 1. Conference forum participants, discussants, attendees

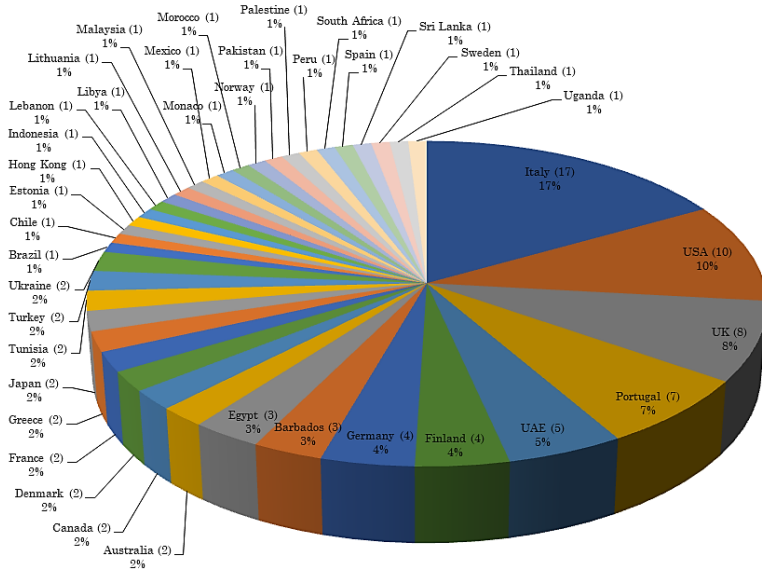
### Conference forum presentations authorship – geographical representation



### Conference forum comments authorship – geographical representation



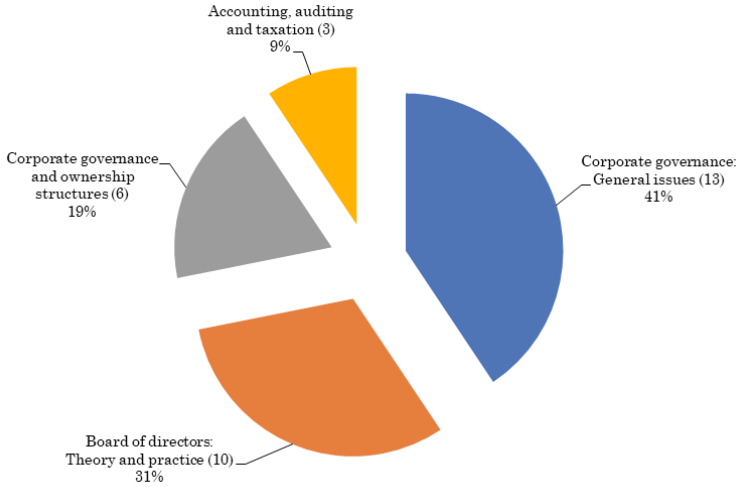
### Conference forum attendees – geographical representation



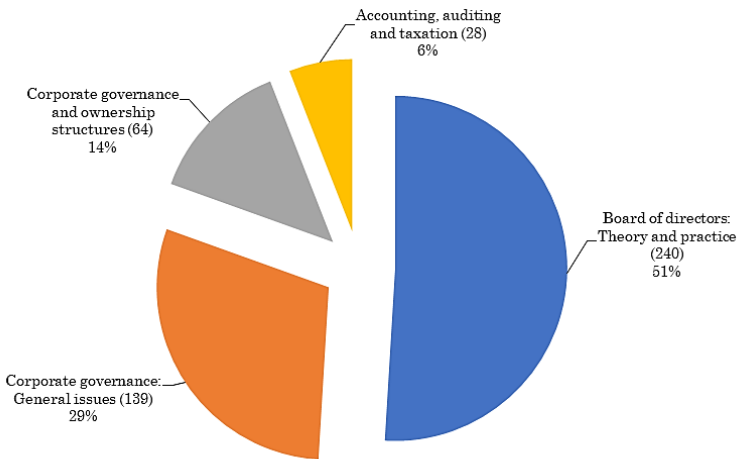


## 2. Conference forum presentations and comments

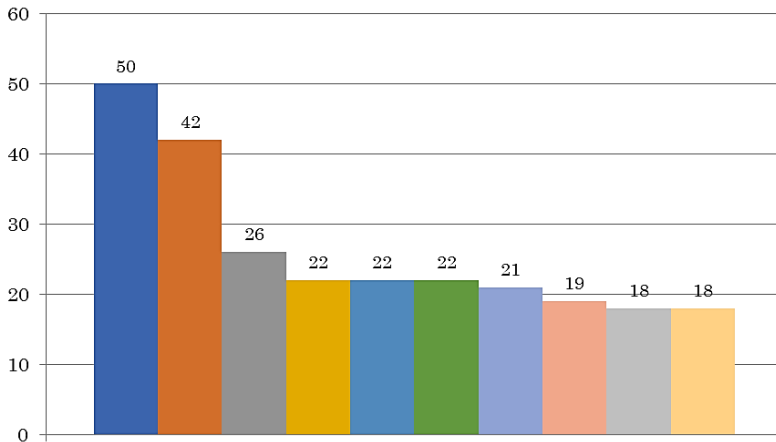
### Topics of the conference forum presentations



### Conference forum comments – topics discussed

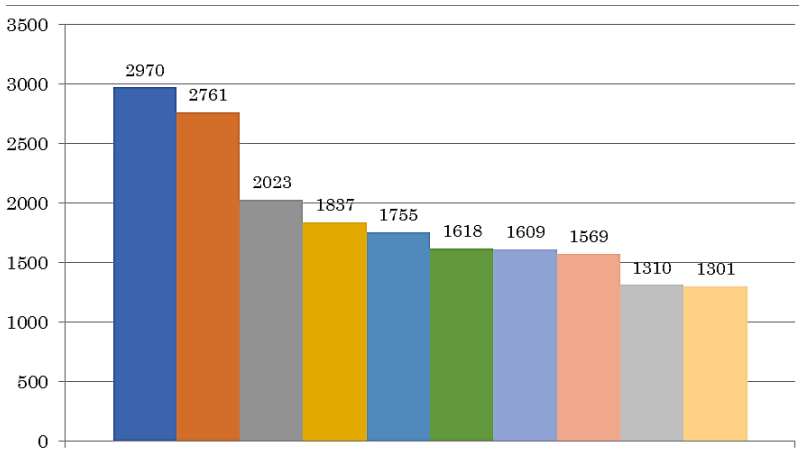


### Conference forum comments – top-10 most discussed presentations (by number of comments)



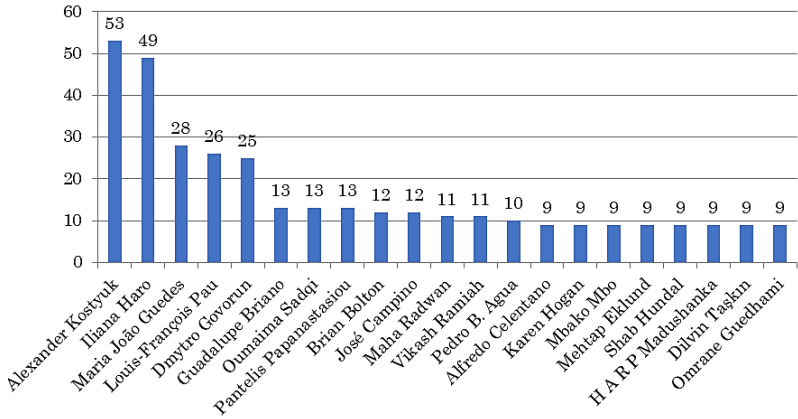
- 1.7. Women in the boardroom and their impact on financial performance and risk-taking: A bibliometric analysis
- 1.5. A configurational approach to the determinants of women on boards
- 1.9. Does CEO turnover influence the dividend policy?
- 1.2. The effect of board structure on dividends policy: A comparative study between Brazilian and Chilean family firms
- 4.3. Human capital's importance in ICOs success
- 4.12. Corporate governance practices in Moroccan listed companies: State of play and international comparison
- 1.1. The joint effect of board independence and CSR committee on CSR disclosure: Evidence from Italian listed companies
- 1.10. Has the traditional board governance model passed its use-by-date?
- 1.6. The framework for the economically and socially fair CEO compensation
- 1.8. The impact of capital structure and board of directors characteristics on investment decisions and performance of Nordic firms

### Conference forum comments – top-10 most discussed presentations (by volume of comments (words))

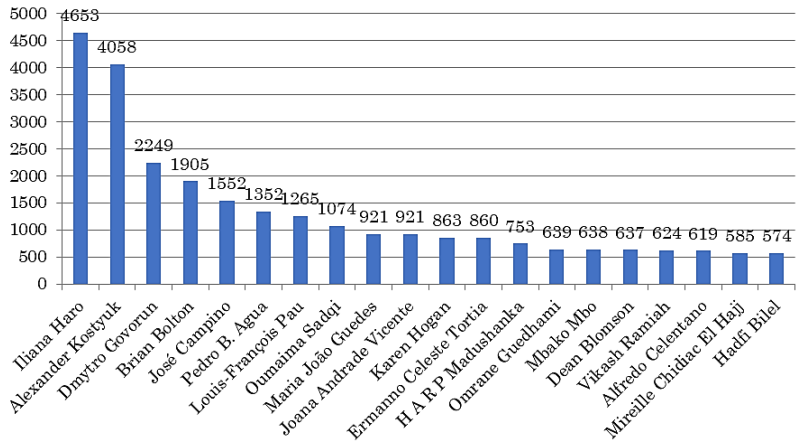


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- 1.5. A configurational approach to the determinants of women on boards
- 1.3. Board leadership legitimacy and director turnover in family firms
- 4.6. Enabling factors in innovation governance: A business policy approach
- 2.3. Corporate governance of state-owned enterprises: Carris company case study
- 2.2. Corporate governance, family firms and innovation
- 4.12. Corporate governance practices in Moroccan listed companies: State of play and international comparison
- 1.1. The joint effect of board independence and CSR committee on CSR disclosure: Evidence from Italian listed companies
- 4.4. A multi country analysis of the shareholder effects of cyber breaches

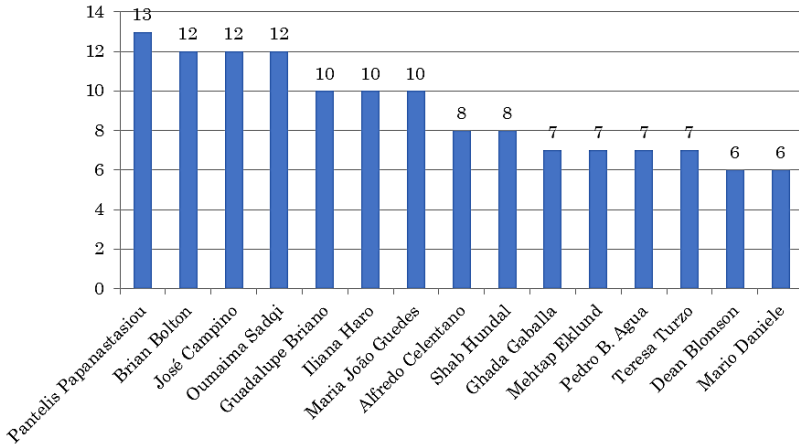
### Conference forum comments – top most commenting discussants (by number of comments)



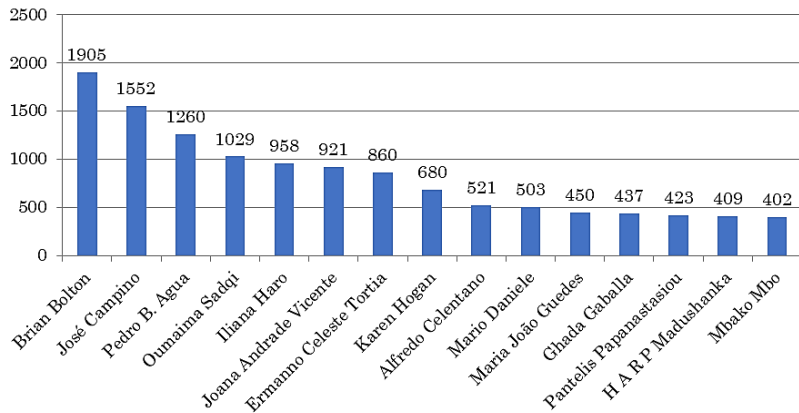
### Conference forum comments – top most commenting discussants (by volume of comments (words))



**Conference forum comments – top-15 most commenting presenters (by number of comments)**



**Conference forum comments – top-15 most commenting presenters (by volume of comments (words))**



# CONFERENCE FORUM DISCUSSANTS INDEX

<i>Names of discussants</i>	<i>Pages</i>
Ahmad Almeile	160
Ahmed El-Masry	64
Alexander Kostyuk	20; 41; 42; 43; 44; 45; 46; 47; 54; 56; 59; 60; 63; 64; 71; 72; 73; 76; 79; 80; 89; 98; 99; 109; 119; 120; 127; 160; 176; 177; 185; 186; 202; 204; 220; 229
Alfredo Celentano	19; 20; 21; 62
Alina Bari	88; 89
Andrea Vacca	140; 141
Bashar H. Malkawi	144
Brian Bolton	37; 38; 39; 40; 98; 99; 100;
Dean Blomson	63; 79; 80; 81; 168
Dilvin Taşkın	62; 72; 160; 185; 187; 203
Dmytro Govorun	19; 20; 21; 26; 27; 37; 42; 47; 127; 129; 132; 140; 144; 154; 193; 209; 219; 220; 224; 229; 234
Egbert Irving	26; 81
Ermanno Celeste Tortia	128; 129
Ghada Gaballa	132; 133
Gonzalo Jimenez-Seminario	27
Guadalupe del Carmen Briano Turrent	26; 27; 28; 65; 218; 235
H A R P Madushanka	19; 20; 60; 88; 152; 218; 233; 234
Hadfi Bilel	28; 77; 78; 99; 111; 140; 144; 234
Iliana Haro	27; 37; 38; 39; 40; 44; 45; 46; 47; 60; 61; 63; 64; 80; 81; 167; 168; 169; 172; 173; 175; 176; 177; 202
Issam Buhaisi	45
Joana Andrade Vicente	109; 110; 111; 112
José Campino	172; 173; 174; 175; 176; 177
Juliet Wakaisuka	45; 62; 98; 202
Karen M. Hogan	78; 81; 89; 186; 187
Khaled Otman	47; 77
Lindriana Sari	41; 59; 89; 219
Louis-François Pau	21; 28; 77; 78; 89; 167; 185; 186; 187; 204; 215; 220; 221; 233; 234
Lucrezia Fattobene	41; 42; 219
Maha Radwan	21; 27; 55; 62; 77; 132; 153; 154; 218
Maria João Coelho Guedes	43; 44; 45; 46; 47; 62; 72; 77; 78; 81; 230; 231
Mario Daniele	152; 153; 154
Marius F. Gros	45
Max Alberto Galarza Hernandez	110; 111; 231; 232
Maxim Dolinsky	141
Mbako Mbo	60; 61; 77; 110; 119; 120
Mehtap Aldogan Eklund	54; 55; 56; 61
Mireille Chidiac El Hajj	26; 38; 73; 100; 112; 154; 205

<i>Names of discussants</i>	<i>Pages</i>
Omrane Guedhami	21; 28; 55; 56; 112; 133; 141; 218
Oumaima Sadqi	144; 229; 230; 231; 232
Pantelis Papanastasiou	59; 60; 62; 63; 64; 65
Patricia Bortolon	37; 76
Pedro B. Água	62; 63; 202; 203; 204; 205
Philipp Prigge	220
Rainy Trinh	133; 160; 202
Sabri Boubaker	21; 28; 132; 133; 141
Salman Saleem	215
Shab Hundal	71; 72; 73; 88
Stergios Tasios	21; 133; 140; 185; 218; 219
Sven-Olof Yrjö Collin	45
Tariq Ismail	19;
Teresa Turzo	218; 219
Victor Barros	76; 77;
Vikash Ramiah	19; 20; 43; 54; 55; 59; 60; 218

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9 786177 309122