CHALLENGES IN THE MEASURING OF COMPARATIVE CORPORATE GOVERNANCE: A REVIEW OF THE MAIN INDICES

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ABSTRACT

Purpose – *This paper discusses the role that indices of corporate governance have had in comparative corporate governance research.*

Design/Methodology/Approach – *We begin with a short discussion of what corporate governance is and its main debates. Then, we review the main indices (which are also summarized in Table 1), highlighting their strengths and limitations as well as describing some of the findings that emanate from them. Then, we discuss the methodological and conceptual assumptions of corporate governance indices that may compromise their construct validity. We conclude with some encouraging suggestions for key methodological and research design issues to take into account in future comparative corporate governance.*

Findings – *Many methodological issues in the measuring and analysis of (comparative) corporate governance remain to be solved. First, although corporate governance practices have a direct effect on some of the firms'*

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strategic decisions, they may only have an indirect effect on firm performance. Second, it is possible that, after all, causality goes the other way around, i.e., the firm performance explains the adoption of certain governance practices. Third, there are also important challenges in measuring firm financial performance as well as measuring and comparing corporate governance effectiveness between firms from different governance settings.

Originality/Value – *This is one of the first papers to give an overview of the most current corporate governance indices, both academic and commercial, to discuss their underlying assumptions and limitations, and, finally, to provide specific directions for future research regarding comparative corporate governance.*

Keywords: Corporate governance; comparative corporate governance; indices; institutions; bundles of governance practices; ownership; governance performance; shareholder activism

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INTRODUCTION

This article discusses how firm-level corporate governance practices have been measured, with a particular emphasis on the growing development of corporate governance indexes. Corporate governance refers to the "structure of rights and responsibilities among the parties with a stake in the firm" (Aoki, 2001). Effective corporate governance entails the installment of mechanisms to ensure that executives respect the rights and interests of company stakeholders, as well as guarantee that stakeholders act responsibly with regard to the generation, protection, and distribution of wealth invested in the firm (Aguilera & Jackson, 2003). Traditionally, empirical literature on corporate governance was rooted in agency theory that takes an insider and undercontextualized view of governance claiming that by managing the principal agency problem between shareholders and managers, firms will operate more efficiently and perform better (Dalton, Hitt, Certo, & Dalton, 2007). From an agency perspective, it is argued that managers and other corporate insiders have different objectives than outside investors and will act in their own best interest whenever they have the opportunity, usually at the expense of the outside investors (Jensen & Meckling, 1976). Such opportunities are more likely to arise in companies

with poor governance, characterized by the absence of effective monitoring and disciplining mechanisms. Company insiders in these companies might adopt suboptimal strategies, manipulate performance measures, resist takeovers, and expropriate value (Shleifer & Vishny, 1997). As a consequence, these firms often exhibit significant underperformance (e.g., Core, Guay, & Rusticus, 2006; Gompers, Ishii, & Metrick, 2001). By implementing effective governance practices, companies are likely to reduce their agency costs and curtail suboptimal insider behavior, which should result in improved company performance.

Yet, we also know that firms' insiders and outsiders will have different incentives, abilities, and rights depending on the institutional context in which they operate (Aguilera & Jackson, 2003; Denis & McConnell, 2003; Doidge, Karolyi, & Stulz, 2007). Thus, the task of understanding and measuring corporate governance practices gets even more complex when we analyze how corporate governance practices compare not only across firms within a given country but also across countries (Aguilera, Desender, & Castro Kabbach, forthcoming; Judge, 2009; Judge, Filatotchev, & Aguilera, 2010). This is the field of comparative corporate governance that has mostly emerged from two disciplines: financial economics and international political economy/economic sociology. Financial economic studies on corporate governance (e.g., Jensen & Meckling, 1976; Rajan & Zingales, 1995; Shleifer & Vishny, 1997; Stulz, 1995) have had a strong influence in international corporate governance research. For example, Shleifer and Vishny's (1997) article "A Survey of Corporate Governance" continues to be a key reading as it draws on agency logic to discuss how the legal protection of investors reinforces different ownership structures in three advanced industrialized. More recently, finance research such as Doidge et al. (2007) and Aggarwal, Erel, Stulz, and Williamson (2009) have pushed the agenda forward, demonstrating that the country environment is determinant in predicting the effectiveness of firm corporate governance.

Doidge et al. (2007) develop and test a model of how country characteristics such as legal protections for minority investors and the level of economic and financial development influence firms' costs and benefits in implementing measures to improve their own governance and transparency. They find that country characteristics explain much more of the variance in governance ratings than observable firm characteristics. In addition, they show that firm characteristics explain almost none of the variation in governance ratings in less developed countries and that access to global capital markets sharpens firms' incentives for better governance. Likewise, Aggarwal et al. (2009) argue that firm-level governance is less productive in

countries with poor economic development and weak investor protection implying that firm-level governance and legal protection of investors are complementary. Furthermore, they suggest that firms have incentives to invest more in firm-level governance when a country becomes economically and financially developed and better protects investor rights.

This financial economics research has in turn influenced comparative research in the tradition of "law and economics" discipline (Bebchuk & Hamdani, 2009; Bebchuck & Weisbach, 2010; Gilson, 2006, 2007; La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1998, 1999), as well as other legal scholars who conceptualize the institutional context more broadly (Black, 1992; Blair, 1995; Coffee, 1999, 2002; Milhaupt & Pistor, 2008; Roe, 1994). For example, Coffee (2002) develops the "bonding hypotheses" in which he argues that firms from countries with weak investor protection get publicly listed in countries with strong investor protection in order to gain some legitimacy and strengthen their governance.

Research on comparative political economy is mostly launched from the country-level concept of "varieties of capitalisms" and "business systems" (Aguilera et al., forthcoming; Hall & Soskice, 2001; Whitley, 1999) and has shaped conceptual models on cross-national comparative research in corporate governance (Aguilera & Jackson, 2003, 2010; Gourevitch & Shinn, 2005). Empirical research in this tradition follows, for the most part, case study comparative methods, such as Goyer's (2011) book on short-term (Anglo-American) institutional investors in France and Germany and Culpepper's (2010) analysis of the political salience of takeovers in four countries (France, Germany, Japan, and the Netherlands), which provide opportunities and constraints on managers to erect antitakeover barriers. In addition, there have been efforts to more systematically account for these cross-national differences, resulting in a wide range of categorizations of corporate governance systems (e.g., Aguilera & Jackson, 2003; Millar, Eldomiaty, Choi, & Hilton, 2005; Weimer & Pape, 1999). For example, Aguilera and Jackson (2003) draw on an "actor-centered" institutional approach to explain firm-level corporate governance practices in terms of institutional factors that shape how actors' interests and conflicts are defined ("socially constructed") and represented. In their model, they examine how labor, capital, and management compete for firm resources to explain firm's governance patterns under diverse institutional settings.

Corporate governance research in the explicit field of management has not been as comparative/international in nature (Durisin & Puzone, 2009). For instance, the most cited management scholars publishing research in corporate governance during 1956–2008 according to Judge, Weber, and

Muller-Kahle (forthcoming) are James Westphal, Edward Zajac, Catherine Dalton, Robert Hoskisson, and Gerald Davis. While these scholars have made a tremendous contribution to the field of corporate governance and the diffusion of corporate governance practices (even across the globe), they have not focused as much on international governance comparisons. Hence, there is a pressing need to address corporate governance from a global perspective.

In the next three sections, we first discuss how comparative corporate governance researchers have used different measures of governance practices, beyond looking at individual practices such as board independence, takeover activity, ownership structures, compensation packages, etc. In particular, comparative researchers have relied on two types of indices that intend to capture a more holistic view of the firm governance. These indices are either developed by scholars or are compiled by commercial firms for investors. In the third section, we discuss some of the underlying assumptions of corporate governance indices and their external validity concerns. We then conclude with a brief overview of promising future methodologies to strengthen comparative corporate governance (Table 1).

CURRENT MEASUREMENT OF CORPORATE GOVERNANCE PRACTICES

There is a vast empirical literature examining the relationship between selected corporate governance mechanisms (i.e., board independence, managerial incentives, proxy voting, etc.) and firm performance. These studies often measure a particular corporate governance practice of interest or draw on governance indices. Within this stream of work, the influence of board independence on firm performance has been of great interest (Dalton et al., 2007; Finkelstein & Hambrick, 1996; Johnson, Daily, & Ellstrand, 1996). Board independence captures the idea that for directors to offer objective advice and effective monitoring to the CEO (Chief Operating Officer) and the TMT (Top Management Team), they must not have ties to the firm, which might influence their voice. In these studies, board independence is measured by collecting from each individual firm the self-reported characteristics of the independent or executive director.

In fact, empirical research from an agency perspective is equivocal as neither Dalton, Daily, Ellstrand, and Johnson's (1998) meta-analysis nor Dalton et al.'s (2007) literature review offer systematic support for the

Table 1. Summary of Main Comparative Corporate Governance Indices.

Corporate Governance Index	Academic/Commercial	Components	Information Input	Coverage
Antidirector rights index	Academic (La Porta et al., 1998)	Six components: three are concerned with shareholder voting (voting by mail, voting without blocking of shares, and power to call an extraordinary meeting), and three with minority shareholder protection (proportional board representation, preemptive rights, and judicial remedies)	Based on company law or commercial codes, as well as secondary sources such as Price Waterhouse's Doing Business reports for various countries	49 countries
Governance index (G-index)	Academic (Gompers, Ishii, & Metrick, 2003)	Corporate governance index consisting of 24 antitakeover provisions and shareholders' rights	Data comes from the Investor Responsibility Research Centre (IRRC), who gathers data from a variety of sources, including corporate bylaws and charters, proxy statements, annual reports, as well as 10-K and 10-Q documents filed with the SEC	1,500 U.S. companies
Governance Metrics International – GMI	Commercial	600+ variables in areas of board accountability, financial disclosure and internal controls, reputational and social responsibility, executive compensation,	Rating is based on public data including regulatory filings, press releases, news articles, company Web site, as well as company policies, confidential documents,	4,318 companies in 16 different countries

		market for control, ownership base and potential for dilution, and shareholder rights	board and management interviews provided by the company	
Corporate Governance Quotient (CGQ) – issued by Institutional Shareholder Services	Commercial	Ratings are relative to other companies in 7 categories plus an overall score	61 variables in areas of board of directors, audit, charter and bylaw provisions, laws of the state of incorporation, executive and director compensation, qualitative factors, ownership and director education	Public information such as regulatory filings, company Web site and press releases
Ratings relative to other companies in market cap and industry peer group (2 scores)		More than 9,000 companies worldwide		
The Corporate Library (TLC)	Commercial Founded by Robert A. G. Monks, Nell Minow and Ric Marshall	TCL analysts review four specific governance areas: the company's board and succession planning, CEO compensation practices, takeover defenses, and board-level accounting concerns	(TCL) relies on their experience and private assessment of a given firm's governance quality	More than 3000 U.S. firms
Standard & Poor's (S&P) – corporate governance scores	Commercial	Rating of 4 areas – ownership structure and influence, financial stakeholder rights and relations, financial and information disclosure, and board structure and process – as well as an overall company score	Public data and confidential information provided by the company and interviews of directors, management, and other key individuals	Thousands of firms worldwide

Table 1. (*Continued*)

Corporate Governance Index	Academic/ Commercial	Components	Information Input	Coverage
Deminor Rating	Commercial	300 criteria, which can be attributed to 4 broader categories: rights and duties of shareholders, range of takeover defenses, disclosure on corporate governance, and board structure and functioning	Deminor Rating Publicly available information and firm's board and management interview	Focus on FTSE Eurotop 300 firms
Report on Business (ROB) – issued by "*The Globe and Mail*"	Commercial	Four blocks of corporate governance are considered: board composition, compensation, shareholder rights, and disclosure, which reflect a set of best practices culled from the corporate governance guidelines and recommendations of U.S. and Canadian regulators, as well as major institutional investors and associations (McFarland, 2002)	The data were obtained from information the companies published in their most recent proxy information circular for shareholders	S&P/TSX firms

proposed agency relationship between board independence and firm performance. However, there is a growing body of empirical research indicating that director independence is associated with improved decisions with respect to some specific types of decisions (e.g., Byrd & Hickman, 1992; Cotter, Shivdasani, & Zenner, 1997; Gillette, Noe, & Rebello, 2003). In particular, it has been shown that director independence has an impact on CEO turnover (e.g., Kaplan & Minton, 2011), on executive compensation decisions (e.g., Chhaochharia & Grinstein, 2006), on the incidence of fraud (e.g., Beasley, Carcello, Hermanson, & Lapides, 2000; Dechow, Sloan, & Sweeney, 1996), and on the incidence of opportunistic timing of stock option grants (e.g., Bebchuk, Cohen, & Ferrell, 2009).

Similarly, scholars and practitioners have been concerned with the effects the combined position of CEO and Chairman of the board, fairly common in the United States, as opposed to separating these two roles into two positions (dual leadership), which is quite common in the United Kingdom and also recommended by the 2002 Sarbanes–Oxley Act. Interestingly, once again, there are no conclusive findings on whether joint or separate board leadership structures universally enhance firm financial performance (Beatty & Zajac, 1994; Dalton et al., 1998, 2007).

Executive compensation is another given governance mechanism that has received a lot of attention. A substantial body of literature suggests that, to constrain managerial opportunism, shareholders may use a diverse range of corporate governance mechanisms, including various equity-based managerial incentives aligning the interests of agents and principals. As Jensen and Murphy (1990, pp. 242–243) observed, ''Agency theory predicts that compensation policy will tie the agent's expected utility to the principal's objective.'' Most of the empirical literature on executive compensation has focused predominantly on the U.S./U.K. corporate sectors when analyzing organizational outcomes of different components of executive pay, such as cash pay (salary and bonus), long-term incentives (e.g., executive stock options), and perquisites (e.g., pension contributions). Despite considerable research effort, the empirical findings on these causal linkages have also been mixed and inconclusive. For example, empirical studies and meta-analyses of the effects of executive equity-related incentives on financial performance have failed to identify consistently significant effects (see, e.g., the surveys and commentaries of Core, Guay, & Larcker, 2003; Daily, Dalton, & Rajagopalan, 2003; Hall, 2003; and Tosi, Werner, Katz, & Gomez-Mejia, 2000).

This lack of conclusive findings uncovering a direct relationship between a given corporate governance practice with firm performance seems to be the

norm in corporate governance research (Filatotchev, Toms, & Wright, 2006) where no support has been found for the hypothesized relationships between performance measures and governance factors such as ownership by large blockholders (Dalton, Daily, Certo, & Roengpitya, 2003), executive pay (Bebchuk & Fried, 2004), or characteristics of the market for corporate control (Datta, Pinches, & Narayanan, 1992; King, Dalton, Daily, & Covin, 2004). As we argue elsewhere (Aguilera et al., forthcoming; Desender, Aguilera, Crespi-Cladera, & Garcia-Cestona, 2011), this might very well be because each of these governance constructs captures different realities for each firm within a unique governance environment. Furthermore, each of them is also socially constructed by the overall set of governance practices in the firm. For example, having a board with majority independent directors might entail a different strategic behavior from these directors depending on who leads them (i.e., a single individual CEO/Chairman versus a Chairman who is not a CEO) or who nominates the directors (i.e., majority owners, institutional investors, or the CEO). One way to obtain more comprehensive governance information about a country's governance environment (shareholder rights, employment contracts, takeover regulations) or firms' corporate governance is to use indices capturing several practices simultaneously. In the next two sections, we discuss corporate governance indices developed by scholars and those developed by commercial firms, mostly for investors.

Academic Corporate Governance Indices

In order to get a more comprehensive view of the overall firm governance practices, academic researchers have compiled individual governance elements into a single metric or rating of the overall quality of a firm's governance. There are two early studies on governance indexes worth discussing: La Porta, Lopez-de-Silanes, Shleifer, and Vishny, henceforth "LLSV" (1998) and Gompers, Ishii, and Metrick (2003). *LLSV* developed the now well-used (and abused) index of six shareholder protection rules in 49 countries, the "antidirector rights index" (henceforth "ADRI"). This index seeks to assess the degree of minority shareholder protection and power at the national level. Of the six ADRI components, three are concerned with shareholder voting (voting by mail, voting without blocking of shares, and power to call an extraordinary meeting), and three with minority shareholder protection (proportional board representation, preemptive rights, and judicial remedies).[1]

Some of the most influential findings from the ADRI are that (1) common law countries grant stronger investor protection than civil law countries to minority shareholders (LLSV, 1998), (2) stronger investor protection is associated with larger capital markets (LLSV, 1997), and (3) with greater ownership dispersion in listed firms (LLSV, 1998). The ADRI has also been central in policy realms to support the idea of liberalization and deregulation of markets that are accompanied by strong shareholder rights (Aguilera & Williams, 2009). As a matter of fact, over a hundred published empirical papers use the ADRI, either as an independent variable or as a control for strength of shareholder rights. To illustrate, the ADRI is used as the main variable, or one of the main variables, to examine the relationships between legal investor protection and the following outcomes: firm valuation (Pinkowitz, Stulz, & Williamson, 2006), stock price informativeness (Morck, Yeung, & Yu, 2000), efficient capital allocation (Wurgler, 2000), voting premiums (Nenova, 2003), firm-level corporate governance mechanisms (Durnev & Kim, 2005), earnings management (Leuz, Nanda, & Wysocki, 2003), cash holdings (Kalcheva & Lins, 2007), dividend policy (LLSV, 2000), and the depth of financial crises (Johnson, Boone, Breach, & Friedman, 2000), as well as to test the bonding hypothesis for cross-listing decisions (Doidge, 2004; Reese & Weisbach, 2002). Beyond corporate finance, it has also been used, inter alia, as an instrument to show the real effects of financial integration (Bekaert, Harvey, & Lundblad, 2005; Imbs, 2006), the relationship between risk sharing and industrial specialization (Kalemli-Ozcan, Sørensen, & Yosha, 2003), and the development of codes of good governance in the world (Aguilera & Cuervo-Cazurra, 2004, 2009).

The *governance index* (G-index) is another important index developed by finance scholars Gompers et al. (2003). They compute a corporate governance index for 1,500 U.S. companies consisting of 24 antitakeover provisions and shareholders' rights compiled by the Investor Responsibility Research Centre (IRRC), which can be objectively assessed. IRRC gathers data from a variety of sources, including corporate bylaws and charters, proxy statements, annual reports, as well as 10-K and 10-Q documents filed with the SEC. The IRRC's sample of firms is drawn from the Standard & Poor's (S&P) 500 as well as the annual lists of the largest corporations in *Fortune*, *Forbes*, and *BusinessWeek*. The IRRC's sample was expanded by several hundred firms in 1998 through additions of some smaller firms and firms with high institutional-ownership levels. Gompers et al. (2003) use all firms in the IRRC sample except for those with dual-class common stock (less than 10% of the total). The IRRC tracks 22 charter provisions, bylaw provisions, and other firm-level rules plus coverage under six state takeover

laws, and duplication between firm-level provisions and state laws, which yields 24 unique provisions. Gompers et al. (2003) divide them into five groups: tactics for delaying hostile bidders (Delay); voting rights (Voting); director/officer protection (Protection); other takeover defenses (Other); and state laws (State).

The G-index is constructed as a proxy for the balance of power between shareholders and managers as follows: for every firm, Gompers et al. (2003) add one point for every provision that restricts shareholder rights (increases managerial power). The authors show that a portfolio buying stocks with the highest level of shareholder rights and selling stocks with the lowest level of shareholder rights generates an annualized abnormal return of 8.5% from 1990 to 1999. The Gompers et al. (2003) study has drawn attention from the media, academia, and investors. For example, Cremers and Nair (2005) study how the interaction between the G-index and institutional ownership affects stock returns, while Klock, Maxwell, and Mansi (2004) and Chava, Dierker, and Livdan (2004) study how the G-index shapes a firm's cost of debt. Fahlenbrach (2003) analyzes how the G-index impinges on CEO compensation.

In a complementary study, Bebchuk et al. (2009) recognize that some of the 24 G-index provisions might matter more than others, and that some of these provisions may be correlated. They point out that six of these provisions fully drive the Gompers et al. (2003) results and propose an alternative entrenchment index (the E-index), comprising of six provisions – four provisions that limit shareholder rights and two that make potential hostile takeovers more difficult. Like Gompers et al. (2003), Bebchuk et al. (2009) employ a strategy investing in a portfolio with a low entrenchment index rating and shorting the portfolio with a high rating. They find that increases in the index level are associated with significant reductions in firm valuation as well as large negative abnormal returns during 1990–2003. Their findings are in line with Gompers et al. (2003). They also state that the other 18 IRRC provisions, not included in the entrenchment index, are uncorrelated with either reduced firm valuation or negative abnormal returns.

Although these academic indices, at the country or firm level, have generated considerable research on the relationship between overall governance and firm performance, their validity is still an open question. Some of the criticisms and concerns are as follow. Spamann (2010) is probably the most salient critic of LLSV's ADRI. He conducts a thorough reexamination of the LLSV legal data, and suggests corrections for 43 of the 46 countries analyzed. Spamann (2010) finds that his corrected ADRI index

fails to support three widely influential claims: that shareholder protection is higher in common than in civil law countries; that shareholder protection predicts stock market size or ownership dispersion; and that weak corporate governance explains the extent of exchange rate depreciation during the Asian financial crisis of 1997–1998. With respect to governance research in emerging markets, La Porta et al. (1998) emphasize that, for antidirector rights to provide effective protection, a country must have functional political and legal systems. It is therefore plausible that the antidirector rights index might be most relevant in countries with good government, where the rule of law prevails. This suggests that it is critical to differentiate across countries with different institutions.

With respect to the G-index, Core et al. (2006) show evidence suggesting that the G-index is not related to superior firm performance. In addition, Larcker, Richardson, and Tuna (2007) report only weak support for a relationship between corporate governance ratings and market value. Bhagat and Bolton (2007) uncover, after controlling for endogeneity, a positive link between a number of corporate governance measures and operating performance, but find no evidence of a relationship with stock performance or market value. Furthermore, Johnson, Moorman, and Sorescu (2009) demonstrate that no abnormal returns are generated using the G-index or E-index when the benchmark asset-pricing model is adjusted for industry clustering. In addition, an important limitation of the G-index, as many other firm-level governance indices, is its focus on U.S. firm. In sum, the empirical results linking overall firm governance indicators or indices to firm performance are also quite mixed, leaving the slate open for more research to get to the bottom of this key corporate governance question.

To conclude, Bhagat, Bolton, and Romano's (2007) paper titled "The Promise and Peril of Corporate Governance Indices" offers an excellent critical review of the theoretical and empirical challenges associated with governance indices created by academic researchers. They argue that there is no consistent relationship between governance indices and measures of corporate performance. They suggest that there is no one "best" measure of corporate governance. Rather, the most effective governance institution appears to depend on context, and on firms' specific circumstances. The authors conclude that governance indices are highly imperfect instruments for determining how to vote corporate proxies, let alone for portfolio investment decisions, and that investors and policymakers should exercise caution in attempting to draw inferences regarding a firm's quality or future stock market performance from its ranking on any particular corporate governance measure.

Commercial Corporate Governance Indices

Given the magnitude of firm-level differences in governance, it is a natural next step for the literature on international comparisons to try to look beyond cross-country differences and incorporate into the investigation firm-level differences. While the above noted studies use self-constructed governance indices, a number of researchers have turned their attention to the governance ratings generated by commercial firms, who on the wave of interest for corporate governance, have begun to develop ratings of corporate governance performance. The most important international firms providing ratings are Institutional Shareholder Services, Governance Metrics International, The Corporate Library, Standard & Poor's, Deminor, and The Globe and Mail. Their ratings are used to estimate share value and to help investors make investment decisions by offering the necessary information on governance characteristics of rated companies. We discuss each of them in turn.

First, the Corporate Governance Quotient (CGQ) rating is produced by *Institutional Shareholder Services* (ISS), a division of RiskMetrics. The rating "evaluates the strengths, deficiencies and overall quality of a company's corporate governance practices and board of directors" and "is designed on the premise that good corporate governance ultimately results in increased shareholder value." ISS reports two main ratings for each firm: *CGQ_INDUSTRY*, which gives a firm's percentile standing within its Global Industry Classification Standard (GICS) industry group, and *CGQ_INDEX,* which gives a firm's percentile within its index. A CGQ of 80 within the S&P 500 and 100 within industry group indicates that the firm is in the top 20% of corporate governance in the S&P 500 and in the top 1% within its two-digit GICS industry group. ISS ratings are based on data obtained from public filings and company surveys in eight categories: board of directors (composition, independence), audit, charter and bylaw provisions, antitakeover provisions, executive and director compensation, progressive practices (such as performance reviews and succession plans), ownership, and director education. ISS conducts "more than 4,000" statistical tests using 16 measures of risk and performance to develop the optimal weighting of 64 governance variables in CGQ according to their correlation with firm risk and prior performance.[2] The ratings are back-tested and calculated for more than 9,000 companies. In addition, ISS states that it changes the ratings model and weights over time to "better reflect current market trends in corporate governance" and to align the rankings with ISS policies.[3]

On March 2010, the RiskMetrics Group announced a new corporate governance rating system to replace their CGQ, which introduces an evaluation model based on four categories: audit, board structure, compensation, and shareholder rights to be known as "GRId" (Governance Risk Indicators). Each of the four categories is assigned a level of governance risk (low, medium, or high) based on a number of different variables. At the core of the GRId methodology for each market is a set of 60 to 80 questions that collectively examine a company's practices across the aforementioned dimensions. These variables are each assigned a number of points between (–5) and (5). For example, a company that has a classified board of directors receives –5 points, whereas a company with an annually elected board receives 5 points. Companies in the process of transitioning from a classified board to an annually elected board would receive a neutral 0. Once all of the variables within the category are assigned a point value, they will be added up to determine the level of governance risk for each category. RiskMetrics claims that a new corporate governance model was necessary because corporate requirements, disclosures, and practices have changed over time, and shareholders are evaluating companies with greater scrutiny with regard to how these companies are governed.

RiskMetrics Group Inc., a leading provider of risk management and corporate governance services to the global financial community, was acquired by MSCI in June 2010.[4] The recently launched GRId™ scores are freely available through Yahoo Finance or Advisen and provide a score on each of the four categories. For example, Yahoo Finance reports on Amazon.com (on the firm's profile page) on November 11, 2011, that: "Amazon.com Inc.'s Governance Risk Indicator (GRI®) as of Nov 1, 2011 is: Audit (Low Concern), Board (Low Concern), Compensation (Low Concern), Shareholder Rights (Low Concern)."[5] Empirical research using the CGQ rating continues to report inconclusive results between quality of firm governance and performance. For example, Brown and Caylor (2006) build a governance score for U.S. firms from the Institutional Shareholder Services database and find evidence of a positive effect on Tobin's Q. However, Epps and Cereola (2008) compare CGQ ratings to two measures of the firm's operating performance, return on assets (ROA), and return on equity (ROE), and do not find statistical evidence suggesting that firms' operating performance is related to the firms' ISS corporate governance rating. Similarly, Daines, Gow, and Larcker (2010) show no consistent relationship between CGQ and performance measures.

Second, *Governance Metrics International* (GMI) collects data on several hundred governance mechanisms (ranging from compensation to takeover

defenses and board membership), as well as on firms' compliance with securities regulations, stock exchange listing requirements, and various corporate governance codes and principles. In all, GMI collects ''hundreds of metrics structured in a manner that can only produce yes, no or not disclosed answers.'' Then, GMI develops a scoring model that examines each metric, weights it ''according to investor interest,'' and then calculates a rating on a scale of 1.0 (lowest) to 10.0 (highest). The GMI scoring algorithm rewards (or penalizes) ''outliers'' and ranks each firm relative to the other companies in the GMI sample.[6] GMI ratings are calculated for over 4,318 companies in 16 different countries throughout North America, Latin America, Europe, and the Asia–Pacific region, and are available on a subscription basis. Using GMI data, the findings by LaFond, Lang, and Skaife (2007) suggest that discretionary smoothing is lower for firms with high governance rankings, especially with respect to related party transactions. On the other hand, Koehn and Ueng (2005) show that GMI ratings are not strongly related to the quality of a firm's earnings or the firm's ethics.

Where the two previous ratings are the product of proprietary quantitative analysis, the third commercial index, *The Corporate Library* (TCL), relies instead on their experience and private assessment of a given firm's governance quality. Robert A.G. Monks and Nell Minow founded The Corporate Library in 1999. The company's main product consists of a large database that aggregates and analyzes public information about thousands of companies. The Corporate Library has worked with shareholders to improve corporate boards and replace poor-performing CEOs, while helping these governance ailing organizations focus on executive engagement and accountability.

TCL analysts review four specific governance areas (the company's board and succession planning, CEO compensation practices, takeover defenses, and board-level accounting concerns) and assign each firm a ''grade'' from A to F. Companies rated A or B do not exhibit significant risk in any of the four basic categories; C-rated companies exhibit risk in no more than one category; D-rated companies in two or more categories; and F-rated companies were either bankrupt or delisted from an exchange or described as companies ''where management has achieved effective control over the company … and conducts its business with flagrant disregard for the interest of any minority public shareholders.'' On July 2010, The Corporate Library and Governance Metrics International agreed to merge. The new firm has indicated to have no immediate plans to change either of their prior companies' systems or products. The new company states that its primary

goal is "to meet current client needs with the combined company's new ability to offer a full breadth of services and expanded global coverage."[7]

Fourth, *Standard and Poor's* (S&P) provides corporate governance rankings using two different approaches. S&P applies 98 disclosure items in their Transparency and Disclosure (T&D) studies, while their corporate governance scores (CGS) are based on 80–100 factors (S&P, 2004). S&P explains that the methodology used in the T&D studies, which is a ranking based on simple summation of binary attributes, is by no means comparable to the CGS rankings. They argue that "interactive corporate governance scoring service is a much more detailed in-depth analysis of the corporate governance practices of companies" (S&P, 2002, p. 4). S&P discloses a score for the following four components in addition to the overall CGS: (1) ownership structure and external influences, (2) shareholder rights and stakeholder relations, (3) transparency, disclosure, and audit, and (4) board structure and effectiveness. A score is constructed either on a confidential basis for intended use only by the company or for external distribution, allowing the company to show their governance standards to a wider audience. In the T&D studies, the S&P analysts thoroughly scrutinize annual reports and use a checklist of 98 possible information items and attributes. These are grouped into three categories: ownership structure and investor relations, financial transparency and information disclosure, and board and management structure and process. Standard & Poor's CGS and T&D ratings are available through subscription.

Patel and Dallas (2002) report on the Standard & Poor's T&D study examining the transparency and disclosure practices of major public companies around the globe. They conclude that there are dramatic differences in how much companies disclose both across regions and countries and within regions and countries. In addition, they report that the amount of information companies provide in their annual reports is correlated to market risk and valuations. In addition, using the Standard & Poor's T&D scores, Durnev and Kim (2005) illustrate that profitable investment opportunities, reliance on external financing, and more concentrated ownership lead to better corporate governance and that the effects are stronger in weaker legal environments. They also show that firms with better governance are valued higher and invest more.

Fifth, *Deminor*, another rating firm, has come up with "governance ratings." They cover between 249 and 269 firms included in the FTSE Eurotop 300. The ratings are based on a corporate-governance grid comprising over 300 criteria, which can be attributed to four broader categories: rights and duties of shareholders, range of takeover defenses,

1 disclosure on corporate governance, and board structure and functioning. Deminor Rating issues a rating on each one of the four categories. Ratings
3 are assigned by senior analysts from the different Deminor European offices after all (most recent) publicly available information on a particular
5 company (i.e., not only financial reports but also articles of association, agendas, resolutions and minutes of ordinary and extraordinary general
7 meetings, investor's handbooks and newsletters, Internet sites, and all other publicly available information) has been benchmarked against the best
9 practice found in internationally accepted standards established by, for example, the International Corporate Governance Network and the
11 Organisation for Economic Co-operation and Development (OECD). A rating is measured on a scale of 5 to 1, with 5 representing the best practice
13 (Deminor Rating, 2001, pp. 9–10).

For a sample of FTSE Eurotop 300 companies, Bauer, Gunster, and
15 Otten (2004) uncover no significant relationship between corporate governance ratings and either market or accounting performance measures,
17 and in some cases even find a negative relation. Focusing on the disclosure component of Deminor's governance rating, Vander Bauwhede and
19 Willekens (2008) find that the level of disclosure is lower for companies with higher ownership concentration, and it is higher for companies from
21 common law countries and increases with the level of working capital accruals. In addition, Renders, Gaeremynck, and Sercu (2010) use the
23 Deminor Ratings and show that controlling for endogeneity is relevant as they report no relation between corporate governance ratings and operating
25 performance when endogeneity is not controlled for. On May 2005, 2011, Deminor announced it had sold its corporate governance unit Deminor AU :18
27 Rating to Institutional Shareholder Services, the leading provider of proxy voting services.

29 The last index that we would like to discuss in this section is the Report on Business (ROB), a marking system on corporate governance for companies
31 in Canada provided by the Canadian newspaper *The Globe and Mail* on an annual basis since 2002. Companies involved are those in the S&P/TSX.
33 ROB distinguishes between four blocks of corporate governance. The first block, board composition, assesses the independence of the members serving
35 on the board, the audit committee, the compensation committee, and the remuneration committee. The second block, compensation, captures,
37 among other things, whether the directors and the CEO are required to own stocks. The third block, shareholder rights, evaluates different
39 scenarios that could impair shareholder rights, including the presence of nonvoting or subordinate shares and employee stock options. Finally, the

fourth block, disclosure, measures the availability and quality of information on corporate governance.

Adjaoud, Zeghal, and Andaleeb (2007) show no significant relationships between the ROB index and performance when using traditional performance measures, such as ROI, ROE, EPS, and Market-to-book. AU :19 However, they reveal significant links between quality and performance of ROB's board when the latter is captured by value performance measures, such as market value added and economic value added.

Despite some criticisms of the commercial ratings, Daines et al. (2010) advocate for these indices over the ones developed by academics. Thus, they argue that there are several reasons to believe that these commercial ratings might provide reliable and valid measures for the construct of corporate governance. First, firms selling ratings appear to be a commercial success, which suggests the possibility that the ratings are useful to their customers. Second, commercial ratings use quantitative algorithms that presumably capture their extensive expertise regarding the relationship between governance choices and firm performance. In contrast, academic governance indices are generally calculated by simply counting the number of "good" or "bad" governance mechanisms for each firm. This approach equally weights governance indicators that likely differ in importance and ignores the possibility that some provisions may be substitutes or complements (e.g., Larcker et al., 2007). Third, commercial indices typically rate each firm relative to industry or size peers, whereas academic indices are usually absolute measures constructed without regard to variation in governance practices across industries. Fourth, commercial rating algorithms explicitly change each year to "take into account market trends," whereas most academic ratings are calculated in the same way over time. Finally, commercial firms employ large, rich databases from multiple data sources, whereas typical academic governance indices rely on relatively limited data sources such as the IRRC data, which are heavily focused on takeover defenses.

Governance Policy: Active Monitoring of Corporate Governance

In addition to the raise of both academic and commercial indices, since the 1990s, shareholder activism has taken a central role, mostly via institutional investors. In particular, pension funds are increasingly becoming more active in monitoring the governance of the companies they invest in because they believe that there is a direct relationship between good corporate

governance and firm performance. Therefore, they are concerned with quantifying these practices. The classic case is the California Public Employees' Retirement System (CalPERS). Initially, CalPERS seeks to influence public opinion on the companies that it was investing in by publicly naming companies having poor corporate governance and then placing them in its "CalPERS Focused List." These days CalPERS is a bit more strategic and succinct, and identifies poorly governed firm where it has a stake and approach them with the goal to change their governance. If the governance is not changed in due time, CalPERS might choose to go public with their governance weaknesses. The rationale behind CalPERS' use of publicity to guide its corporate governance program rests on its belief in the power of the media in influencing public perceptions (Parisot, 1988). CalPERS takes into account two important factors when deciding which companies to include on its CalPERS' Focus List: long-term stock performance and board size. Companies whose stock performance over the past 5 years is poor relative to industry peers and companies with fewer than 5 or more than 15 board members in their board of directors (too small or too large) are included. Additional factors that CalPERS takes into consideration when putting together its Focus List include (1) percentage of independent directors on the board's key committees; (2) whether the board's Chair is also the CEO; (3) whether there is a lead independent director to offset a joint Chair/CEO position; (4) whether there are board interlocks; (5) whether directors sit on too many other boards; (6) whether director attendance has been less than 75%; (7) whether the auditor provides substantial nonaudit services; (8) whether directors and officers own too much or too little stock; (9) whether directors have been serving the company for too long; (10) whether the board has a good skill mix; (11) whether the company has antitakeover devices not approved by shareholders; and (12) whether the company uses cumulative voting (Wu, 2004).

In an attempt to assess the effectiveness of CalPERS' governance program, Anson, White, and Ho (2005) examined the market impact of the Focus List and found that companies on the list experience positive excess stock returns of about 12% over the 3 months following release of the list. This wealth effect is even greater for companies with a large, widely dispersed shareholder base, as might be expected given the relative inability of such shareholders to act collectively. Furthermore, English, Smythe, and McNeil (2004) study the relationship between CalPERS' public targeting and both short- and long-term stock returns. Their results indicate evidence of an announcement effect and that, while there is also evidence of some long-term improvement, it is limited to 6 months from the announcement of

the target list in the *Wall Street Journal* when more consistent empirical methodologies are employed. Finally, Nelson (2006) confirms the early period results, but indicates that results reported in studies examining later periods are driven by the inclusion of early 1992–1993 targeting and from a significant bias in the market model parameters caused by estimation during periods of known underperformance. Additionally, these results are partially driven by the failure to control for contaminating events and the use of unnecessarily long event windows. Contrary to previous studies, after addressing these methodological concerns, Nelson (2006) found no evidence to support the continued existence of a "CalPERS effect."

While theoretically it is well established that corporate governance matters, as we have noted above, empirical evidence on the relationship between corporate governance and performance is mixed. One important challenge relates to the scoring of the quality of corporate governance, as it is subjective and potentially controversial. In fact, governance ranking studies are based on the assessment of certain governance standards of the past and thus on historic data. The standards investigated (and often the weight attached to them) vary across the studies. So the selection of a set of governance standards introduces a subjective element into governance ranking research. Researchers may attach different weight to these standards for the purposes of the ranking that underlies the studies, introducing further subjectivity. Moreover, as the standards assessed depend on the regulation applicable in a particular market and may vary over time, it is difficult to draw general conclusions.

UNDERLYING ASSUMPTIONS OF CORPORATE GOVERNANCE INDICES

Shareholders, regulators, hedge fund managers, press commentators, board members, and policy makers, among others, increasingly stress the importance of effective governance, claiming that it improves firm performance, shareholder welfare, and the health of the public markets. However, the inconclusive findings of a relationship between corporate governance indices and firm performance may require different arguments. First, while against theoretical predictions, it could be the case that, empirically, there is no well-established relationship between corporate governance and firm performance. Alternatively, corporate governance indices may not adequately capture the quality of governance. Distinguishing

effective from ineffective governance presents a huge challenge, especially given the great variety of corporate governance mechanisms (and combinations thereof) employed by firms. Daines et al. (2010) argue that a plausible interpretation of the weak and mixed empirical results is that the commercial ratings contain a large amount of measurement error. They find support for this interpretation in the surprisingly small correlations between three important commercial corporate governance ratings (CGQ, GMI, and TCL). This suggests that either the ratings measure very different corporate governance constructs or there is substantial measurement error in, at least some of, the ratings. Since governance rating agencies use the same basic governance data, examine similar governance dimensions (e.g., antitakeover provisions, board structure, and executive compensation), and claim to measure overall "corporate governance," the absence of a strong correlation between different indices is consistent with a high degree of measurement error in the rating processes across firms.

Corporate governance indices part from a series of implicit assumptions, which may compromise their construct validity. The fundamental assumption is that a firm's corporate governance structure will explain its behavior. In addition, a comprehensive list of all relevant corporate governance mechanisms needs to be identified and the mechanisms must be comparable across industries or countries. One of the main challenges in measuring and validating corporate governance indexes is in what extent these indexes are capturing firm-level governance quality or simply disclosure quality. As most of the indices rely on proxy information and the issues of mandatory and voluntary disclosure interact, which may create significant noise both academic and commercial indices. Moreover, disclosure quality is a component of governance quality itself and evidence exists that it is associated with firm valuation (e.g., Botosan, 1997). In addition, the importance and legal requirements of each mechanism is unlikely to be the same across the globe. Elements common in Anglo-American corporate governance systems often remain absent in other countries, where other corporate governance mechanisms may effectively substitute and display different sets of complementarities. Where one specific mechanism is used less, others may be used more, resulting in equally good performance (Agrawal & Knoeber, 1996; Garcia-Castro et al., 2011). The two following examples illustrate this issue.

A 100% independent audit committee is mandatory for NYSE listed firms, after the introduction of the 2002 Sarbanes–Oxley Act. On the other hand, Japan introduced reforms in its corporate governance system, seeking to change from the traditional Japanese board structure that encompasses a

separate board of auditors, instead of an audit committee within the board. Beginning in 2003, Japanese companies had the option to continue with the traditional statutory separation between the board of directors and the board of auditors, or to change to the Anglo-American board style that includes an audit committee. Only eight Nikkei-225 firms made the switch by the end of 2008 (Desender, Aguilera, & Crespi, 2011). In addition, many Continental European codes differ from the NYSE requirement regarding the audit committee, in that they do not require 100% independence and follow the "comply-or-explain" principle, instead of being mandatory. Another example of the difficulty to construct a corporate governance measure that compares firms across countries is given by the German and Japanese corporate governance practices, where monitoring by relationship-oriented banks may effectively substitute for an active market for corporate control (Aoki, 1994). Jensen (1986) also suggests that when the market for corporate control is less efficient, the governance effects of debt holders may play a particularly important role in restraining managerial discretion. The long-term nature of bank-firm relationships may also display critical complementarities with a more active role of stakeholders, such as employees, as employees' investments in firm-specific capital are protected from "breaches of trust" (Aoki, 2001) and employee voice helps to make managers more accountable internally by more thoroughly justifying and negotiating key strategic decisions (Streeck, 1987). If corporate governance mechanisms deal with agency problems, ignoring differences in agency problems across firms would be an important limitation. Therefore, if international comparisons are not without problems, corporate governance indices may be only useful for within country (or industry) analysis.

A second assumption in indices is that a higher score on the index should capture better governance. However, this ignores the cost–benefit analysis of corporate governance investments as well as the existence of complementary/substitutory relationships (Desender et al., 2011; Rediker & Seth, 1995; Zajac & Westphal, 1994). Corporate governance mechanisms are unlikely independent from each other, and ignoring the interaction between mechanisms may reduce the validity of an index. For example, corporate boards are able to influence strategic decisions including decisions about investment policy, management compensation policy, and board governance itself. It is plausible that board members with appropriate stock ownership will have the incentive to provide effective monitoring and oversight of important corporate decisions noted above. Furthermore, the effectiveness of antitakeover provisions may depend on the legal context.

In this sense, Bruno and Claessens (2007) argue that companies' specific corporate governance choices have to be considered in light of the corporate governance regime in the specific country. Take two similar companies implementing exactly the same governance practices but located in two different countries. Identical corporate governance practices may be valued differently by investors depending on whether they are required or voluntarily adopted. Also shareholders may consider some aspects of the legal regime in one country as substitutes to the same corporate governance practices used in another country. Or shareholders may prefer to invest in companies whose country of incorporation guarantees better protection in the eventuality of legal disputes, irrespective of the company corporate governance practices. Correspondingly, shareholders may value corporate governance practices differently depending on the legal regime in the country. Corporate governance practices are not independent of the legal regime and vice versa. Thus, it may not be optimal for many firms to have the highest possible score, which further limits the possibility of indices to fully capture corporate governance quality.

A third assumption in indices is that they part from a "one-size-fits-all" perspective without recognizing the possibility of patterned corporate governance variation. In this sense, Filatotchev (2008) argues that one reason for the mixed empirical results related to the effectiveness of various governance mechanisms may be the neglect of patterned variations in corporate governance contingent to the contexts of different organizational environments. Likewise, Aguilera and Jackson (2003) posit that the "undercontextualized" approach of agency theory remains restricted to two actors (managers and shareholders) and abstracts away from other aspects of the organizational context that impact agency problems, such as diverse task environments, the life cycle of organizations, or institutional context of corporate governance. The number of potential combinations of corporate governance practices, and hence their complementarities, is extensive. These configurations remain to be systematically theorized and investigated empirically.

The use of the RiskMetrics dataset for this purpose, however, has some limitations. Bebchuk and Hamdani (2009) point out that the RiskMetrics dataset is U.S.-centric in that it focuses on features that are important for the companies without a controlling shareholder that are dominant in the U.S. capital market but not in most other capital markets around the world. Indeed, the finding of Aggarwal et al. (2008) that firm-level governance is better in U.S. firms than in firms from other countries is likely to be at least partially due to the U.S.- centric nature of the dataset used by this study.

1 Bebchuk and Hamdani's (2009) analysis suggests a direction that would be worth pursuing by work on international comparisons.
3 Much of the work thus far has sought to develop and employ a single global governance standard for making either country-level or firm-level
5 comparisons around the world. However, governance arrangements that are optimal for investor protection in companies without a controlling
7 shareholder could be suboptimal for companies with such a controller and vice versa. Consequently, the quest for a single global governance standard
9 should be replaced with separate standards for evaluating governance in firms with and without a controlling shareholder. The development and
11 application of such standards is potentially an important task for future research.
13

15

CONCLUSION AND FUTURE COMPARATIVE
17 GOVERNANCE RESEARCH METHODS

19 Many methodological issues in the measuring and analysis of (comparative) corporate governance remain to be solved, but we are making good progress
21 at identifying them as challenges. There are three of them. First, although corporate governance practices have a direct effect on some of the firms'
23 strategic decisions (such as how CEOs are replaced or dividends are allocated), they may only have an indirect effect on firm performance
25 (Deutsch, 2005). Second, it is possible that, after all, causality goes the other way around, i.e., the firm performance explains the adoption of certain
27 governance practices (Agrawal & Knoeber, 1996). Third, there are also important challenges in measuring firm financial performance (and this is
29 the topic for another essay). In this regard, Bellavance and Schiehll (2009) suggest that while accounting performance measures are noisy (lack
31 precision, timeliness, and reliability), measures to capture effects of control governance practices, market-based measures, e.g., stock price, are strongly
33 affected by exogenous factors. Finally, there are critical challenges in measuring and comparing corporate governance effectiveness between firms
35 from different governance settings. For example, family firms in emerging markets may score low on an U.S.-based corporate governance index,
37 without considering the firm's context.
To conclude, we would like to suggest that future research should con-
39 sider breaking down the governance-performance link as well as expand on the methodological issues. First, we urge scholars that rather than

examining corporate governance effectiveness by looking at firms' financial performance, a more accurate evaluation can be obtained by analyzing discrete governance practices involving a potential conflict of interest between shareholders and management and its effects on firm strategic decisions (e.g., Mallette & Fowler, 1992; Sundaramurthy, 1996). Building on strategic governance and institutional analysis, a number of recent studies develop a conceptual framework for better understanding the influence of organization–environment interdependencies on the effectiveness of corporate governance in terms of firms' contingencies, complementarities, and costs between governance practices and potential costs of corporate governance (e.g., Aguilera, Filatotchev, Gospel, & Jackson, 2008). This research perceives corporate governance as a system of interrelated firm elements having strategic or institutional complementarities and suggests that particular practices will be effective only in certain combinations. And, in turn, these practices may grant different patterns of corporate governance (Aguilera et al., 2008). This research sustains that corporate governance recommendations and policymaking will be more effective if they take into account the potential diversity of governance mechanisms, which captures critical firm-level contingencies. In this line, Desender et al. (2011) argue that the importance of the monitoring role of the board of directors is not independent from the context in which the company operates. The importance of the monitoring role is expected to be influenced by other elements of the corporate governance bundle, such as the legal protection of shareholders or the firm's ownership structure. This approach may also be useful to study the interaction between firm-level and country-level corporate governance in emerging markets or markets with distinct governance characteristics.

Second, we need to become more sophisticated in our research designs and have the ability to include multimethods approaches. For example, to analyze different patterns of corporate governance mechanisms, one promising approach is provided by Fuzzy Set/Qualitative Comparative Analysis (Fs/QCA), where causal claims are developed by means of supersets and subsets and outcomes are achieved through equifinality or multiple paths (Ragin, 2008). Thus, Fs/QCA is particularly appropriate when researchers want to demonstrate that a combination, or bundle, of factors work in concert with one another to be a sufficient cause for a firm outcome (Mahoney & Goertz, 2006). A key advantage of Fs/QCA over traditionally used regression analysis is that it helps overcome difficulties by using multiple interactions among regressors since it ignores variation and distribution in individual variables, and does not focus on the isolated net

independent effect of a single variable. Another method, quite common in other disciplines, and yet not as applied in comparative corporate governance, is the matching sample technique. Matching samples of adopters and nonadopters of specific control mechanisms have been widely used in management research to examine effectiveness of management control system packages (e.g., Jog, Zhu, & Dutta, 2010). A second critical area to break in is more qualitative research whether it entails grounded theory, ethnographic research, discourse analyses, or systematic case comparisons.

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Michel (2010); Sorge (2005); Vitols (2001).

NOTE

1. LLSV (1998) define the ADRI as the sum of the following:

"Proxy by mail allowed: Equals one if the company law or commercial code allows shareholders to mail their proxy vote to the firm, and zero otherwise."

"Shares not blocked before meeting: Equals one if the company law or commercial code does not allow firms to require that shareholders deposit their shares prior to a general shareholders meeting, thus preventing them from selling those shares for a number of days, and zero otherwise."

"Cumulative voting or proportional representation: Equals one if the company law or commercial code allows shareholders to cast all their votes for one candidate standing for election to the board of directors (cumulative voting) or if the company law or commercial code allows a mechanism of proportional representation in the board by which minority interests may name a proportional number of directors to the board, and zero otherwise."

"Oppressed minorities mechanism: Equals one if the company law or commercial code grants minority shareholders either a judicial venue to challenge the decisions of management or of the assembly or the right to step out of the company by requiring the company to purchase their shares when they object to certain fundamental changes, such as mergers, asset dispositions, and changes in the articles of incorporation. The variable equals zero otherwise. Minority shareholders are defined as those shareholders who own 10% of share capital or less."

"Preemptive rights to new issues: Equals one when the company law or commercial code grants shareholders the first opportunity to buy new issues of stock, and this right can be waived only by a shareholders' vote; equals zero otherwise."

"Percentage of share capital to call an extraordinary shareholders' meeting: The minimum percentage of ownership of share capital that entitles a shareholder to call

for an extraordinary shareholders' meeting … is less than or equal to 10% (the sample median)."

To illustrate, France scores 3 on six, while Germany scores only 1, compared to an ADRI score of the U.K. and U.S. of 5.

2. ISS website: http://www.isscgq.com/cgqratings.htm
3. http://www.issgovernance.com/press/20100303_grid
4. MSCI, Inc., a provider of investment support tools, agreed to acquire RiskMetrics Group Inc., the leading provider of risk management services, corporate governance ratings, and proxy advisory services, in a deal valued at approximately $1.55 billion.
5. http://finance.yahoo.com/q/pr?s=AMZN+Profile
6. Governance Metrics International, September 2006, Governance and Performance: Recent Evidence.
7. http://blog.thecorporatelibrary.com/blog/2010/07/the-corporate-library-and-governancemetrics-international-agree-to-merge.html

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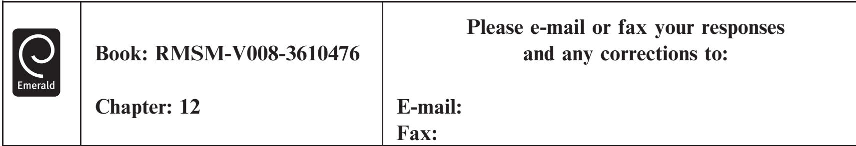

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