

**CORPORATE  
OWNERSHIP & CONTROL**

**КОРПОРАТИВНАЯ  
СОБСТВЕННОСТЬ И КОНТРОЛЬ**

Postal Address:

Postal Box 36  
Sumy 40014  
Ukraine

Tel: +380-542-611025  
Fax: +380-542-611025  
e-mail: alex\_kostyuk@mail.ru  
alex\_kostyuk@virtusinterpress.org  
www.virtusinterpress.org

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Почтовый адрес редакции:

Почтовый ящик 36  
г. Сумы, 40014  
Украина

Тел.: 380-542-611025  
Факс: 380-542-611025  
эл. почта: alex\_kostyuk@mail.ru  
alex\_kostyuk@virtusinterpress.org  
www.virtusinterpress.org

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## EDITORIAL

*Dear readers!*

This issue of the journal *Corporate Ownership and Control* is devoted to several issues of corporate governance.

First of all, we would like to accentuate your attention to such very important issue as board practices. Authors considered board practices from the various aspects. Independent directors were considered from the point of view of the merger effectiveness. Thus, it was concluded that the change in board independence is positively related to post-merger cash flow difficulty, suggesting that independent directors are more likely to be added if the firm faces financial constraints. Outside directors are taken for the effective instrument to improve corporate performance too. Higher proportion of appointed outsiders yields more efficient boards. Outsider-dominated boards, given enough time, will reduce information asymmetry among directors and thereby execute institutionally preferred policies. Audit committees practices are extremely important to improve corporate performance too. Fewer audit committee members in the Netherlands, and a higher frequency of audit committee meetings in the UK and Belgium, countries where corporate governance codes do not proscribe a minimum number of meetings.

The country we explored in this issue of the journal was Malaysia. It was very interesting to know some important conclusions on corporate governance in Malaysia. Thus, increasing the proportion of non-executive directors in a firm could lead to a decrease in dividend payout. Besides that we have concluded on the importance of the auditor's report in the financial reporting framework in Malaysia.

Section Academic Investigations and Concepts was strongly built around the international corporate governance. There are very interesting papers about corporate governance in such countries as Egypt, China, Brazil. Industrial specifics of corporate governance were investigated in the paper on corporate governance in banks. Taking into account that corporate governance in banks is a quite rare topic to research we are really happy to deliver papers on this issue to you.

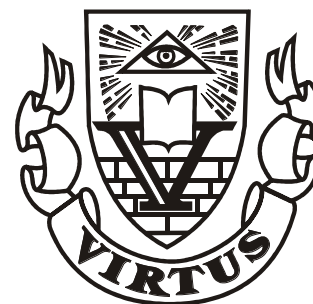
Results of some corporate governance issues are truly innovative and convincing. Results suggest the poison pills may serve a more constructive role in the governance of publicly traded firms than is generally assumed. With application to China, the company which had turnover of top management after the corporate control right changed, had significant performance improvement, and had better performance than the company which had not had turnover of top management after the corporate control right changed.

We hope that these issues of corporate governance were considered by us very thoroughly from inside. This is a fruitful soil for developing new concepts of corporate governance.

# CORPORATE OWNERSHIP & CONTROL

Volume 5, Issue 3, Spring 2008

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*M<sup>a</sup> Belén Lozano*

This survey synthesizes the study of public contracts from an agency perspective, detecting possible inefficiencies in the contracting context between government and firms. In this sense, we offer a clear analysis framework in order to improve efficiency in contracting processes. To do this, we have divided this situation into two conflicts of interest. On the one hand, we have the conflict between citizens and the firm with which the services will be contracted (fundamentally when there is a divergence in the price determination) and, on the other hand, the difference in interests between citizens and public officials. This analysis from a managerial perspective allows us to delve more deeply into a topic scarcely treated in the literature: the relationship of firms to the public sector. It also allows us to reflect on the efficient (or inefficient) behavior which firms are subject to in the contracting process.

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*Ismail Adams*

This paper focuses on governance from an institutional economic perspective in trying to better understand the complexities of the decision making process and their implications for economic outcomes and growth. Section I provides an introduction and background. Section II sketches various governance models within the conventional western paradigm. These are basically the 'market-based' model and the 'relationship-based' model. A recent third paradigm is also gaining momentum in the literature, namely 'family capitalism' or the 'family business'. Together, these three models or frameworks may be construed as the *quantitative* perspective to governance, driven by a rule-based environment. It will be indicated that these models are a necessary but not sufficient condition for effective and qualitative delivery of governance ensuring trust, honesty and integrity. This section also emphasizes the critical importance of institutions, cultural traditions, value systems, mores and history as crucial ingredients in the development process over and above issues of compliance.

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*Ricardo Lopes Cardoso, André Carlos Busanelli de Aquino, José Elias Feres de Almeida, Antônio José Barbosa das Neves*

This study investigates if the level of discretionary accruals (DAs) is different for companies whose corporate governance level is certified by Bovespa compared to those ones that are not. And also for companies whose stocks negotiated at Bovespa have high liquidity compared to the ones with low liquidity. The main purpose is to comprehend the phenomenon of accounting choices (measured as DAs), its incentives and counter-incentives. In this context, the issues were: i) Is there any difference of

DAs intensity between certified and non-certified companies, considering the corporate governance level?; ii) Is there any difference of DAs intensity with high liquidity stocks at Bovespa and those ones with low liquidity? This research took into consideration Jones' original model (1991), a sample with 1,791 observations collected from 1997 to 2004. Empirical results from our study show that there is no significant statistic difference in the level of DAs between the firms listed or not in the corporate governance index. This suggests the need to consider incentives and counter-incentives from the capital market to those different set of firms, in relation with accounting choices.

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*J. Young*

Operational risk management is one of the fastest growing management disciplines within a banking environment as a result of various disastrous international incidents. Subsequently, various global institutions got involved in order to ensure that the effect of similar events do not negatively influence the international industries, for example, the Basel Committee on Banking Supervision regarding banks. It is, however, a known fact that operational risks are difficult to manage, as it is not easy to quantify. Therefore, it is of the utmost importance to understand the concept of operational risk management and, more specifically, the actual roles and responsibilities of various role-players within an organisation. This paper aims to identify the main role-players involved in the management of operational risk in a banking environment and to identify their specific roles and responsibilities.

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

Management scholars have argued that an active takeover market discourages risk-taking by managers and that takeover defenses serve to counter the risk-reducing pressures of an active takeover market. This study employs the Black and Scholes Option Pricing Model to determine whether or not adoption of poison pill securities increases investor perceptions of firm risk. The results provide evidence that the Option-Implied Standard Deviations of common stock returns increase significantly on the poison pill adoption date, on average. Furthermore, the implied standard deviations remained significantly above pre-adoption levels for several days after the poison pill adoption, suggesting that the perceived increase in firm risk is permanent. These results suggest the poison pills may serve a more constructive role in the governance of publicly traded firms than is generally assumed.

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*Magdi El-Bannany*

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*Jian Chen, You-min Xi*

In this paper, we analyzed the relationship between turnover of top management and performance of listed companies after takeover, according to the previous researches on corporation governance and corporate control market. We made a hypothesis that after equity change of listed corporations, the turnover of top management improved the performance of these corporations. We chose the sample of listed corporations in Shenzhen and Shanghai security exchanges which had equity change, and we used the assessment of the "Operating Performance" Methodology to analyze the performance of these listed corporations empirically. We find that the company which had turnover of top management after the corporate control right changed, had significant performance improvement, and had better performance than the company which had not had turnover of top management after the corporate control right changed.

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*Donna L. Paul*

This study documents an overall increase in board independence and size following completed mergers. The increase in board size is positively related to the size of the target firm, suggesting either that large targets have bargaining power to negotiate inclusion of their directors on the board of the merged firm, or that high target director representation is perceived to be vital in mergers of equals. The change in board independence is positively related to post-merger cash flow difficulty, suggesting that independent directors are more likely to be added if the firm faces financial constraints.

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*Esmée Van Gansbeke, Patricia Everaert, Gerrit Sarens, Ignace De Beelde*

This paper compares the number of audit committee (AC) members, meeting frequency and the presence of internal auditors at AC meetings of listed companies according to their country of domicile. We consider the USA, the UK, the Netherlands, France and Belgium. Hypotheses are developed based on differences in corporate governance codes. Data are gathered from annual reports of 100 listed companies in these countries. Our results indicate fewer AC members in the Netherlands, and a higher frequency of AC meetings in the UK and Belgium, countries where corporate governance codes do not proscribe a minimum number of meetings. The presence of an internal auditor at AC meetings was, on average, highest for firms listed in the USA.

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*Katja Rost, Sören Salomo, Margit Osterloh*

A rarely studied trend in corporate governance is the increasing tendency to fill CEO openings through external hires rather than through internal promotions: Kevin J. Murphy and Ján Zábajník (2004) show that the proportion of outside hires has doubled and their pay premium almost quadrupled over the last thirty years. Assuming that general managerial skills are becoming more important relative to firm-specific skills, the authors conclude that competition in the managerial labor market establishes optimal contracts. In our model and our empirical analysis we question this explanation by assuming that over the past decades the dishonesty of the predecessor has become relatively more important for the appointment decisions of firms. We conclude that outside hires are a suboptimal trend because external candidates even step up the regression of integrity in firms: As nobody has an incentive to invest in firm-specific knowledge, not only the performance of firms drops, but also the remaining integrity.

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*Chun-An Li, Kun-Chin Lee*

We examine the value of outsiders by voting behavior of boards. Our model proves that boards with a majority of trustworthy but uninformed outsiders can implement institutionally preferred policies and augment corporate performance by upgrading resource allocation. Our laboratory experiments strongly support this conclusion that higher proportion of appointed outsiders yields more efficient boards. We also find outsider-dominated boards, given enough time, will reduce information asymmetry among directors and thereby execute institutionally preferred policies.

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*Shamsul Nahar Abdullah, Mohamad Naimi Mohamad Nor, Nor Zalina Mohamad Yusof*

This study investigates whether a firm's management decision to locate the auditor's report in the financial statements is explained by information signaling theory. We posit that a firm that conveys good news is more likely to place its auditor's report at the beginning of the financial statements than at the end, and vice-versa. Based on 698 firms listed on the Bursa Malaysia as on December 31, 2002, we find that majority of Malaysian listed firms in Malaysia place their auditor's reports at the beginning rather than at the end of the financial statements. This could be a manifestation of the importance of the auditor's report in the financial reporting framework. However, our evidence the type of news, as measured by Tobin's q, ROA and EPS, does not have any association with the location of the auditor's report. Thus, it is concluded that information signaling theory is not supported.

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*Chang Aik Leng*

This paper examines the impact on dividend payouts of internal and external monitoring measures instituted by companies to improve their corporate governance structures. The study involves 120 selected Malaysian listed companies over a four-year period from 1996 to 1999. This period encompassed the 1997/98 Asian financial crisis which affected most countries in the Southeast Asian region including Malaysia. Using dividend payout as the dependent variable, it was established that the size of firm, gearing ratio (borrowing) and the proportion of non-executive directors on a company board significantly influenced the dividend payout of firms. The impact of size on dividend payout of firms followed a quadratic fashion with payout increasing with the size of the firm up to the optimal size of around 11,321 million ringgit, in terms of turnover. Beyond that, firm's dividend payout declined with increasing size. The study also found that company borrowing had a negative effect on dividend payout. Finally, increasing the proportion of non-executive directors in a firm could lead to a decrease in dividend payout.

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*Helen Wildsmith*

This paper tentatively concludes that, although there is a possible collective developmental role for these funds, this is unlikely to occur unless leadership from government or the funds emerges. If a leadership role is chosen, government should probably focus on a transition management approach to sustainable development, trustees on the implementation of long-term investment policies, and the members of the investment community on a high leverage initiative, possibly linked to the Financial Sector Charter review. Some of the tentative conclusions reached in this paper also provide pointers for overseas pension funds and their stakeholders. Firstly, governments could support collective action between the largest public sector pension funds globally, and in return develop an unusually powerful long-term voice in support of a transition to sustainability. Secondly, a more significant role for these funds will highlight the issue of prioritisation, and the development of legitimate processes is likely to be needed. Thirdly, full implementation of genuinely long-term investment policies will probably lead to significant changes in the role funds play in the investment industry, possibly including the establishment of their own investment co-operatives.