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Dear Readers!

The recent issue of the journal is devoted to several aspects of corporate governance. First of all, we keep the hand on the pulse of the mergers and acquisitions.

Khalil Torabzadeh and Sema Dube investigated the change in the post-acquisition share and operating performance, the dividend policy, the liquidity, and growth prospects of U.S. firms whose shares were partially acquired by other corporations during 1995-2000, wherein the target firms remained independent publicly traded companies following the acquisition.

Thomas A. Turk, Jeremy Goh and Candace E. Ybarra found evidence, that firms adopt poison pills following a period of significant negative revisions in earnings forecasts.

In another research by R. S. Rathinasamy, Ronald E. Shrieves, C. R. Krishnaswamy, authors found and investigated evidence of wealth transfers between stockholders and bondholders of merging firms and some support for the theory that bondholder returns are negatively related to the pre-merger correlation between cash flows of the merging firms.

For the second, we introduced a new country to explore corporate governance, i. e. Canada. Authors made an excellent contribution to the field of research corporate governance. Results indicate that in Canadian firms, dividends are used as a protective mechanism for minority shareholders against the possibility of expropriation by large shareholders. Another paper looks at the insurance demand of a firm's directors and officers using a sample of Canadian corporations (excluding firms from the financial services and mining sectors) from 1993-1999.

Besides that we tried to do our utmost to develop the academic investigations and concepts through publishing papers on Fall of "Organ Bank" Relationship over Bank Failure and Consolidation Wave: Experience in Pre-war Japan by Tetsuji Okazaki, Michiru Sawada, Ke Wang; The Impact of Large Shareholders on Firm Risk-Taking: Evidence from a Small Market by Michael Graham; The Legitimacy of Corporate Social Responsibility by Rebecca Stratling and many other excellent papers.

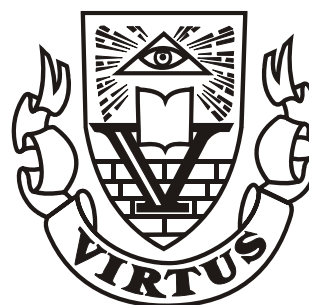
We hope that our practitioner's corner with the paper „Corporate Governance in Brazil: A study on 647 open corporations" by Douglas C. Monaco will be read by you with interest and benefit.

We would like to remind that all our efforts are directed to develop corporate governance through intensive research and in this way your contribution is welcome by us.

CORPORATE OWNERSHIP & CONTROL

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SECTION 1. ACADEMIC INVESTIGATIONS AND CONCEPTS

The Societas Europaea – A Step Towards Convergence of Corporate Governance Systems?

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Udo C Braendle, Juergen Noll

Since October 2004 the idea of a European Company, the Societas Europaea, has become reality and companies are allowed to incorporate in this legal form. Concerning corporate governance the Statute allows the companies to choose between a two-tier organisational structure typical for Civil Law countries and a one-tier organisational structure which is predominant in Anglo-Saxon Common Law countries. By analysing the regulations of Austria and the United Kingdom for the two board systems to elaborate the respective advantages and pitfalls, we find a strong evolution of the systems towards each other.

Fall of “Organ Bank” Relationship over Bank Failure and Consolidation Wave: Experience in Pre-war Japan

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Tetsuji Okazaki, Michiru Sawada, Ke Wang

This paper examines how the close ties between banks and non-bank firms – so called “organ bank” relationship in Japanese banking literature – declined through bank failures and banking consolidations in pre-war Japan. With a unique dataset compiled for 1,007 Japanese banks from 1926 to 1936, we measure the degree of “organ bank” relationship by the number of persons who worked as directors or auditors for a bank and a non-bank firm at the same time. We observe that this number of “director interlocking” declined along our sample period, when there were lots of bank failure, bank merger and acquisition events. Our findings suggest that banking consolidation and selection thorough failures may help to eliminate the detrimental connections between banks and non-bank firms, based on Japan’s experience.

Toward an Empirical Institutional Governance Theory: Analyses of the Decisions by the 50 us State Governments to Adopt Generally Accepted Accounting Principles

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Vivian L. Carpenter, Rita H. Cheng, Ehsan H. Feroz

In this paper, we develop and empirically test an institutional governance theory for explaining the decisions by the population of 50 US state governments to adopt Generally Accepted Accounting Principles (GAAP) for external financial reporting. Governmental accounting studies have generally explained the governance choice of an accounting method in terms of the economic consequences of

these choices for managerial welfare and other microeconomic determinants of those decisions. Our study develops an institutional governance theory and demonstrates that institutional governance variables in conjunction with traditional economic agency variables can improve the explanatory power of government accounting choice models. Our empirical results are consistent with the stipulations of the institutional governance theory.

The Impact of Large Shareholders on Firm Risk-Taking: Evidence from a Small Market

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Michael Graham

This paper investigates the impact of active large shareholders on three measures of firm risk-taking. The results suggest a positive relationship between active large shareholding and income instability risk as well as strategy risk. Large shareholding was found not to exert any influence on risk based on stock returns.

Stock Incentive Plans in Europe: Empirical Evidence And Design Implications

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Alessandro Zattoni

Traditionally, stock incentive plans have been used by American companies for two primary purposes: as tools of corporate governance to align the interests of top managers and shareholders, and to motivate managers to maximize shareholders' value. Recently, just as the misuse of stock option plans is the subject of scathing criticism, such plans are seeing widespread dissemination in several European countries. The characteristics of the process through which they are designed and of the equity incentives implemented raise the concerns of investors and academics about the ability of such plans to align managers' interests to shareholders'. Since stock incentive plans were created and developed in the Anglo-Saxon capitalistic system, the last part of the paper reviews the reasons why firms should set up these plans. The aim is to ascertain whether European companies have good reasons to create SIPs and if the features of the incentive plans designed by these executives are consistent with achieving these goals.

The Legitimacy of Corporate Social Responsibility

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Rebecca Stratling

Based on deliberations on the legitimacy of CSR from the perspective of stakeholder and legitimacy theory on the one hand and the more critical view of Milton Friedman and Michael Jensen on the other hand, this paper analyses how major energy companies legitimise their CSR activities in their Annual Reports and their CSR reports. The research indicates that managers recognise the potential contribution of CSR to long-term financial performance of firms as well as the need to socially legitimise the firm's operations. A surprisingly limited number of the companies in the sample take a very explicit strategic approach to CSR by stressing long-term shareholder value maximisation. The CSR policies therefore appear not to focus solely on a strategic stakeholder approach geared towards maximising shareholder value but to reflect considerations raised by legitimacy theory.

Information Disclosure and Regulatory Issues: A Survey of South African Hedge Funds

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JH van Rooyen, R Mutingwende

Several contributory factors have worked to ensure that the mystical aura surrounding hedge funds has, if at all, only slightly diminished even in the Information Age in which we live. One factor has been the fact that hedge funds are neither fully understood by the majority (due to restricted participation) nor have hedge funds been forthcoming with the disclosure of information regarding their activities and practices. This study sought to shed light on the historical and current issues relevant to the hedge fund industry, and to identify some of the difficulties facing regulatory authorities in their attempts to introduce regulation to the industry. One of the most significant findings of the research was that it revealed that the commonly quoted size of the South African

hedge fund industry was grossly understated. Various criteria, among others, regarding communication with investors, frequency of communication, level of information communication, benchmarking, penalties, volatility, maximum gearing were commented on by respondents. The challenges of implementing effective regulation and ensuring adequate investor education were identified by the respondents as the most pertinent challenges facing the industry. This research attempted to identify some of the pressing issues affecting the regulation of the Hedge Fund industry in South Africa as an emerging economy. These issues need to be addressed to uplift investor confidence, ensure effective regulation of the industry and the further develop South Africa as an investment destination.

The Duration of Ownership and Control in Brazil

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André Luiz Carvalhal da Silva, Leonardo Augusto Andrade

This paper analyzes the duration of equity ownership and analyze whether it affects the valuation and performance of firms in Brazil. Long equity duration can have both positive and negative corporate governance effects. On one hand, long-term owners may have incentives to monitor the company. On the other hand, long-term owners can become passive and allow managers to expropriate shareholders. We provide evidence that the latter effect dominates for most companies in Brazil. Our results indicate that a negative relationship between valuation, performance and ownership duration. The negative impact of the ownership duration is not constant across owner types. While the duration is positively related to the valuation of foreign-owned companies, it is negatively related to the valuation of government-owned companies.

Descriptive Study of Audit Quality Review and Administrative Inquiries Arising From Misrepresentation of Financial Statements in Brazil

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Joshua Onome Imoniana, Carlos Hideo Arima, Sergio Paulo Stahn

Objective of this study was to analyze the administrative inquiries handled by the Brazilian SEC during the periods of 2000 through 2004 with a view to identifying motives for their instauration. In order to attain the said objective, we assume the premise that: a) the said inquires have been documented as a result of misstatement of Financial Statements undermined by the auditors; and b) the growth and strength at which regulating bodies are bent to ensure transparency in the financial statements is directly related to the trend of administrative inquiries judged in Brazil. The study envisaged a descriptive one. Results indicate that the quantities of administrative inquiries installed in years 2000 through 2004: 19, 38, 32, 32, and 48 respectively signifies a growing trend; this in terms portrays the rate at which the regulating bodies all over the world are keen to curb frauds arising from misrepresentation of financial statements.

Corporate Governance: Shareholders' Interests' and Other Stakeholders' Interests

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Elena F Pérez Carrillo

Much of the traditional Company Law doctrine considers that Corporations must be managed to promote, above all, shareholders' rights. Activities in favour of non-shareholder constituencies such as suppliers, consumers, employees or the Community at large can be perceived as a means of Management to increase its power and personal prestige. Stakeholders' interests can be interpreted as opposing Shareholders rights to obtain fair revenue for their investment. In this paper, we argue that Shareholders and Stakeholders interests are compatible and both contribute to corporate long term efficiency and progress. It is further argued that it is essential to achieve a wide consensus on how to control Management actions in support of Stakeholders interests.

SECTION 2. MERGERS & ACQUISITIONS

Motives for Partial Acquisition: Evidence from the Effects of CEO Change on the Performance of Partially Acquired U.S. Target Firms 103

Khalil Torabzadeh, Sema Dube

We investigate the change in the post-acquisition share and operating performance, the dividend policy, the liquidity, and growth prospects of U.S. firms whose shares were partially acquired by other corporations during 1995-2000, wherein the target firms remained independent publicly traded companies following the acquisition. Using a change in CEO post acquisition as a proxy for the extent to which the acquirer wishes to change the direction of the target management, we find that target firms where the CEO was retained show negative risk adjusted abnormal share returns and significant deterioration in operating performance after the acquisition while having a substantial increase in CEO compensation compared to those target firms that replace their CEO during the post acquisition period.

Corporate Mergers and the Impact of Pre-merger Variance, Leverage and Maturity of Bonds on Wealth Transfers 112

R. S. Rathinasamy, Ronald E. Shrieves, C. R. Krishnaswamy

This paper addresses several hypotheses concerning wealth transfers among bondholders and stockholders in two firms which merge. We find evidence which supports the presence of diversification effects (coinsurance) to some bondholders, incentive effects (risk increases) to other bondholders, and wealth transfers between stockholders and bondholders. This study examines the impact of 49 industrial mergers between 1970 through 1984 on the returns to bondholders and stockholders of the merging firms. Results indicate that bondholders of the acquired firm group gain significantly in the announcement month, suggesting a diversification effect for acquired firm bondholders.

The Effect of Takeover Defenses on Long Term and Short Term Analysts' Earnings Forecasts: The Case of Poison Pills 127

Thomas A. Turk, Jeremy Goh, Candace E. Ybarra

This study examined the effect of poison pill adoption on long term and short earnings forecasts by security analysts. Our results provide no evidence of significant revisions in one-year or five-year earnings forecasts following the adoption of poison pills. We do find evidence, however, that firms adopt poison pills following a period of significant negative revisions in earnings forecasts. Our results suggest that poison pill adoptions may be a response to downward revisions in earnings forecasts.

SECTION 3. NATIONAL PRACTICES OF CORPORATE GOVERNANCE: CANADA

Corporate Control, Family Firms And Dividend Decisions In Canada 132

Yoser Gadhoun, Michel Y. Bergeron, Jean-Pierre Gueyjié

The purpose of this paper is to examine the relationship between dividend payments, firms' decisions control and the nature of family firms, in order to assess whether large shareholders expropriate wealth from minority shareholders in Canada. Our results indicate that in Canadian firms, dividends are used as a protective mechanism for minority shareholders against the possibility of expropriation by large shareholders. The protective power of dividend, however, seems less effective in Canadian family firms. The hidden reason is the control that families exert on the dividend payout policy.

Directors' and Officers' Insurance in Canada

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M. Martin Boyer

This paper looks at the insurance demand of a firm's directors and officers using a sample of Canadian corporations (excluding firms from the financial services and mining sectors) from 1993-1999. More to the point, we study the demand for directors' and officers' insurance. Contrary to the financial distress theory of hedging, our results suggest that larger corporations are more likely to purchase D&O insurance. On the other hand, insurance is more likely when the firm is financially weak. Firms are also more likely to purchase D&O insurance when there are few outsiders on the board of directors and when the board members have an important financial stake in the corporation, suggesting that D&O insurance is yet another tool for managerial entrenchment.

SECTION 4. PRACTITIONER'S CORNER

Corporate Governance in Brazil: A study on 647 open corporations

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Douglas C. Monaco

This article draws on a sample of 647 Brazilian publicly traded corporations to explore some of the features of corporate governance in this country. The results show that ownership concentration is by far the mostly used governance mechanism what matches the patterns observed in Continental European countries. Results raise doubts about the real role boards of directors play in Brazilian open corporations.

Is the Tone Set at the Top? A Review of the Literature Relating Corporate Behavior to Characteristics of the Board of Directors

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Wanda Causseaux, Bruce Caster

The financial community has been stunned by the flood of reports of corporate accounting scandals. Congress reacted swiftly with the Sarbanes-Oxley Act, and the Securities and Exchange Commission (SEC) imposed sweeping changes for corporate boards of directors. One major objective of this regulation was to improve corporate behavior by mandating changes in corporate governance structures. But, do changes at the top actually permeate the corporation, or do such changes only result in token attempts to comply with a list of rules, regulations and requirements? This literature review covers: the relationship between board characteristics and high quality financial reporting; the role of the board in corporate governance; and literature linking board characteristics with corporate behavior.

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