Challenges for Actual Compliance in Corporate Governance in Greece

By Maria Fotaki, Doctoral Candidate

The disclosure of important failures in the management and audit practices of large multinational companies (e.g., Enron, World.Com, AIG, Ahold) has rendered business activity during the last decade more control intensive. The importance of Corporate Governance mechanisms to regain and sustain investors' confidence is well recognised and the reform of the various corporate governance systems has made it to the top of the agenda of national governments, regulatory bodies, institutional investors and stock markets worldwide.

Academics, occupied with the design of the proper governance mechanisms that limit managerial opportunism, demonstrated that information structures (such as the Board of Directors, budgeting, efficient markets, etc.) and outcome-based contracts (such as executive stock holdings, golden parachutes) mitigate the goal conflict, inherent in the business domain. The application of these mechanisms and their strength constitute a particular country's corporate governance model, which is built upon each country's history, economic and political factors, ownership structure, and institutional arrangements.

In considering how to best apply the aforementioned control mechanisms, public authorities had to find the proper balance between compulsion and self-regulation. In US, policy makers adopted the mandatory approach to corporate governance, and consequently, the Sarbanes-Oxley Act of 2002 constitutes a statutory regime that applies the same rules to all companies. Its basic premise is that "one size fits all". On the other hand, European countries chose to build their corporate governance models on the principle of "self- regulation" or "voluntary compliance" through the issue of Codes of Best Practice. The "comply or explain" approach was first articulated in 1992 in the Cadbury Report and, as Sir Derek Higgs points out, "it offers flexibility and intelligent discretion and allows for valid exceptions to the sound rule". In particular, this approach is based on a set of best practices (Code of Best Practice), which all companies should adopt. In case they do not comply, they have the option to explain to their shareholders their noncompliance. The advantage of this approach, in comparison to mandatory systems, is thought to be that it fosters compliance to the spirit rather than the letter of the code. The "comply or explain" approach has been reinforced by the recent directives of the European Commission and the OECD guidelines on Corporate Governance and has been put into practice by almost all European Countries though Codes of Best Practice. Examples include the Combined Code on Corporate Governance (2000) and the Revised Combined Code (2003) for the UK, the Vienot Report (1995) for France, the Baums Code (2000) for Germany, the Olivencia Code (1998) for Spain and the Preda Report (1999) for Italy (see figure 1).

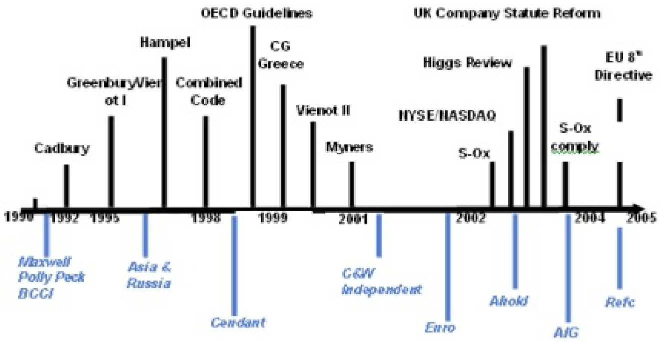

Figure 1: Directives and guidelines for Corporate Governance. Source: "Trust and Governance: Why communicating substantive good governance is crucial", Ian Burne, S&P, 2005.

In Greece, corporate governance behavior is controlled by the Statute 3016/2002 and by the Principles on Corporate Governance by the Capital Market Commission (P.C.G.G.). While the Statute 3016/2002 is rules-based and mandatory for all listed companies, P.C.G.G. constitutes a Code of Best Practice based on the "comply or explain" approach to corporate governance.

In particular, the Greek corporate governance system is characterized by concentrated ownership, as the majority of firms are owned by dominant shareholders. Moreover, most of the Mid- and Small-cup firms declare themselves family businesses, which in turn is a sign of congruence between owners and managers. In addition, the State controls a considerable amount of shares in large public listed companies, indicating the extension of its strong position into the Board of Directors. In fact, boards in Greek companies are sometimes considered to be "weak", in the sense that they do not always exercise their supervisory role as intended. Moreover, although the percentage of shares of Greek listed companies assigned to institutional investors has increased in the last 5 years, institutional investors in Greece do not come out for shareholders activism, while in addition, there are not many hedge and mutual funds encouraging shareholders activism. Furthermore, according to the FTSE ISS Corporate Governance Series Report of 2005, Greece performs relatively poorly with a corporate governance rating of 1 compared to a rating of 3 for the European Union average in a range of 1 to 5.

Given the above-mentioned features, it seems that Greek firms have not taken the notion of Corporate Governance into heart. Moreover, up to this point we cannot draw any conclusions regarding the effectiveness of the "comply or explain" approach in the Greek business environment. In the UK, Arcot & Bruno (2005) investigate the impact of the "comply or explain" approach on the compliance of 245 UK listed firms. In Greece, up to our knowledge, an assessment of the "comply or explain" approach on compliance has not yet been conducted. All prior research in the field has focused exclusively on the assessment of the degree of compliance. Therefore, the assessment of the quality of compliance of Greek listed firms remains largely unexplored.

The Corporate Governance Survey 2005, conducted jointly by the MSL of the Athens University of Economics and Business and Grant Thornton, was aimed at investigating this issue. All listed in the Athens Stock Exchange firms were asked to convey information regarding the corporate governance practices they apply. In particular they were asked to state whether they comply, as well as to explain their non-compliance. Making use of 110 answers, representing about 53% of ASE's total capitalization, covering all the major industry sectors, we found that the majority of firms pay lip service' to the concept of Corporate Governance, in the sense that they show compliance to the letter rather than the spirit of efficient governance'. Indicatively, with respect to some specific components of Corporate Governance:

- Most of the firms fail to divide responsibilities at the top: Even though the Chairman and the CEO are different persons in 6 out of 10 firms, however, in 8 out of 10 firms the Chairman has also executive responsibilities.
- Although the General Shareholders Meeting sets the compensation of Board members in all companies, their majority has not established a Remuneration Committee, comprised of independent non-executive members. Moreover, only 5 out of 10 firms disclose executive compensation.
- Although 7 out of 10 firms have established an Internal Audit Committee, only 1 out of 2 has the minimum number (3) of non-executive members in the Internal Audit Committee.
- Although all firms claim that they endorse the participation of their shareholders in the decision making process, only 6 out of 10 provide systematically their shareholders the right to vote through a representative at the General Shareholder Meeting.

In conclusion, the survey results reveal that Greek listed firms seem not to have embraced the flexibility offered by the "comply or explain" approach regarding compliance and, therefore, display formal rather that actual compliance to the principles of sound corporate governance. However, in this respect, there are a lot of issues to be addressed in the future, such as a detailed assessment of the value of flexibility of the "comply or explain" approach in parallel with an investigation of the potential achievements of a more statutory governance system.

In order to fill this void, the MSL in collaboration with Grant Thornton conducted between March and November 2006 the second annual Corporate Governance Survey, placing emphasis this time on the quantity and quality of explanations regarding non-compliance. The main objective of the Corporate Governance Survey 2006 is to portray attitudes and trends in compliance across the "comply or explain" approach. Moreover, it seeks to highlight the specific features of Corporate Governance in Greece, drawing mostly on how firms use the flexibility of the approach to modify their governance practices. Results are forthcoming.

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