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Journal of Business Systems, Governance and Ethics

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Contents

Editorial

This is the first issue in the third year of publication of the *Journal of Business Systems, Governance and Ethics*. As usual the articles included cover a wide range of topics and come from a spread of different countries; in this case Belgium, the United States of America, Australia and Malaysia.

The first article in this issue was written by Sven H. De Cleyn from the University of Antwerp in Belgium. This article: *Compliance of Companies with Corporate Governance Codes: Case Study on Listed Belgian SMEs* notes that both listed and large companies are becoming increasingly subject to internal and external pressure to comply with ethical and social standards. It focuses on corporate governance, one important aspect of this issue. The paper investigates whether, and to what extent after its first year of introduction, publicly listed Belgian SMEs comply with the Corporate Governance Code. Compliance is analysed in a sample of 78 Belgian listed SMEs, showing that after its first year of introduction, companies comply with, on average, 70% of the Code's provisions.

In the second article: *The Global Context of Human Rights Violations: the Impact of the Alien Tort Claims Act*, John Betton from the University of Wisconsin-La Crosse in the USA, notes that corporate responsibility for human rights violations has historically been approached as a domestic national issue in the United States. He points out that despite international legislation governing human rights violations in an international context, courts have generally held that activities of U.S. corporations outside the United States involving individuals who are not U.S. citizens does not fall within their jurisdiction. This view of culpability for human rights violations has recently changed both informally, with the emergence of global guidelines regarding human rights applying to corporations such as the Global Reporting Initiative, Amnesty International Guidelines and O.E.C.D. guidelines for Transnational Corporations, and with the application of an 18th century law, the Alien Tort Claims Act, that has been used to sue corporations for human rights violations outside the United States. The article examines the implications of this changed context for corporate responsibility in the context of the emergence of the multiple voluntary guidelines that seek to hold corporations accountable for conduct outside their own countries.

Ronald D. Francis and Anona Armstrong, from Victoria University in Melbourne, then discuss issues associated with *Personal Ethics in a Corporate World* and propose an assessment of the value of moral intelligence to business, arguing that development of the concept and a test, have substantial commercial benefits. The article addresses the relationship between personal morality and ethical corporate behaviour by positing the concept of moral intelligence – the relationship of personal moral stance and corporate behaviour. The authors argue that just as there is intellectual competence (IQ) and emotional intelligence (EIQ), so too there is moral intelligence. The article outlines the theoretical and practical basis for the case, making mention of confounding issues such as the stability of moral intelligence, the way in which situational context may over-ride it, and how it might be identified in a manner that is economical, reliable, and valid.

In the final paper on *Governance and Performance: Publicly Listed Companies in Malaysia*, Cyril H. Ponnu of the University of Malaya and Sarimah Ramthandin from the Malaysian Securities Commission investigate the relationship between corporate governance practice (as indicated by corporate governance disclosure) and a company's financial performance. The results of their study show that there is a positive relationship between corporate governance practices and company performance and findings could be used by regulators, investors, corporations and others who contend that good corporate governance is important for increasing performance and investor confidence.

Finally, on behalf of all the member of the Journal's Board of Management, I thank Dr Andrew Wenn for his efforts for the journal over its first two years of operation in reviewing articles, editing a special issue and taking a very constructive part in the journal's management. We all wish him all the best for his new job.

Arthur Tatnall
Editor

Compliance of Companies With Corporate Governance Codes: Case Study on Listed Belgian SMEs

Sven H. De Cleyn
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Abstract

Listed and large companies become increasingly subject to internal and external pressure to comply with ethical and social standards. This article focuses on one aspect of this matter, namely the corporate governance issue. Within the framework of recent corporate scandals, this paper investigates whether and to which extent Belgian publicly listed SMEs comply with the Belgian Code on Corporate Governance after its first year of introduction, which has been constituted in the framework of the European Action Plan on Corporate Governance.

In a sample of 78 Belgian listed SMEs, the compliance with the Code is analysed. After its first year of introduction, companies comply with on average 70% of the Code's provisions. The most problematic topics in terms of disclosure of information seem to relate to (individual) remuneration, private information and content of shareholders' meetings.

Keywords

Corporate Governance; European Action Plan; Belgium; Code Lippens; Code on Corporate Governance

Introduction

Listed companies become increasingly subject to internal and external pressure to comply with ethical and social standards (Levis, 2006). This article focuses on one aspect of this matter, namely the corporate governance issue. The attention paid on the corporate governance issue has been growing unremittingly, especially since some large corporate failures due to fraud and manipulation in the nineties (Becht et al., 2005; Coffee, 2005; Commission of the European Communities, 2003; Marnet, 2007). In recent years, many countries engage in debates on the implementation and enforcement of a corporate governance code or law for companies. In 2003, the European Commission formulated an action plan on corporate governance, intending to enhance transparency and the disclosure of information (Berglöf 1997; Berglöf and Pajuste, 2005). Indeed, information disclosure is seen as a pillar in the move towards better governance of European companies (Dalton and Dalton, 2006a). The ultimate goal of the EU is to foster the global efficiency and competitiveness in EU companies and safeguard the position of shareholders and all stakeholders involved (Commission of the European Communities, 2003), where a corporate governance code serves as one tool amongst many other to reach this objective. Amongst many other countries, Belgium has started initiatives to comply with this call.

Within this framework, this paper investigates whether and to which extent the Belgian publicly listed Small and Medium-sized Enterprises (SMEs) comply with the Belgian Code on Corporate Governance (further referred to as the "Code") after its first year of introduction, better known as the Code Lippens (named after the chairman of the committee). Generally, the Belgian corporate governance model is based on the stakeholder approach (Wieland, 2005), as opposed to the shareholder model, common in countries such as Switzerland, Sweden, Finland and the UK (Wieland, 2005). The analysis is based on the annual reports, the companies' website and the Corporate Governance Charters. The purpose of the paper is then to unveil to which extent the companies comply with the code and the main reasons for non-compliance.

The remainder of the paper is structured as follows. The second section deals with general aspects of the corporate governance theory and practice. The literature elements most relevant to this paper are discussed in more detail. In the third section, the Belgian corporate governance situation is touched upon. A rather recent development is of major importance in this research field, namely the (separate) creation of a corporate governance code for listed (the "Code Lippens") and non-listed Belgian companies (the "Code Buysse"). In the same section, the research focus of this paper is specified. The fourth section deals with methodological issues and description of the research sample. A case study approach on the Belgian situation has been chosen. The presentation and discussion of the findings occurs in the fifth section. Special attention is drawn on provisions of the corporate governance code with which the companies comply least. A final discussion on the implication of the findings and the limitations of the study ties up this paper.

Corporate Governance

General framework

The competitive environment in which companies operate has changed at fast pace in recent decades (Revilla et al., 2005; Trott, 1998; Vuola and Hameri, 2006). The development of effective and efficient control systems is then required if companies wish to seize these opportunities and stand up to the accompanying risks. A corporate governance system forms an important part of this control system. In the light of this context – and as a result of the recent corporate scandals, mainly in the United States – many countries and international communities (e.g. the OECD) have been developing regulations and guidelines on required levels of corporate governance (Berglöf, 1997; Gillan, 2006; Marnet, 2007).

In the light of the recent corporate scandals, the existing systems proved not to be satisfactory and could easily be undermined (Marnet, 2007). In the United States the Sarbanes-Oxley Act provided a quick reaction to the scandals. Poor governance by some companies has, according to the European Commission – "*greatly undermined confidence in capital markets*" (Commission of the European Communities, 2003, p. 10) and has fostered the need a European tackling of the issue. Shareholders and stakeholders proved not to be protected sufficiently. Therefore, the EU decided to put effort into the subject at a supranational level. According to Becht et al. (2005), two alternative responses are possible: stricter standards and more tight regulation on the one side or more optimal functioning of markets – through better information disclosure – on the other side. These approaches do not need to be mutually exclusive – an opinion which is reflected by the particular elaboration of the EU call in Belgium. However, in most cases, changes in legislation is the easiest response to corporate scandals (Marnet, 2007), leaving companies and courts struggling with the new rules (Berglöf and Pajuste, 2005). The European Union has mainly chosen the path of issuing guidelines and creating a reference framework – through the European Action Plan of May 2003 – instead of imposing a new legislative regime. This plan delegates the constitution of a corporate governance code to the individual member states, as – after careful analysis of advantages and obstacles – it is estimated not interesting to formulate a single corporate governance code for the European Union (Commission of the European Communities, 2003). The code should be applicable to all listed European companies and the main goal is disclosure of relevant and important company information, as stimulus for having well-functioning markets (Berglöf 1997; Berglöf and Pajuste, 2005; Claessens and Fan, 2002). An important aspect of the intended codes is the 'comply or explain' principle. According to this principle, companies not complying with one or more provisions of the code should explain their reasons for deviation (this subject will be dealt with in more detail in the next section).

The Action Plan then seeks to enhance the general framework on several domains. Information disclosure is a key pillar for achieving these goals (Basu et al., 2007; Berglöf and Pajuste, 2005; Claessens and Fan, 2002). Secondly, as the corporate scandals illustrate, shareholders' rights should be strengthened, especially through – again – substantial and adequate information disclosure and increased shareholder democracy and activism (Commission of the European Communities, 2003; Daily et al., 2003). Additionally, an important role is in store for the Board of Directors. Through its composition (strengthening the role of especially independent and non-executive directors), remuneration and responsibilities, the governance of a company can strongly be enhanced (Dalton and Dalton, 2006a; Giannini, 2001; Hendry, 2005; Siebens, 2002).

The European Commission intends to achieve two main objectives with the Action Plan (Commission of the European Communities, 2003). In the first place, the intention is to strengthen shareholders' rights and third party protection in the competitive environment. Secondly, the policy objective is to foster business effectiveness and competitiveness (Commission of the European Communities, 2003; Wymeersch, 2006).

Many European countries have opted not to wait for or respond to Community initiatives but have already compiled up-to-date regulations or guidelines on corporate governance. As first European countries, France, the UK and the Netherlands have published their respective codes on corporate governance in 2003. Belgium built upon separate draft versions of 1998 of three instances and published an integrated code on corporate governance in 2004 (see further on for more details). As the Commission of the European Communities takes part in the work of the OECD, the EU initiatives relates strongly to the OECD guidelines on corporate governance.

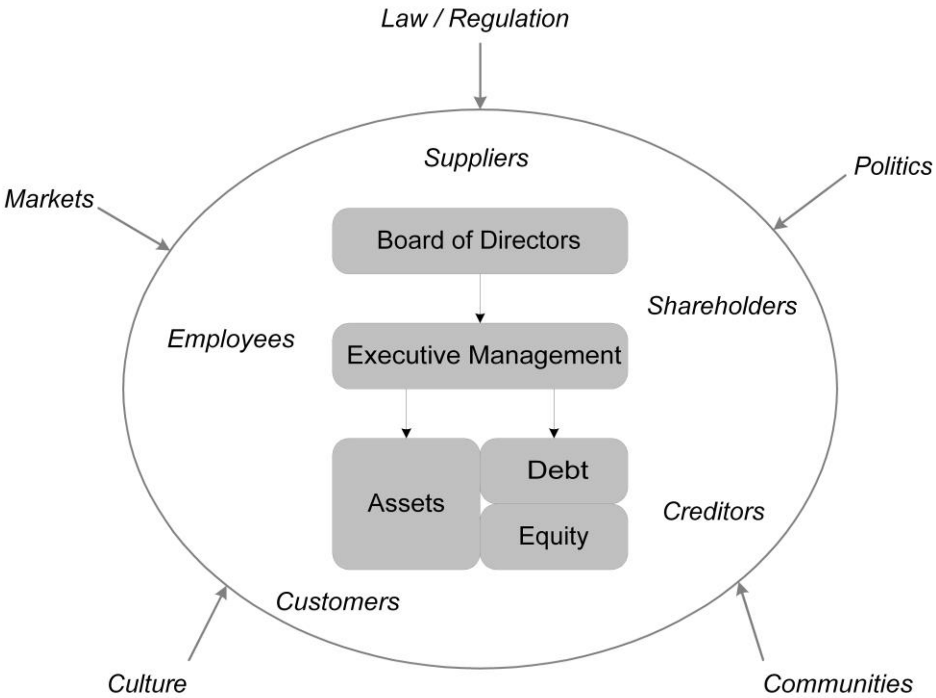
Some theoretical considerations

Many scholars have investigated different aspects of corporate governance. The main theoretical stream influencing actual body of thought on corporate governance is the agency theory. The ongoing discordant field of tension and conflicting interests of a company's owners and managers as a result of the separation of ownership and control – as often a company's ownership and control are separated through these parties – leads to a potential governance problem (Frey and Benz, 2005; Hendry, 2005; Shleifer and Vishny, 1997; Wieland, 2005). The central legislative solution to solve the agency problem is the monitoring role of the Board of Directors (Hendry, 2005). Therefore, many scholars and corporate governance codes stress the important role of the Board. According to Van den Berghe and Baelden (2005, p. 680), there is indeed a strong attention in both literature and practice (especially in corporate governance codes) on this monitoring role, offering a solution and mechanism to align the interest of shareholders and managers and thereby reducing or solving the agency problem at least partially (Hendry, 2005).

As corporate governance is currently gaining more and more research attention (Claessens and Fan, 2002), different perspectives and definitions appear, depending on one's view of the world. Shleifer and Vishny (1997) proposed a rather narrow, shareholder-oriented definition. They define (p.737) corporate governance as "*Corporate governance deals with ways in which suppliers of finance to corporations assure themselves of getting return on their investment*". This reflects the more Anglo-American view on companies, where investments and ownership have to be protected and shareholder value is the cornerstone of the corporate governance system (Shleifer and Vishny, 1997; Wieland, 2005; Aaboen et al., 2006), whereas other goals have to be served (e.g. job security) according to for example Japanese firms (Becht et al., 2005). To reflect this wider view on corporate governance, Gillan and Starks (1998) presented a broader definition. They defined corporate governance as "*the system of laws, rules, and factors that control operations at a company*". The European Commission employs a similar definition: "*Corporate governance is the system by which companies are directed and controlled*" (Commission of the European Communities, 2003, p. 10). These definitions reflect the broader view, involving all stakeholders of a company instead of focussing exclusively on shareholder value (Wieland, 2005; Wymeersch, 2006). However, these definitions refrain from stressing the accountability aspect, which corporate governance makes for. The corporate governance framework indeed emphasizes a company's responsibility towards all stakeholders.

In both perspectives, internal and external mechanisms have impact on the organisation. In a recent work, Gillan (2006) provided an overview of the latest developments in the corporate governance field. Thereby, he developed a framework over the borders of different perspectives on this issue, adopting a broad view on corporate governance (see Figure 1). The company is then seen as a nexus of contracts between individuals and groups, both internal and external, cooperating with the company (Jensen and Meckling, 1976; Ooghe et al., 2002).

Figure 1: View on corporate governance.



Source: Gillan, S. L., 2006. Recent developments in corporate governance: An overview. Journal of Corporate Finance 12, 381-402.

Regulation versus self-regulation

An ongoing debate in corporate governance matters relates to the need for regulation (a legal framework) versus self-regulation by companies (e.g. non-binding corporate governance codes). A legal framework offers clarity and uniformity across companies and industries and enhances the enforceability of good governance practices. Additionally, first studies related to the subject indicate that little outcome can be expected from initiatives that rely on self-regulation and monitoring without any legal enforcement (de Jong et al., 2004). Additionally, obligatory reporting can be argued to be a powerful incentive to achieve compliance. Alternatively, obligatory reporting is in itself not enough to guarantee compliance genuine compliance with corporate governance codes and the philosophy behind them. Several arguments plead however for self-regulation.

The external factors fostering the introduction and compliance with corporate governance codes meet two different risks: regulatory risks and social risks. The first argument is used by companies in order to reduce the need for other forms of regulation and legislation (Levis, 2006, p.51). They argue that, by implementing and complying with a corporate governance code, less formal legislation is needed. However, as there is no formal and external control organ to assess and enforce the compliance with the codes, its effectiveness is doubtful.

Secondly, corporate governance codes provide a response to social pressure and need for legitimation (Aguilera and Cuervo-Cazurra, 2004; Levis, 2006, p.51), meeting the demands of different stakeholders and external parties (McWilliams and Siegel, 2001). In a related manner but somewhat more specific, Wymeersch (2006) identified peer pressure as motivation for compliance and argument for self-regulation. As weak governance practices in one company may spill over to damage the reputation of other board; peer pressure can be seen a self-controlling element, thereby justifying self-regulation.

A third internal driver for managers to adopt corporate governance codes is the desire to protect both the company's and their own reputation (Levis, 2006, p.52). Wymeersch (2006, p.2) stated that corporate governance codes essentially have "*moral value*", which can be seen as driver for compliance, thereby reducing the need for legal regulation.

In fourth instance, capital market will assess compliance with the code and will (a) penalise non-compliance through the stock market valuation (Easterbrook and Fischel, 1996; Wymeersch, 2006) or (b) accept non-compliance in case of a justifying circumstances (Anand, 2005).

A fifth and last argument in favour of opting for self-regulation concerns flexibility. In corporate governance matters, the "one size fits all" approach is not deemed satisfactory. Companies need flexibility to adapt good governance practices to their specific situation. According to Wymeersch (2006, p. 4) codes should be an incentive to evolve towards better governance standards, without revolution in the internal structures and procedures. This dynamism and flexibility are cornerstones in the process towards better governance practices. The "comply or explain" principle (see further for a more detailed discussion) fits in this view. On the other hand, an equal countervailing argument can be put forward, as a minimal regulative framework is needed to uphold the intrinsic values behind corporate governance codes.

McWilliams and Siegel (2001) argued that effective corporate governance systems tend to cost companies less than they yield. This idea is very important, as the enforcement and viability of corporate governance codes relies on its costs and benefits perceived by the companies. In previous decades, the costs of compliance outweighed the benefits by multiple factors. However, as a legislative and social framework is being built up in recent years, 'irresponsible' companies incur increasingly disadvantages because of their non-compliance. The constitution of codes on corporate governance throughout Europe can therefore be seen as an important step towards a stronger corporate governance framework.

"Comply or explain" principle

Many corporate governance codes have been based on the "comply or explain" principle, according to which compliance with the code's provisions is not a necessity but disclosure relating to compliance is (Aguilera and Cuervo-Cazurra, 2004; MacNeil and Li, 2006). The principle has been in operation in the United Kingdom for 13 years and has been introduced in most recently adopted codes in different EU member states. Its main goal is information disclosure, which has been previously identified as cornerstone in creating a good corporate governance framework and helps to protect investors (Basu et al., 2007; Berglöf and Pajuste, 2005; Claessens and Fan, 2002; MacNeil and Li, 2006).

The reasoning behind the introduction of the "comply or explain" principle consists of two main arguments. Firstly, one might argue that a "one size fits all" approach in corporate governance matters is not practicable (MacNeil and Li, 2006; Wymeersch, 2006). Companies differ strongly in their structures, goals and subsequent corporate governance needs. Therefore, the principle brings flexibility in order to meet the company's needs and specific characteristics. The second argument relates to capital market's role in evaluating the extent to which company comply with the provisions of the code (MacNeil and Li, 2006). According to this argument, the code represents the view of institutional investors as to best practice, which can serve as incentive to comply, as compliance might have a positive impact on share price evolution (Mallin, 2001). Non-compliance offers then the possibility to justify a company's position towards investors (MacNeil and Li, 2006).

Monitoring compliance with codes

The disclosure obligation of corporate governance codes provides a mechanism to observe and monitor a company's compliance (MacNeil and Li, 2006; Wymeersch, 2006). However, compliance viewed apart is subjective, as not all analysts and investors will agree on this matter. Moreover, not all provisions of such codes are capable of independent verification (MacNeil and Li, 2006; Wymeersch, 2006). Additionally, a gap might exist between what companies report concerning compliance and what they actually exercise in daily business practice. The same holds for the use of the "comply or explain" principle. The explanation provided to justify non-compliance might not be true and reliable (Wymeersch, 2006).

Corporate Governance in Belgium

This section turns our minds to the Belgian corporate governance situation in general and the specific recent development in particular. The research opportunity is identified, stemming from the EU Action Plan. The opportunity identified at EU level is executed and analysed at Belgian level.

Code Lippens & Code Buysse

In the last decade, the attention paid to corporate governance has grown substantially in Belgium – especially since 1998, when 3 parties independently developed guidelines and recommendations on the subject. The three parties involved were the Banking, Finance and Insurance Commission, the Federation of Enterprises in Belgium (FEB) and Euronext Brussels. In a more recent joint effort – acting upon the decision of the European Commission of 21st May 2003 – the same three parties established the Corporate Governance Committee on 22nd January 2004 under the chairmanship of Maurice Lippens.

The aim of the Committee is "*to update these recommendations by drafting a single reference code for listed Belgian companies. The Code is to set out principles of good governance and transparency, which will contribute to the development of companies and to the quality of their image among investors and the general public*." (Corporate Governance Committee, 2007). The final Belgian Corporate Governance Code has been published in December 2004. In line with European train of thought, the Belgian Corporate Governance Code (Code Lippens) encompasses guidelines for listed companies and contains no legal obligations.

Additionally, Belgium has decided to constitute a second code, intending to provide guidelines for smaller, non-listed companies. This code has also been presented at the end of 2005. This Code Buysse aims to provide helpful and practical insights for SMEs and other non-listed companies in order to fully realise the growth and innovation objectives of the company. A specific part of the Code Buysse is directed towards family-owned ventures, to address their specific problem areas and concerns.

The focus of this study will entirely remain with the Code Lippens, as adequate and substantial information is only available for listed companies. The Code Buysse therefore falls outside the scope of this study.

Research opportunity

The new Code on Corporate Governance can be considered a milestone in the corporate governance practice in Belgium and – taking the European action plan into account – in Europe. The renewed élan opens up several research opportunities for researchers, legislators and practitioners. In the first place –

the most obvious question – one can investigate to what extent companies comply with the provisions set out in the code. The question is relevant and interesting, as the Code contains guidelines and does not hold any regulatory obligations for the companies under investigation. The answer on this question not only reveals the extent to which companies comply with imposed guidelines, it also reflects the companies' culture and real concern at corporate governance and explains different statistics and facts (Berglöf and Pajuste, 2005; Dalton and Dalton, 2006b). Therefore, the first research question can be formulated.

Research Question 1

To what extent do the listed Belgian SMEs report compliance with the Belgian corporate governance code (Code Lippens)?

The Code foresees in the possibility to explain non-compliance with provisions of the code – the "comply or explain principle". These explanations can be considered being interesting sources of information, especially because they reflect areas subject to more controversy in business practice. The non-disclosure of information can possibly be an indication of companies' reluctance on some subjects. Information disclosure is critical in ameliorating markets' functioning (Becht et al., 2005; Berglöf, 1997; Claessens and Fan, 2002). Therefore, analysing the reasons for non-compliance can reveal interesting concerns in the business world with respect to corporate governance (Berglöf and Pajuste, 2005). The second research questions can then be formulated.

Research Question 2

What are the reasons in case of non-compliance with the Belgian corporate governance code (Code Lippens)?

Research Sample and Methodology

Sample

The research sample has been constituted of the list of all 124 Belgian listed SMEs[1] (status date: end of December 2006). This list of potential research subjects has been reduced with the elimination of Belgian Initial Public Offerings (IPOs) of the year 2006, as these companies did not fall within the scope of the Code Lippens in 2005 (the last available year for annual reports). However, some companies provide the necessary information (especially the annual report of 2005). As a result, they have been maintained in the population. Due to the IPO restriction, the effective population has been reduced to 101. Additionally, the companies of which the website did not exist or was not accessible in the period February-April 2007 have been excluded. This way, the population has been reduced to 86 companies. Additionally, the shares of three companies have been cancelled of Euronext at the beginning of 2007, due to a merger or an acquisition. As an effect, the annual accounts and corporate governance charter have been withdrawn from the corporate website. Additionally, 4 companies turned out not to be an SME and one company was in the process of liquidation.

These choices reduce the effective population to 78 listed Belgian SMEs. The entire population (100%) has been investigated in this research, in order to be able to draw meaningful and relevant conclusions.

The specific category of companies addressed in this research – SMEs – is important for many European economies. Recent figures show that SMEs account for almost half of the GNP and more than 60% of total employment in Belgium. Therefore, they can be seen as cornerstone of Belgian economy. Other countries such as Finland and the Netherlands have similar figures. Especially in small open economies, SMEs usually play this role. Additionally, the adoption of the Code and its main effects can best be assessed within this SME framework. Indeed, larger companies usually tend to

1 The companies included in the sample concern companies with maximally 250 employees, publicly listed on a stock exchange and with registered office in Belgium. Bel-20 companies, the basket of Belgian reference shares, have been excluded of the research sample.

comply at higher rate and faster pace, due to higher social visibility and larger resources. Recent research of the Federation of Enterprises in Belgium (2006) and the Belgian Governance Institute shows that BEL-20 companies on average comply with 87.9 % of the Code's provisions after the first year of its introduction. As SMEs tend to have more work in adapting to the new guidelines and standards, this set of companies is key in analysing the real influence of the Code and the main obstacles. Following both arguments, SMEs have been chosen as main research subject to assess the influence of the Code on corporate governance practice in Belgium.

Methodology

The research data have been based on the companies' websites of February / March 2007, the last available version of their Corporate Governance Charters in February / March 2007 and the Annual Reports of 2005. This enables us to assess the compliance with the Code after its first year of introduction.

Not all the provisions of the Code (Corporate Governance Committee, 2004) have been included in this research, as it is impossible to assess each parameter based on the data available in annual reports, corporate governance codes and websites. Only these parameters have been included that could be investigated based on the publicly available information sources. Therefore, a selection has been made with the view to assuring the evaluation. The provisions that have been included in the research can be found in Appendix 1.

A case study approach in Belgium has been chosen instead of a broader international study. This idea has been inspired mainly by practical constraints. As the data-gathering and analysis process is time-consuming, it would be unfeasible to perform the same in-depth analysis for more than one small(er) economy. The choice for investigation of one country allows performing the analyses with the entire population, thereby ensuring significant results and clear implications. It goes without saying that this single case study approach holds several limitations. Under these circumstances, it is impossible to provide a broader international comparison of governance practice after code introductions. Similarly, cultural differences on the compliance can not be studied, which could provide interesting knowledge. As a result, the conclusions and implications of this study should be considered exploratory and their scope and impact limited.

Results

This section will deal with the results of the study. In the first place, the most remarkable and eye-catching results will be discussed. The most important items of each section will be discussed in more detail.

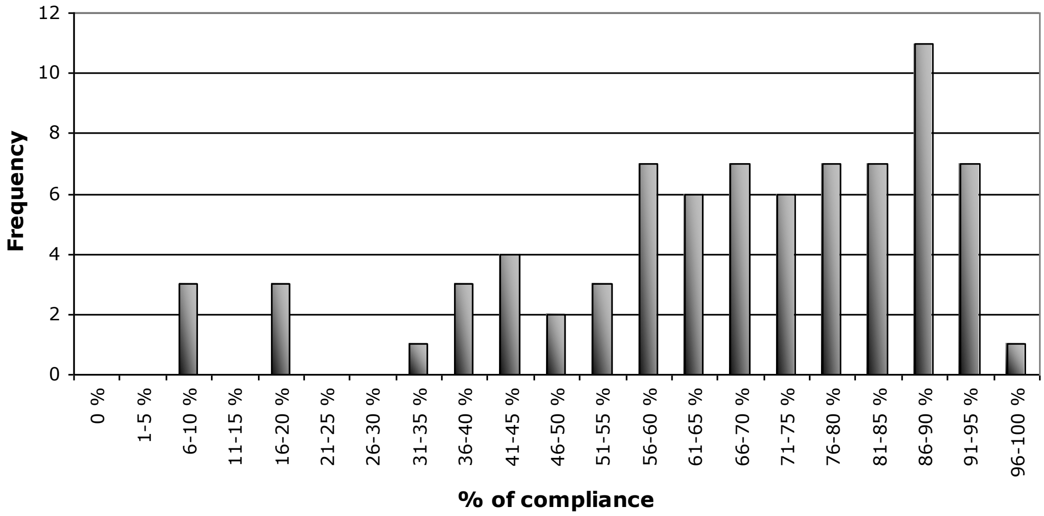
The results (see Appendix 1 for detailed information) show that – on average – the listed Belgian SMEs included in the sample comply with 70 % of the provisions as stipulated by the Belgian Code on Corporate Governance after the first year of its introduction (see Table 1 for more descriptive statistics). The 'comply or explain' principle is on average used in only 3% of the cases (equal to 10% of non-compliances). However, the disparity between different companies is large. The weakest student in class only complies with 7 % of the provisions under investigation, while the best company complies with 98 % of the provisions of the code and explains the other 2 %. Due to this largely dispersed landscape (for more detailed information, see the histogram in Figure 2), the results should be considered with cautiousness.

Table 1: Descriptive statistics.

Mean % compliance	70 %
Std. Dev.	23 %
Min. % compliance	7 %

Max. % compliance	98 %
Min. % compliance + explanation	7 %
Max. % compliance + explanation	100 %

Figure 2: Histogram.



Interesting, remarkable and even a little frightening is the fact that only one company in our sample managed to have no provisions with non-compliance. This company made use of the explanation possibility for one provision. This observation can have two possible causes. In the first place, it is possible the incentives (socially, legally and financially) for companies to comply with the Code on Corporate Governance are insufficient, whereas the costs outweigh the benefits at this moment. Secondly, companies might more time to adapt their structures and operations to the new guidelines. After all, this study relies heavily on data of the first year of introduction of the Code.

Provisions with high compliance

The provisions with the highest rate of compliance all concern topics where no strategically important or 'private' information is disclosed and that firms used to disclose before the widespread attention to corporate governance. Mostly, the provisions complied with at high rate considers topics which have been disclosed in the annual reports previously to publication of the Code Lippens. Almost each company discloses the composition of its Board of Directors (97%). In general, the recommendations related to the Board of Directors' composition are acted upon positively. Additionally, all but three companies (96 %) provide information on the relevant corporate governance events that took place during the year under review. The last provision with the highest compliance is the announcement of the timetable with periodic information and shareholders' meetings (96 %).

These first results actually do not contain any surprises or newly generated effects by the publication of the Code. Most listed companies have previously been disclosing this information in their annual reports.

Provisions with high non-compliance

In contrast to the previous items, where the provisions with the highest compliance included topics where no strategically important nor private information was to be disclosed, the provisions of the Code with the highest non-compliance concern more 'important' information.

In the first place, 69% of the companies do not publish the main contractual terms of hiring and termination arrangements with executive managers. As with the results concerning low compliance (see section 5.3), this concerns more 'private' and individual information concerning team members. It seems that listed companies in general and SMEs in particular struggle with information disclosure on this kind of topics. A logical argument for this could be that they fear otherwise finding no suitable and competent Board and management members. Anyway, transparency in board transactions should not be over-ridden by considerations of directorial privacy. It is unacceptable that the privacy argument hampers overall transparency, which is one of the main aims of corporate governance codes.

Secondly, more than two-third of the companies (67 %) did not impose their non-executive directors not to consider taking on more than 5 directorships in listed companies. A reason for this low compliance rate could possibly be that companies are afraid of losing the best available directors by restricting their freedom. An alternative explanation relates to the interlocking directorates (Dooley, 1969; Schoorman et al., 1981), which are rather common in Continental Europe. In their research, Fich and White (2005) reported that about one company in seven was having interlocking directorates. The low compliance rate might be influenced by this common practice.

In third instance, the level of shareholding for the submission of proposals by a shareholder to the general shareholders' meeting, which should – according tot the Code – not exceed 5 %, is not complied with by 62% of the companies in our sample. In more than half of the cases, this level is higher (mostly 20% of shareholding). This higher level gives an indication of protection of larger shareholders (Berglöf and Pajuste, 2005; Claessens and Fan, 2002; Krivogorsky, 2006), thereby by-passing the objectives of the EU Action Plan, which aims at protecting all shareholders at equal level.

Additionally, companies are reluctant to disclose the results of the votes and the minutes of shareholders' meetings (59 % of the sample did not comply with this provision). In some way, it can be understood from a competitive point of view not to disclose the decisions being taken on a shareholders' meeting. On the other side, the most important decisions and strategies are being elaborated in the executive management and board meetings, without being disclosed to the outside world. Therefore, the non-compliance can be qualified as an obstruction to the goal of information disclosure, which has earlier been said to be very important for the functioning of markets.

Finally, the individual attendance of board members was not disclosed nor explained in almost half of the cases (54 %). The main reason can probably be found in the violation of the directors' privacy. Again, similar to the previous remark concerning the directorship in other listed companies, limiting the privacy and freedom of directors might be seen as a disadvantage in the search for good board members.

Provisions with low compliance

In contrast to the previous section, this section addresses the provisions of the Code with the lowest compliance. The difference is subtle but important, as low compliance does not necessarily mean non-compliance, especially in the context of the 'comply or explain' principle. Companies can decide not to comply, but have grounded arguments for deviation. However, low-compliance mostly reflects non-compliance without any explanation.

In the first place, the level of shareholding for the submission of proposals by a shareholder to the general shareholders' meeting returns in this section. As discussed in the previous section, this level should not exceed 5%. However, the results reveal a small proportion of companies complying with this provision (22%). The combination of these two elements (high non-compliance and low compliance) gives an indication that this provision really bothers companies. This indication should however be further investigated before any relevant inferential statements can be made.

A second interesting topic in this category concerns the frequency of audit committee meetings with the external and internal auditors. As prescribed by the Code, the committee should annually meet these auditors at least twice. However, only 26 % of the sample elements comply with this guideline. In more than half of the cases, it is unclear whether these meetings take place or not. Generally, the annual reports provide little information on this subject, which explains the low compliance rate (as in only 21 % of the cases non-compliance can be registered with certainty).

Thirdly, less than one-third of the companies (28 %) did not impose their non-executive directors not to consider taking on more than 5 directorships in listed companies. Potential reasons have been discussed earlier. Again, the combination of two elements (high non-compliance and low compliance) gives an indication that this provision is not at all supported by listed Belgian SMEs and therefore requires more attention.

Finally – and again similar to the topic in the previous section, only 30% of the companies publishes the main contractual terms of hiring and termination arrangements with executive managers.

Provisions with High Explanation for Non-Compliance

The Code leaves a lot of freedom to companies by means of the 'comply or explain' principle. In case of non-compliance, the company can stipulate the reasons for the deviation, while still informing the public. Additionally, the principle offers the possibility of tailoring the general guidelines of the Code to the company's needs, which encourages and stimulates the general thought of corporate governance (Gillan, 2006; Marnet, 2007). As the results demonstrate, companies prefer not to disclose the reasons for non-compliance, thereby reducing the power of the 'comply or explain' principle and endangering the goal of information disclosure (Basu et al., 2007; Berglöf 1997; Berglöf and Pajuste, 2005; Claessens and Fan, 2002).

For some provisions however, the 'comply or explain' principle proves its use. Especially for the disclosure of CEO remuneration, the principle has found acceptance. In 13 % of the cases, companies explain why the remuneration is not disclosed, while only 47 % of the companies fully comply with the provision. Looking in more detail to this provision sheds another light on reality. Most explanations for non-compliance fence with protection of the CEO's privacy. They stipulate that disclosing the remuneration would bring damage to the privacy, which is an easy argument for non-compliance. The situation is even worse for detailed disclosure of the remuneration. The Code requires a split between basic and variable remuneration and other extra-legal components. The low compliance (42 %) is supplemented by a small amount (6%) of explanations – again for reasons of privacy. This leaves 52 % of the companies not complying or explaining deviation of the Code.

An important conclusion could be drawn out of this ascertainment. CEO remuneration, being an important tool to align the interests of shareholders /owners and management (Gillan, 2006), is being treated with high reluctance in the corporate governance framework. The good will of companies to align with the social and legal pressures towards more corporate governance might reach its limits when it concerns more personal items. Additionally, top managers might be afraid of downward pressure on their compensation packages in case of disclosure. This fear might be heightened by a study by Coombs and Gilley (2005), who found that a negative relationship exists for listed companies between the engagement in stakeholder management and CEO compensation. The authors concluded that "*these results indicate that CEOs may jeopardize their personal wealth by pursuing stakeholder-related initiatives*" (Coombs and Gilley, 2005, p.827). The same conclusion is found in another study by Basu et al. (2007). This suggests – in view of the actual discussion on the results of this study – that companies disclosing the remuneration package are more willing to pursue stakeholders' benefits and install good corporate governance mechanisms. In all cases, it should be stated that the individual privacy should not obstruct the primary goal of transparency.

The third provision with a high explanation rate for non-compliance envisages the level of shareholding for the submission of proposals by a shareholder to the general shareholders' meeting, which should – according tot the Code – not exceed 5 %. In more than half of the cases, this level is higher, while only 10 % of the companies provide an explanation. This higher level gives an indication of protection of larger shareholders (Berglöf and Pajuste, 2005; Claessens and Fan, 2002; Krivogorsky, 2006).

A last provision giving a warm welcome to the 'comply or explain' principle relates to the constitution of advisory committees (audit, remuneration and nomination). These committees should be installed in order to support the Board with advice on specific matters, depending on their goal. As Siebens (2002) argued, the formation of specific committees can be helpful in case of specific knowledge or experience being required or in case of time consuming dossiers. Although generally companies effectively install and make use of these committees (respectively 76%, 76% and 59% for the audit, remuneration and nomination committee), non-compliance is generally explained (respectively in 13%, 15% and 17% of the cases). The main argument is that the size of the company – the sample only includes listed SMEs – does not justify the installation of 3 additional committees, bringing additional costs and efforts.

Special topics

A first interesting topic concerns the Corporate Governance Charter. According to the Code, each listed Belgian company should constitute and publish a Corporate Governance Charter. In our sample 16 companies (21 %) have not met this requirement in early 2007, more than two years after the introduction of the Code. This indicates a potential discordant situation, where companies estimate that the cost of complying surpasses the benefits. As long as this situation holds, the (social and business) enforcement of the Code might become problematic (McWilliams and Siegel, 2001).

Another topic with remarkable results concerns the Board of Directors. In general, companies comply very well with the specifications concerning the Board of Directors. Not only do almost all companies disclose the composition of the Board, almost all of them meet the requirements concerning independence of at least 3 directors – as is common practice in the US (Krivogorsky, 2006) – and having half non-executives members (respectively 76 % and 92 %). The last point is in contrast with the Japanese system, where the Board is being dominated by insiders (Basu et al., 2007). Additionally, as is called for by most corporate governance codes (Drew et al., 2006; Krivogorsky, 2006), most companies separate the role of CEO and chairman of the Board (82 %). These high compliance rates indicate that companies really put effort in getting their Board right.

The last topic with remarkable results is the part of the Code on remuneration in general. The disclosure of individual remuneration packages seems difficult to enforce via the Code. The only remuneration provision that receives sound compliance is the disclosure of executive managers' remuneration on a global basis. However, companies remain incredibly reluctant to disclose the individual remuneration packages of CEOs and non-executive directors. The situation becomes even worse in case of breakdown of the remuneration into basic remuneration, variable remuneration and other remuneration components. As quoted earlier in the article, privacy reasons lay the foundation for the low information disclosure, possibly combined with a fear for not being able to attract the best managers and directors. However, according to several studies, the relationship between disclosure of remuneration packages and the willingness to invest in corporate governance might be relevant in this context (Basu et al., 2007; Coombs and Gilley, 2005).

Conclusions

The institution of the Belgian Code on Corporate Governance at the end of 2004 in particular and codes on corporate governance in general can be seen as manifestations of the growing attention for corporate governance matters worldwide (Claessens and Fan, 2002). In Europe, the stimulating incentive has been generated by the European Commission with the main goal of disclosure of relevant and important company information, as stimulus for having well-functioning markets (Berglöf 1997; Berglöf and Pajuste, 2005; Claessens and Fan, 2002). This new élan has been identified as an interesting opportunity to evaluate the compliance of the targeted companies – listed Belgian SMEs – after the first year of the Code's introduction. This specific category of companies is important for many European economies. Recent research shows that SMEs account for almost half of the GNP and more than 60% of total employment in Belgium. Therefore, they can be seen as cornerstone of Belgian economy. Other countries such as Finland and the Netherlands have similar figures.

In general, companies have embraced and adopted the Code rather well. The average compliance of the companies is rated at 70 % after its first year of adoption. Large differences remain between the companies in the sample. Especially for smaller listed companies, the adaptation to the new set of guidelines and policy does not occur without striking a blow. Another interesting conclusion is that the 'comply or explain' principle has not become established yet. Non-compliance stays too often without any explanation. Time will tell whether this low level of explanation stems from unwillingness to disclose or from unfamiliarity with the principle.

However, some problematic areas remain. On a more abstract level, the identification of the provisions and topics with rather low compliance rates concern remuneration, private information on directors and inside information on shareholders' meetings. In first instance, the general level of disclosure of remuneration packages seems to experience substantial resistance from the companies, especially disclosure at individual and detailed level. This reluctance can be an important fact in view of different studies stressing the relationship between the disclosure of remuneration packages and the pursuit of stakeholders' interests (Basu et al., 2007; Coombs and Gilley, 2005). However, as this research focuses on data after the first year of introduction, this conclusion should not be dramatised. It is also possible that the reluctance to disclose the remuneration package is related to resistance to change, which will diminish in the course of time.

Secondly, the reluctance to disclose 'private' information concerning board members is significant. Too often, companies make a play with privacy statements to hide after. The hesitation to disclose this kind of information will probably erode over time – the corporate and societal culture needs an adaptation period. The fearfulness to disclose the individual-related information of board members can also be generated by the apprehension of not being able to attract some board members. As stated earlier, these obstacles will probably disappear in the course of time. The notion of directorial privacy should not override overall disclosure and transparency.

The third and last domain being subject to low compliance levels is the disclosure of 'inside' information, such as the results of the votes and the minutes of shareholders' meetings. Sometimes it is indeed preferable to keep aspects of these meetings behind closed doors. However, the most strategically important decisions are seldom taken on shareholders' meetings.

After the corporate scandals in the Western economies, a wave of corporate governance measures has been announced. The codes on corporate governance, recently introduced in many (European) countries are a manifestation of this 'hot topic'. As this study reveals, a long way remains to reach the goal of transparency and information disclosure, helping to assure good governance of companies. This should not discourage the many companies really working on the topic, as their results are rewarding. Obligatory reporting and regulation is in no way a guarantee to obtain genuine compliance with the code's principles and philosophy.

The generally encouraging image depicted in the previous sections should however be nuanced. More than one fifth of all listed Belgian SMEs does not comply with more than 50% of the provisions under investigation. This result provides a strong indication that companies estimate the benefits (mainly social, to a lesser extent financial) of complying lower than the costs associated with adoption. As long as this (perceived) negative cost balance holds, the adoption will remain problematic with a rather substantial proportion of companies. However, after the first year of introduction and considering the time companies sometimes need to adapt their policies, structures and procedures to the Code, it seems reasonable to give them the benefit of the doubt. Time will teach whether corporate governance has improved according to EU goals.

Limitations of the study

As discussed earlier, the chosen case study approach on Belgium holds several limitations. It is impossible to pronounce upon the influence of codes' introductions on corporate governance practice in a broader international context. Similarly, cultural differences on the compliance can not be studied. As a result, the conclusions and implications of this study should be considered exploratory and their scope and impact limited.

Secondly, the nature of the research design hampers in-depth analysis of real attitude changes in daily corporate governance practice. From this research, it is unclear whether the investigated companies really adapted their policies and actions and adopted the code. A gap might exist between what is reported and what actually happens in the field. Therefore, more in-depth qualitative research methodologies could complement the actual (exploratory) research.

A third important limitation of the study concerns the use of publicly available information. This kind of study only provides indications of to what extent companies live up to corporate governance recommendations. Reliance on publicly available information holds several risks. Companies might put a gloss on their real corporate governance practices in order to induce goodwill. Only a more in-depth study on day-to-day practices can provide further evidence on companies' real efforts to comply with corporate governance codes.

Implications

The results of the study potentially hold severe implications. Policy makers might have to reconsider the effectiveness of corporate governance codes as an attempt to foster good governance practices. As long as the costs to comply with governance codes outweigh the benefits – both financially and non-financially – the grounds for compliance will be lacking. The role of self-regulating codes has – according to a long-term study in the United Kingdom by MacNeil and Li (2006) – been overstated. It seems that "*investor's tolerance of non-compliance is linked to some extent with superior financial performance (in terms of share price*" (MacNeil and Li, 2006, p. 494). Non-compliance is then not penalised in case of superior financial performance, while reasoned arguments for non-compliance remain unvalued (MacNeil and Li, 2006). In another study de Jong et al. (2004) indicated that little outcome can be expected from initiatives that rely on self-regulation and monitoring without any legal enforcement. The results of the study therefore plead for an integration of the corporate governance code into mainstream company law. Our results provide another indication – although preliminary and early in the Code's adoption process – for this statement.

Further research opportunities

Some research opportunities have been identified earlier in this article. In the first place, the study could be replicated in a broader international context, enabling more widely applicable conclusions. Intercultural comparison can reveal interesting differences in governance practices, taking different circumstances such as concentrated versus dispersed ownership into account. Additionally, research could address changes in daily practice after introduction of corporate governance codes with more in-depth qualitative research methods to evaluate the gap between what companies report and what they actually do. Applying other approaches, such as participant observation and anonymous surveys, can substantially add to the understanding of obligatory reporting. Part of this study could relate to the question whether the Code should (partially) be integrated in company law. Thirdly, the scope of the research can be extended towards all listed companies, instead of focussing on SMEs, thereby analysing group differences between smaller and larger companies.

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The Global Context of Human Rights Violations: The Impact of the *Alien Tort Claims Act*

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Abstract[2]

Corporate responsibility for human rights violations has historically been approached as a domestic national issue in the United States. That is, despite international legislation governing human rights violations in an international context, courts have generally held that the activities of U.S. corporations outside the United States involving individuals who are not U.S. citizens does not fall within the jurisdiction of U.S. courts. This has been consistently affirmed at the Supreme Court level; and, indeed, the court has been zealous in seeking to avoid any reference at all to legislation like the European Human Rights Act in writing opinions.

This view of culpability for human rights violations has recently changed, both informally, with the emergence of global guidelines regarding human rights applying to corporations such as the Global Reporting Initiative, Amnesty International Guidelines and O.E.C.D. guidelines for Transnational Corporations and with the application of an 18th century law, the Alien Tort Claims Act, that has been used to sue corporations for human rights violations outside the United States.

A suit was brought against Unocal, a California based oil corporation, for complicity in crimes committed against Burmese citizens under this Act. The 9th District Circuit Court of Appeals held in this case that Unocal had a case to answer for complicity in the rape and murder of Burmese citizens perpetrated by the ruling military junta. Recently, Unocal settled out of court in what is reported to be a sizeable financial settlement. Additional lawsuits have been brought against Ford Motor Corporation for its complicity in the holocaust by providing military vehicles to the German Army through their German subsidiary and I.B.M. for providing counting machinery for concentration camps during the Second World War. Cases involving other countries include the conduct of business with the South African apartheid government by several U.S. based corporations. These cases raise a new concept of corporate responsibility in a global setting as they depend upon an assumption of moral responsibility by corporations for violations of human rights committed by regimes with which they do business. This paper examines the implications of this changed context for corporate responsibility in the context of the emergence of the multiple voluntary guidelines that seek to hold corporations accountable for conduct outside their own countries.

Keywords

ATCA, Human Rights, Corporate Governance, CSR

Introduction

Social expectations of corporate behaviour have produced increased attention to issues of corporate governance and to issues that generally fall within the rubric of corporate social responsibility. While it is clear that

2 An earlier, preliminary version of this paper was presented at the Second International Conference on Corporate Social Responsibility in Berlin, Germany

over the past decade, there has been a rapid growth in the number of non-governmental organizations (NGOs) addressing social responsibility and in the number of voluntary guidelines concerned with corporate social responsibility, the evolution of this concept has been somewhat ambiguous in a global context.

At one level, national systems via constitutional, judicial or legislative mechanisms provide frameworks for defining corporate responsibility; these generally are domestic in scope. The rapid growth of multinational and transnational corporations facilitated in part over the past two decades by the formalization of international trade rules and financial architecture has resulted in a more global context for concerns about corporate social responsibility.

It is clear at the start of the twenty-first century that few businesses operate in ways that are unaffected by globalization. The operations of global corporations represent a particular challenge, both because the revenues of the largest global corporations far exceed the GNP of many nation states and because, for some corporations, it is increasingly unclear whether describing them as “national” entities has much meaning. Organizations like DaimlerChrysler or Royal Dutch Shell, for example, cannot be viewed as German, America, British or Dutch in any meaningful way. For these organizations, national legislation affects only the parts of their operations operating in particular local (national) contacts.

The impact of trade rules following the formation of the WTO has, for example, facilitated the operations of corporations globally, but has also resulted in constraints on their behaviour being largely defined in the national contexts in which they operate. For example, Swedish corporations which in Sweden are subject to fairly stringent environmental legislation may also operate in nation states where there are few, if any, such regulations and if such regulations exist, may be enforced to a limited extent, if at all. There is a dilemma, then, in that nation states may be able to regulate the activities of their corporate “citizens” in their domestic jurisdictions; however, such regulation cannot normally extend to a global context. This has resulted both in corporations seeking competitive advantages through production in poorly regulated or non-regulated environments and fierce opposition by corporations (particularly corporations based in the U.S.) to any such global regulation. As Roth (2005) comments, “Most multinational corporations automatically oppose calls for enforceable standards of corporate social responsibility. Under growing public scrutiny of their behaviour, many western companies have adopted voluntary codes of conduct. But for most, the notion of enforceable standards remains anathema.”

The dilemmas and contradictions of corporate social responsibility are examined in the discussion that follows. The discussion briefly reviews the emergence of voluntary guidelines regarding corporate social responsibility with a particular focus on human rights. Next, the traditional antipathy of the U.S. to global legislation is considered in the context of global operations of transnational corporations. The key development with regard to corporate social responsibility, it is argued, is the emergence, despite substantial political and corporate opposition of cases involving the Alien Tort Claims Act, part of an 18th century U.S. statute. This act (ATCA, also sometimes referred to as Alien Torts Statute), it is argued, represents an important advancement on voluntary guidelines as it sets precedent for international law. The act, via reference to the “law of nations” both extends judicial jurisdiction by U.S. courts to human rights violations committed by corporations in other countries and also suggests in the opinion in the recent *Unocal* case that corporations conducting business with government agencies or entities in other countries may be held to be complicit in violations of human rights committed by those entities. What is interesting is that the ATCA by reference to the law of nations appears to create precedents for reviews of human rights violations under international law. The history of the act and some examples of cases brought under this legislation are considered in this paper. Although many of these cases have been dismissed, it is clear from court holdings in *Unocal* and the albeit narrow upholding of the right to bring cases under this act in *Sosa* that what is emerging is a series of challenges to corporate actions with regard to human rights violations that will extend far beyond the U.S.

The Emerging Field of Corporate Social Responsibility Guidelines

It is not the intent in this paper to review the voluminous literature on corporate social responsibility, but it is necessary to briefly review the emergence of voluntary guidelines, particularly as they affect the conduct of human rights. Robinson (1999) has summarized succinctly this field as comprising three basic areas, the protection of human rights, labour rights and the environment. In the context of this paper and the Alien Tort Claims Act, the focus is on human rights, although the act also has been utilized in tort cases involving the environment. Labour rights are obviously a key component of this analysis.

The recent emergence of guidelines and initiatives insofar as they relate to human rights largely originate in the conventions of the I.L.O founded after the first world war in 1919 and in the Universal Declaration of Human Rights of 1948. These documents provided key elements for a range of guidelines and initiatives institutionalized at a global level in the U.N. global compact and the subsequent emergence of the U.N. norms for transnational corporations. The U.N. human rights norms, for business adopted by the sub-commission on the protection and promotion rights in August 2003 identify key human rights responsibilities for companies including: "…ensuring equal opportunity and non-discrimination, not violating or benefiting from the violation of the security of persons, protecting workers' rights, including freedom from forced labour and exploitation of children and a number of other rights within what are viewed as corporations' spheres of influence." (ESCR 2005) The U.N. norms are not an international treaty, however, and are not legally binding. Nevertheless, these "norms" have provided the basis for NGOs to interact with corporations regarding human rights violations (see, for example, cases documented in ESCR 2005 including the Global Justice Center and Candonga Consortium, Amnesty International and Union Carbide Corporation (Dow Chemicals), Oxfam and the Marinduque Mine, Amnesty International and Shell, and Human Rights Watch and Caterpillar).

Similarly, the OECD guidelines for multinational enterprises provide voluntary guidelines that are non-binding but, like the U.N. norms, deal with discrimination, equal opportunity and child labour. Many of the human rights issues in these documents derive from the I.L.O. Tripartite Declaration based on I.L.O. conventions and recommendations but also considered the deliberations of the World Employment Conference and O.E.C.D. and U.N. documents. Issues of social responsibility have also been incorporated in the Global Reporting Initiative (see 2006 Draft Guidelines). The G.R.I. guidelines are concerned with sustainability but also consider the organization's impact on the social systems within which it operates. The G.R.I. social performance indicators identify key performance aspects surrounding labour practices, human rights and broader issues affecting consumers, community and other stakeholders. The guidelines note that the specific aspects under the category of labour practices and human rights performance are based on "international standards" such as the I.L.O. Conventions, the Universal Declaration of Human Rights, the I.L.O. Tripartite Declaration and the O.E.C.D. Guidelines.

Oldenziel (2005) has provided a valuable analysis of the value added by the U.N. norms to the O.E.C.D. guidelines, the U.N. global compact and the I.L.O. Tripartite Declaration. He points out that under international law, there are only two kinds of legally binding documents: treaties or customary international law and that the U.N. norms are not yet either but that "their language" is stronger and they have a more authoritative approach than existing standards. Where voluntary guidelines become problematic is they may easily become part of corporate public relations campaigns. Some companies, for example, signing on to the U.N. Human Rights Norms have been criticized by the human rights community for human rights violations. The dilemma is, of course, that voluntary guidelines do not generally have effective mechanisms or consequences for breaching those guidelines, or regulatory or judicial mechanisms that can enforce compliance. This is why the emergence and application of the Alien Tort Claims Act in the U.S.A. represents a significant aspect of accountability for human rights and other violations by corporations operating transnationally. What is particularly interesting is that the act has been applied recently in a political environment that has very much emphasized American "exceptionalism" and the premise in the U.S. that international law regulating extra-territorial human rights violations is superseded by domestic law.

Philippe Sands (2005) has noted, "with the election of George W. Bush in November 2000, a U.S. administration took office that was outspoken in its determination to challenge global rules" (p.xii). He adds that "there emerged a presumption against international rules; they no longer created opportunities but were seen as imposing significant constraints," (p.14) and "we are different…; the rules cannot apply to us." (p.15) Ignatieff (2005) has similarly commented, "At the same time (the U.S.A.) has also resisted complying with human rights standards at home or aligning its foreign policy with these standards abroad. Under some administrations, it has promoted human rights as if they were synonymous with American values, while under others, it has emphasized the superiority of American values over international standards." (p.1) As Ignatieff characterizes it, the United States signs on to international human rights and humanitarian law conventions and treaties and then "exempts itself from their provisions by explicit reservation, non-ratification or noncompliance." (p.3)

What makes it all the more interesting, therefore, is that an 18th century statute has proved to be a mechanism that, despite attacks by the U.S. business community and the current administration, has become a vehicle for establishing accountability for global human rights violations. It is also, it is argued, a more powerful mechanism than voluntary guidelines insofar as it constitutes international law (somewhat accidentally) and is more influential in what Hooker (2003) describes as a "rule based culture." As Hooker suggests, the U.S. is a low context culture with norms transmitted "explicitly" by legal requirements rather than by norms of behaviour.

What makes the Alien Tort Claims Act influential and the reason it has been attacked by the business community and the current administration is that it has the force of international law in that it permits the pursuit of civil actions for human rights and other violations in a global extra-territorial context. This statute is considered next, together with the applicability to corporations and human rights violations.

Alien Tort Claims Act

The Alien Tort Claims Act was adopted in 1789 by the first U.S. Congress as part of the original judiciary act and states that, "The district courts shall have jurisdiction of any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States" (Title 28.IV.ch85s1350). What makes the act interesting and provided a mechanism for addressing global human rights violations is that it refers to "aliens," "violations of the law of nations" and "a treaty of the United States." This provides for cases to be brought by non U.S. citizens and also globalized the application of torts placing them in the context of the law of nations and also integrating them with international treaties such as the U.N. Convention on Torture which the U.S. was signatory to.

The law of nations has had a long and interesting history. Rather than constituting specific legislation, "from the time of the Peace of Westphalia of 1648 and the emergence of a still substantially intact system of nation states, the law of nations has been pretty much what contemporary nations have agreed to in writing" (Moynihan, 1990, p.9). During the colonization of the new world, the "law of nations" was widely used to justify territorial claims in the guise of "national law." Elizabeth I of England in the 16th century, for example, claims the "law of nations" meant that territorial claims should not, "hinder other persons from carrying on commerce in these regions…nor from navigating the vast ocean." (Cheyney 1905) This brief reference in the judiciary act clause (ATCA) thus positioned alien torts firmly within the evolving context of customary international law.

Beginning in 1979 in the landmark *Filártiga v. Peña-Irata* case (*Filártiga v. Peña-Irata*, 630 F.2d 876, 877 and n.2 (2nd cir 1980), U.S. courts have recognized "that a limited number of crimes including genocide, crimes against humanity, war crimes, torture, "disappearances," extrajudicial executions, forced labor and prolonged arbitrary detention, violated the "law of nations" and that claims for such abuses can, therefore, be brought under the ATCA (HRW 2003). The Torture

Victim Protection Act of 1991 (TVPA) approved the *Filártiga* decisions regarding the ATCA and extended rights to U.S. citizen plaintiffs to bring claims against individuals acting under "actual or apparent authority, or color of law, of any foreign nation." (HRW 2003) The *Filártiga* case was brought under the Alien Tort Claims Act and established that U.S. courts had jurisdiction over non-criminal abuses that occurred anywhere in the world, "so long as the alleged wrong would violate international law" (Slaughter and Bosco 2006, p.1). Issues arising from the rulings in *Filártiga* were examined by the U.S. Supreme Court in the case of *Sosa v. Alvarez-Machain*. The Supreme Court decision established that "victims of egregious international human rights violations have a right to sue perpetrators found within the United States for monetary compensation (Hoffman 2006). The implications of *Sosa* were far reaching for the business community in the context of human rights issues.

Alien Tort Claims Act and Transnational Corporations

Following the early cases that resurrected the Alien Tort Claims Act plaintiffs sought to establish vicarious liability for the conduct of corporations outside the United States. Cases brought against corporations outside the United States. Cases included Exxon Mobil's activities in Aceh, Indonesia alleging human rights violations by security forces employed by Exxon, the use of paramilitary death squads targeting trade union leaders at Coca-Cola's plant in Colombia; the alleged use of torture by managers employed Del Monte in Guatemala and numerous other cases involving corporations like Dyncorp, Shell, Chevron and Rio Tinto. Of particular prominence are suits brought by victims of apartheid in South Africa and holocaust victims in Germany against companies complicit in crimes by those governments.

The South African cases (for example, the suit brought by *Khulumani v. Berelays et al.*) utilized the conclusion reached by the South African Truth and Reconciliation Commission that "business was central to the economy that sustained the South African State during the apartheid years " (cited in brief by Cohen, Milstein, Harsfield and Toll). The summary of the complaint notes that "this complaint seeks to hold those businesses that aided and abetted the apartheid regime responsible for the wrongs they made possible." (cited in brief)

This suit and others brought against companies doing business during the apartheid period in South Africa were consistent with U.N. sanctions imposed against South Africa at that time. For example, in December 1968, the General Assembly of the U.N. condemned "the main trading partners of South Africa and the activities of those foreign financial and other interests, all of which, through their political, economic and military collaboration with the government of South Africa and contrary to the relevant General Assembly and Security Council resolutions, are encouraging the government to persist in its racial policies" (General Assembly resolution A/RES/2396 (XXIII), 2nd December 1968 cited in Cohen, Millsfield et al document). Earlier, Archbishop Desmond Tutu had recommended a sum of \$270m be paid to an estimated 20,000 victims giving evidence to the Truth and Reconciliation Commission and called on businesses to contribute to the reparations process (BBC document "Pay Apartheid Victims Now" at http://www.bbc.co.uk). The U.S. lawyers pursuing the apartheid suit brought under the Alien Tort Claims Act sought \$20 billion in reparations from companies including NatWest, Barclays and Standard Chartered Banks (Robins 2004a). The lawyer representing the plaintiff, Ed Fagan, had personally headed efforts to secure multibillion out-of-court settlements from Swiss banks and German corporations, including subsidiaries of Ford and IBM. (Innocenti 2003) Interestingly, the South African Government of Thabo Mbeki was a partner in the request by companies to dismiss the suit. Penuell Maduna, Minister of Justice and Constitutional Development, stated, "The government accepts that corporate South Africa is already making a meaningful contribution to the broad national goals and rehabilitating the lives of those affected by apartheid." (Innocenti 2003) Thabo Mbeki, President, also commented, "We consider it completely unacceptable that matters that are central to the future of our country should be adjudicated in foreign courts which bear no responsibility for the well-being of our country." (Innocenti 2003)

Like the South African example, ATCA cases have been contentious and have often prompted the intervention of governments. This was the case with the cases brought on behalf of holocaust victims, some of which were also initiated by Ed Fagan. Also involved was Stuart Eizenstat, deputy secretary of the treasury in the Clinton administration was also involved in intervening in cases brought against Swiss banks. (Robins 2004b)

The agreements involving the U.S. government in these cases since 1998 when the first settlement took place, reached by 2001 a figure of $8-11 billion. (Bazyler 2004)

Other cases brought against corporations that have attracted a lot of attention include: *WIWA v. Royal Dutch Petroleum*, cases brought against Exxon Mobil in Aceh which prompted intervention by the Attorney General of the U.S. and the Bush Administration (discussed in the next section), Coca-Cola and paramilitary death squads, Del Monte and numerous other cases. In general, many of these cases have failed either because of jurisdictional problems, an inability to demonstrate influence over the defendant by the corporations involved or absence of "knowing complicity." The case that has attracted the most recent attention has been *Unocal*. The case has prompted both antagonism by the business community and enthusiasm by the human rights community.

The U.S. company, Unocal, was sued for complicity in forced labour, rape and murder by the Burmese government. Two landmark cases *Doe v. Unocal* and *Roe v. Unocal* were brought on behalf of Burmese villagers. In April 2005, Unocal agreed to compensate Burmese villagers. Chambers (2005) has commented that the final settlement "brought widespread cheer to those who hope to make transnational corporations accountable for their perpetration of and complicity in human rights abuses." (p.14) As Chambers (2005) points out, the *Unocal* litigation had proceeded "further than any other case brought under the ATCA." (p.14) Another company implicated in Burma, Total, the French oil corporation, also settled in 2005 for 5.2 million Euros. What was interesting about the *Unocal* case was the holding by the 9th District Circuit Court of Appeals that reversed the lower court's decision in finding that there were genuine issues of material fact that concerning Unocal's complicity in rape and murder by the Burmese government. (*Doe v. Unocal Corp.*, 395f3d 932 (9th cir. 2002). This case and the Exxon Mobil case in Aceh, Indonesia prompted considerable response by the business community.

Alien Tort Claims Act and the Business Community

The court decision in the apartheid cases discussed earlier by Judge John Sprizzo emphasized considerable caution in "permitting suits here based upon a corporation's doing business in counties with less than stellar human rights records." (Birchall 2005) and seemed to signal that the Alien Tort Claims Act did not represent a significant issue for U.S. companies doing business abroad. The *Unocal* decision, however, suggested that companies were, indeed, vulnerable to litigation brought under the act. One of the lawyers in the case was cited as stating, "You companies are capable of knowing right from wrong and what we are telling you is that if you put yourselves on the side of wrong, then there is some room under this statute for you to get sued." (Birchall 2005)

Similarly, Taylor and Ruge (2005) have commented that companies "must be prepared to answer critical questions about whether their operations are in accordance with international law." (p.1) A more emotional response was provided by Niles (2002) who asked, "What might happen if U.S. courts increasingly assert jurisdiction over such cases?" (p.1) and "Unless Americans are prepared to accept these risks, as well as the accompanying danger that the U.S. judicial system will become the world's civil court of first resort, the U.S. government needs to act now to curb misuse of the Alien Tort Claims Act." (p.1) Bauer (2006) cites Phil Rudolph of the Ethical Leadership Group and former international general counsel for McDonald's as stating that, "Frankly, the greatest risk to companies facing ATCA is reputational" and "in the court of public opinion, *Unocal* suffered mightily." (p.13)

Shrage (2003) suggests that the Alien Tort Claims Act is "just the beginning" and that now "any meaningful defense of (ATCA) Claims will require a company to show that it has made a good faith effort to closely examine local practices and ensure that they meet international human rights standards." (p.17) As he says, "claiming ignorance of relationships with business partners "will not be credible." (p.17) A similar warning came in Britain from Herman (2006) who described "a growing threat of being sued in the U.S. over (their) dealings with foreign governments accused of human rights violations" (p.1) and cites Roe Lindsay, a partner at Clifford Chance as claiming the ATCA is having a detrimental impact on foreign investment by U.K. companies and John Trenor, a partner in a British law firm, as suggesting that "litigation in U.S. courts under the Alien Tort Claims Act seeking to hold companies liable for alleged international law violations at the hands of government or others can present a serious threat to U.K. and other companies doing business round the world." (p.2) Collingsworth (2004) referring to corporate social responsibility as "a charade" comments that many "leading" business organizations (including some who were signatory to the U.N. global compact) filed a brief in *Sosa v. Alvarez-Machain* urging the Supreme Court to nullify the ATCA. He notes that their brief asserts, "(ATCA) lawsuits harm the economy by putting companies with a U.S. presence at a unique and unfair competitive disadvantage (p.1). Collingsworth tellingly makes the point that codes of conduct by these major corporations and their claimed support for various international initiatives like the global compact constitute "simply public relations misrepresentations" (p.2) when viewed in the light of their opposition to the ATCA.

Amicus briefs filed by the U.S. government in conjunction with briefs by these corporations in *Doe v. Unocal* and *Roe v. Unocal* made similar claims. Not only did the U.S. government intervene in the *Unocal* case, but it also intervened in the suit against Exxon Mobil Corporation for alleged complicity in human rights violations in Indonesia. The U.S. government's position not only raised arguments concerning business interests but argued that the Indonesian government would view judicial scrutiny of the company's conduct as a referendum on the human rights record of the Indonesian armed forces which would dissuade it from cooperating with the U.S. on counter terrorism." (*Human Rights Watch,* 2002) The U.S. Chamber of Commerce has referred to the ATCA as "litigation run amok" in an article that claimed, "Your company could be sued—by foreigners in U.S. courts—if you simply did business in, paid taxes in and complied with the laws of a foreign country in which those foreigners alleged an atrocity occurred." (Bruno 2003, p.6)

What seems clear is that the proliferation of suits brought under the Alien Tort Claims Act has raised issues of corporate responsibility for human rights violations that have redefined these global responsibilities and perhaps represented corporate responsibility in a way that has shifted the debate from voluntary codes of conduct to emerging international law. This shift in the debate is evaluated in the concluding section of this paper.

Conclusions – The Shifting Debate on Corporate Social Responsibility

The issue of corporate social responsibility which continues to evolve through avenues involving voluntary norms, standards and initiatives as well as through mechanisms that have implications for customary international law has remained somewhat ambiguous. Critics have charged that it represents little more than astute corporate public relations. Supporters of the concept point to cases like the Gap Corporation where there have been significant changes such as the acceptance of independent auditing of labour practices.

From a corporate perspective, however, the key issue seems to be one of regulation. While many corporations were willing to be associated with the U.N. global compact, there has been considerably more antagonism to the Norms for Transnational Corporations which are viewed as more of a threat as they incorporate supply chain responsibility that, as Oldenziel (2005) points out, goes far beyond the weak phrasing of the OECD guidelines. In addition, there are external and internal monitoring processes.

However, the U.N. norms are, "not a treaty which states ratify and lead to binding legal obligations and certainly not international law." (Oldenziel 2005, p.19) Nevertheless, the norms may in the future evolve into having some legal effect. Indeed some applications of the norms have already been made (for example, to the Alcan Corporation in Brazil, the Union Carbide Corporation, and the Placer Dome in the Philippines (ESCR 2005). Even the implication of possible international legal obligations has prompted considerable criticism by organizations like the International Chamber of Commerce. None of these voluntary norms or even norms which have the possibility of becoming established via U.N. tribunals as possible precedents has attracted the degree of opposition by transnational corporations that recent cases brought under the Alien Tort Claims Act has attracted.

What is interesting about the Alien Tort Claims Act is by reference to the "Law of Nations" and by U.S. Supreme Court Decisions regarding issues like torture, it is being embedded in and has the force of international law premised on the idea of complicity. The cases brought against transnational corporations so far have focused on "the obligation of corporate actors not to assist others in the commission of human rights abuses." (Manzella p.1) As Manzella (2006) points out, "Anyone that knowingly provides practical assistance, encouragement or moral support that has a substantial effect on the perpetration of a human rights abuse violates international law" (p.1), a principle applied at the Nuremburg Tribunals and also at International Criminal Tribunals in Yugoslavia and Rwanda (Manzella 2005). This principle has the same basis as decisions regarding ATCA cases.

The recent Earth Rights Report (Manzella 2005) identifies the issue of direct complicity that emerged with the Nuremburg Tribunals' findings that corporations were liable for expropriation and labour violations during the Nazi regime (e.g. I.G. Farber and Krupp). These standards of complicity are noted in the U.N. norms, but have also been applied directly under prosecutions brought under the ATCA. Under U.S. law, corporations are "persons" and thus can be treated as complicit in the same way as individuals. The recent case of *Presbyterian Church of Sudan v. Talisman Energy, Inc.* (374F.Supp. 2nd 231, 337-41) established that "there is no disagreement that the notion of aiding and abetting liability in international law is a core principle that forms the foundations of customary international legal norms." (Manzella 2005, p. 11)

The U.S. Supreme Court has both adopted this principle of international law and contributed to its development through its recent decisions in cases brought under the ATCA. The *Sosa* case established that federal courts could hear such cases despite a campaign of opposition from the business community. As Apple (2004) points out, the *Sosa* case rejected the business lobby position that corporations should not be held liable under the ATCA and the Bush Administration position that the ATCA should not be applied by the courts (Apple 2004). The recent *Unocal* case reiterated the question of whether corporations can be complicit in acts violating human rights committed by business partners. The 9th District Court of Appeals held that they had such accountability, and as Apple (2004) suggests, "By addressing the question of corporate complicity in human rights abuses, the courts have taken on one of globalization's biggest problems: Multinational corporations have achieved unprecedented international power without corresponding global accountability." (Apple 2004, p.19) Despite many cases brought under ATCA being dismissed largely because they were not achievable under the law of nations or on procedural grounds, a number of cases have been settled out of court because of the likelihood of their being successful, including *Unocal*.

Given that the ATCA is the only U.S. legislation with a specific civil (tort) statute that permits foreign claimants "to seek civil redress from companies for breaches of international criminal and humanitarian law" (FAFO 2006) these decisions are critical to the development of accountability internationally for violations of human rights by corporations.

As Ellis (2005) has stated, "Corporations are looking more closely at the issue of corporate responsibility. They are beginning to see that business and human rights are not, as conventional wisdom has suggested, distinct and separate." (p.5) Baker (2006) cites the comment by John Ruggie, Special Representative on Human Rights and Transnational Corporations, that the most explicit definition of complicity (in human rights abuses) was that provided under the *Unocal* case. The criteria for complicity established in this were:

1. giving practical assistance to the actual perpetrator of a crime,

2. the requirement that such assistance had a substantial effect on the commission of the criminal act; and
3. the company knew or should have known that its acts would result in a possible crime even if it did not intend for the crime to take place.

This obviously has been of great concern to some businesses with organizations like the International Chamber of Commerce calling the jurisdiction under ATCA "unacceptable" (Bruno 2003). However, as Ruggie (2005) has pointed out, "the raw statistics favour the companies." As at the end of 2005, twenty-one cases have been dismissed under ATCA, sixteen are ongoing, and only three have been settled. He suggests that ATCA's power has been "mainly existential" but that "the mere fact of providing a remedy for certain human rights abuses companies may have committed abroad has made a difference to corporate human rights practices." (p.3)

Collingsworth (2002) considers that as litigation of international law issues under ATCA becomes more common, links between violators and defendants will become "an extremely valuable part of the enforcement process." (p.10) Howen (2005) has made the point that, "We need global rules because most large corporations have overgrown the ability of many individual states to regulate them effectively." (p.5) Slaughter's (2001) conclusions are that, "Beyond their significance for individual litigants, these suits are also part of an important trend in international law. Increasingly, national courts are becoming involved in global issues. At the same time, states are creating new international tribunals and granting new power to established international courts. The result is an increasingly complex transnational justice system, in which international, national and regional courts interact and overlap. Management of this complex system to defend fundamental values will be one of the great challenges ahead." (p.4)

The recent decisions under ATCA prompt the question of whether the way forward in the globalization of business and human rights lies in the role of social norms or by legal compliance. Howen (2005) argues that there is a need for binding human rights rules related to corporate accountability but that "what divides some companies from many human rights advocates is whether human rights should be a matter of obligation or voluntarianism." (p.9) Certainly, there has been enormous opposition by some corporations to the development of legislation that acknowledges the liability that corporations have for complicity in human rights violations committed by governments or other actors with whom they choose to do business. There also has been considerable debate as to whether progress in this area will be effective via voluntary processes or by forcible legal compliance resulting from litigation. ATCA has been criticized by some constituencies. On the other hand, as Richard Hermer, a barrister at Doughty Street Chambers in London has commented, "It is entirely right and appropriate that those companies that involve themselves in disreputable practices are held to account, if necessary, through the courts. Adopting socially responsible policies should be a priority for business, not least because it is in their own self interest." (Herman 2006, p.2)

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Personal Ethics in a Corporate World

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Abstract

This paper addresses the relationship between personal morality and ethical corporate behaviour. The main issue addressed here is the positing of the concept of moral intelligence – the relationship of personal moral stance and corporate behaviour. Just as there is intellectual competence (IQ) and emotional intelligence (EIQ), so too there is moral intelligence. This paper outlines the theoretical and practical basis for the case. Mention is made of confounding issues, such as the stability of moral intelligence, the way in which situational context may over-ride it, and how it might be identified in a manner that is economical, reliable, and valid. It is argued that the development of the concept, and a test, has substantial commercial benefits.

Keywords

Personal morality, ethical corporate behaviour, emotional intelligence, moral intelligence

Introduction

This conceptual paper is designed to assess the value of moral intelligence to business. In so doing it considers the issue of the selection of board members, managers, and employees. It is argued that the selection, and the training, for moral intelligence has consequences for both the long-term profitability, and the overall reputation for commercial dealings. Additionally, such a trend should result in an improvement of the overall quality of life. Thus, the aim of the study is to determine the components of moral intelligence. It addresses the relationship between personal morality and ethical corporate behaviour. The main issue here is to map the concept of moral intelligence.

Morality is about the beliefs and values that guide people in their decisions. Ethics is about the decision-making, and based upon an expressed code of values and of conduct. The main question here is the identification of any personal qualities that contribute to the relationship of personal moral stance and corporate behaviour. Just as there is intellectual competence (IQ) and emotional intelligence (EIQ), so too there might be a moral intelligence (or moral intelligence quotient - MIQ).

Here there is an important distinction to be made. Emotional intelligence is to do with sensitivity to the wishes and feelings of others: moral intelligence is similar but with the vital distinction of moral intelligence having human values as a reference point. One might say that a salesperson should have emotional intelligence: indeed, without it the insensitivity would diminish the chances of a sale, and a career. Moral intelligence detects wishes and feelings, but makes judgements in terms of conforming to agreed values rather than on mere understanding, or of satisfying a need.

Here the issue is to map the concept of moral intelligence, and the suggestion that a test of an internalised quality of moral commitment and behaviour is worthy of development. Any investigations must accommodate the relationship between personality, ethical experience and demographic information. Having established the validity of the concept of moral intelligence the ensuing task is clearly that of developing a valid and reliable measure.

The Overall Importance of the Proposal

There is increasing agreement that ethics in business is influenced by many factors: individual, economic, social and cultural operating both within and outside an organization (Logsdon and Corzine, 1999). The focus of the proposed study is limited to the question of what are the individual personal characteristics of those who are ethical and those who are not and how might they be readily and economically identified. A further requirement of this overall concept is that any test developed should be linked to identifiable behavioural markers and not be restricted to attitudinal items.

Background

It is to be noted that a search of the literature using ABI/Inform, Ebsohost, PsycINFO, and *SocioFile* failed to yield reference to any such test. A reading of the *Mental Measurements Yearbook* (2005), similarly, yielded no such test. A perusal of the catalogs of the major suppliers of psychological tests (eg. *ACER*, *Savile Holdsworth*, *The Psychological Corporation*, etc.) did not yield any tests. There are some tests that have sub-scales of honesty, and the like but no direct and complete test. Further, such subscales as are available are attitudinal ones, and that may not necessarily relates to what respondents have actually done, or might do.

One could readily imagine someone being honest with family and friends, and much less so in business. This is recognised as a complex issue. In noting that the point needs to be made that moral intelligence is most probably as normally distributed as are other characteristics, such as cognitive intelligence, emotional intelligence, and extraversion. Any test developed here would be an indicator of that level, much as one measures other personal qualities. The notion that moral responses are situationally determined has been canvassed widely by Zimbardo (2007). His classic Stanford Prison Experiment showed that ordinary decent people would, in the right (wrong) circumstances, behave brutally. His work with the guards from *Abu Ghraib* prison affirmed that notion. Here the basic question concerns human moral malleability, and how sensitive it is to situation. That point is addressed further below.

As the moral stance of a leader is a critical variable it is surprising to see so few studies which examine that aspect. One of the few published studies was conducted by Logsdon & Corzine (1999). Their proposition number five held that a CEO's stage of moral development (in the Kohlbergian sense) is related to the organisation's ethical culture: CEOs whose ethical reasoning is more utilitarian are more likely to form and maintain negative ethical climates.

There are other ways of approaching this problem. One is that of looking at meta-studies, which are rarer: one might also look at selectors using clinical versus actuarial judgements. Litwack (2001) argued that, at this stage, there is no case to be made for replacing clinical judgements with actuarial ones. And yet another approach is looking at actuarial risk.

Of the various studies that could help illuminate the concept are ones that utilise data on prisoners incarcerated for offences that are clearly breaches of trust, as well as breaches of law. A second example is that of using a standard personality test that contains many items to see if a personality profile emerges that characterises the employees of high reputation organisations compared to organisations that have a reputation for marginal ethical behaviour. A third test could be that of conducting such a standard test on those who have been whistleblowers, and whose actions were clearly motivated by moral concern.

Research considerations

Much of the research into ethics in business and society has focused on theoretical developments that attempt to explain the relationships between ethics and organizational attributes. For example, Armstrong, Sweeney *et al,* 1999), examined the relationships between ethical theories and the four dimensions of organizational climate that Victor and Cullen (2001) used to describe organizations. The study related behaviours that corresponded to the three theories with Kohlberg's (1969: 1976) theory of moral development.

Other studies, such as that of the substantial study by Trevino *et al* (1998) are essentially normative studies. That approach is an attempt to tease out the influence of such variables as organisational commitment, and deal with such concepts as organisational climate. It differs from the present analysis in that the Trevino *et al* study is normative, and reports empirical data: this present paper is individually based, and is conceptual rather than empirical.

In the early history of the mental testing movement there was a perceived need to make a quick and reliable assessment of cognitive ability. It was from that beginning that the concept of IQ was developed. The notion of testing for cognitive ability has thus been around for well over a century, and remained one of the best regarded and highly used personal capacity measurements. Apart from personality testing emotional capacity received a very low level of attention until the publication on the concept of emotional intelligence by Goleman in (2001). The concept is now referred to as the 'Emotional intelligence quotient' (EIQ). The idea that intelligence might have a number of components and a number of sub-categories received early attention from those as notable as Sir Francis Galton, to more recent commentators such as Sternberg (1995).

One of the consequences of this present idea is that of drawing of attention to forms of intelligence other than the strictly cognitive. It is noted that cognitive testing, now supplemented by testing for emotional intelligence, might have yet a third kind added, a moral intelligence representing personal qualities that contribute to the relationship of personal moral stance with their corporate behaviour. The issues that must be addressed are what are the components of this construct and how should it be measured?

Studies have shown that ethical decision making is related to perceived risk and locus of control (Cherry 1997); interpersonal competitiveness, locus of control, religious beliefs, age, gender, and competitiveness all relate to stated ethical decisions on insider-trading (Terpstra *et al*, 1993). Self monitoring is closely related to values, cognitive variables; and problems in using the Employment Inventory (in relation to workplace fraud) (Mikulay & Goffin, 1998).

There is doubtful value of using the Employment Inventory alone, and probably better value in measuring `conscientiousness' (Murphy & Lee 1994). Social conscientiousness (Collins & Schmidt 1993); and socialised control (Woolley & Hakstian 1992) are relevant, as is the connection between honesty and other personality variables, as measured by the California Personality Inventory (CPI) and the Multidimensional Personality Questionnaire (Lilienfeld, Andrews, Stone & Stone (1994); emotional stability (Logan, Koettel & Moore 1986). There was reference to a test in Baehr *et al* (1993). That reference mentioned a business ethics scale consisting of 20 items. It is a proprietary test and is attitudinal rather than behavioural.

The Kohlberg notion of the stages of moral development noted that the early moral view of the world by a child is something akin to psychopathy: they seem unable to conceive that others might have legitimate although divergent views of core relationships, and that sensitivity to the feelings of others is a prerequisite to social life, and that being a short-run social hedonist is not the moral way. Although we have nominated extremes here it is worth noting that, like most human qualities, it is distributed normally, following the Gaussian curve.

Clinical evidence does suggest that the capacity to be internally ethically dictated is a quality that is normally distributed – that individuals have it in varying degrees. That is to say, there are some whose moral stature is strong enough to withstand improper external pressures; and there are those whose actions are externally dictated. This Gaussian distribution is the quality that this proposal suggests as worthy of investigation.

In this respect a number of variables have been identified from the literature in a series of minor studies: among such concepts are attitudes to time; a sense of distrust about basic human natures; generosity of spirit; familial sense; sensitivity to stress; attitude to risk; social desirability, and collectivist versus individualistic outlook. A person's level of ethical behaviour relates to interpersonal competitiveness. Locus of control, religious beliefs, age, and gender are all related (Terpstra *et al*, 1993).

Approaches

There are various ways of approaching the issue of identifying moral sense. Such approaches may be characterised as falling along a continuum. At one end is that of social biology – that our genes carry the imprint of evolution, and express and foster those strategies that have had survival value. Following along those lines is the neurological approach. There is a concept labelled psychopathy (also called sociopathy) (as set out in the *American Psychiatric Association* manual (DSM IV)). Here the defining characteristics are those of being guiltless, loveless, and amoral. The hypothesised underlying cause is that of neurological immaturity. Just as small children behave immaturely so we expect them to grow out of it. Adult psychopaths may be grown in other respects but have failed to develop the later stages of sensitivity, as given in the Kohlberg analysis.

This manifestation of amoral behaviour finds formal expression in criminal courts, and in the appellation 'White collar crime'. For example, Blickle *et al* (2006) conducted a study on 150 German managers and 76 white collar criminals who formerly held such positions. The scales used were hedonism, conscientiousness, narcissism, social desirability, and behavioural control. They found that a logistic regression analysis accounted for 69% of the inter-group variance. Business white collar crime is predicted by gender (males being more likely to commit), low behavioural self-control, high hedonism, high narcissism, and high conscientiousness – after controlling for social desirability. The conclusion that high conscientiousness predicts white-collar crime seems to be at odds with the expected conceptual frame of reference, a point discussed by the authors. It was concluded that high ranking white-collar crime in business combines low integrity with high conscientiousness.

Another approach is that of using biodata. Such information would include; age, sibling position, marital history, qualifications, work history, illnesses, and hobbies/interests. Here the correlations might give an indication of the variables that operate to determine moral intelligence. This method is one that has been used with some success in determining suitability for certain occupations, but should be used with caution.

Methodological issues

To capture, and reiterate, the notion being put forward here involves four data sets: one on physiological measures (such as reaction time to certain stimuli – delayed and low reactions are characteristic of psychopathy); the second is the use of biodata (such as age, sibling position, work history, etc); the third is that of existing pencil and paper tests of the conventional psychological kind; and the fourth designed to measure the attributes identified by the professional practitioners which may not be captured in the existing tests (eg. judgements from 'thin slices of behaviour'. It will be appreciated that any target test will be one that is both reliable and valid. Further, it must not be too complex, nor too evident in its purpose lest responders' perceptions influence their conduct in the test.

The use of a conceptually simple but complex method of analysis method provides a protection against informed guesswork that might beat such a test. In addition to theses studies one of the aims of the project is to attempt to develop behavioural tests that could be effectively used to identify moral commitment.

Some other methodological issues mar many studies. Those difficulties include tests conducted on undergraduates and then reporting the results as though they had external validity in the business world; a second problem is that of using constellations of subscales on standard tests and reporting on small samples as though the researcher were using the whole validated scale. A third problem is that of not taking domain specificity into account. This besetting problem bedevils many studies.

One of the more enterprising approaches that would be used here is to look at the converse of ethical behaviour, and examine such concepts as psychopathology. The idea of using the converse approach is that of measure involving either reversing a test, or applying a particular test and reversing the norms. What is needed is a validation of that approach.

The majority of the populace are neither psychopaths nor saints, and thus it is important in this field of endeavour that we identify the disposition toward ethical behaviour. There is increasing agreement that ethics in business is influenced by many factors: individual, economic, social and cultural operating both within and outside an organization.

The focus of the proposed study may be limited to the question of what are the individual personal characteristics of those who are ethical and those who are not, and how such persons might they be readily and economically identified. A further requirement is that any test developed should be linked to identifiable behavioural markers and not be restricted to attitudinal items. A search of literature and databases did not yield any detailed analysis or effective tests that would meet this need. The purpose of the proposed study is to fill that gap.

The notion of having to have extensive testing is not essential. Ambady & Rosenthal (1993) have shown that 'thin' slices of behaviour may be quite effective, a point confirmed by Frank & Ekman (1997) (see also Lubinski, 2000: Wehrle *et al,* 2000). The idea that testing should be time consuming and intrusive is a deterrent to the construction of a moral commitment test. Thus it is proposed any test developed be economical of time and resources.

Issues in the development of a discrimination test

It seems most improbable that moral intelligence will be comprised of a single quality. For example, a morally intelligent person would not only have firm standards, but would also believe them to be important; further, such a person would also have a strong internal locus of control, and thus be able to resist contextual pressures that would lead them to betray their principles.

Examples of previous studies on this point are to be found in one theoretical model which considered several hypothesised relations relative to the major independent variables of risk and locus of control; and the dependent variables of choice of moral rationale, ethical judgments, and behavioural intentions. As mentioned earlier, Cherry (1997) concluded that locus of control is the best available measure of moral autonomy; and increased risk perception led to stronger endorsement of the deontological position. Baer *et al* (1993) administered a business ethics scale and a test of locus of control. They found the largest correlations between the internal locus of control measure and a measure of emotional health in the test battery.

A veiled purpose test made for better predictions than did one calling for direct admission of misdeeds (Murphy & Lee, 1994). Those authors also found that `conscientiousness' is the best single predictor of scores on measures of integrity. The point here is that tests of ethical disposition need to have low face validity as otherwise they could be readily completed in an evasive fashion. The comparison of overt and personality based integrity tests was examined by Whitney *et al* (1999). They found that overt integrity tests were perceived as having greater face and predictive validity that were personality based integrity tests. This, of course, is comparing one concept to another rather than comparing a proposed concept to some observable empirical events.

Significance of the proposal

The significance of this project is likely to be the successful implementation of such a means of personal selection which could result in less technical compliance problems, diminish legal transgressions, and save the costs and trouble of contentious breaches. From a theoretical point of view it would greatly enhance our understanding of a major character trait, and make a contribution to theories of individual differences.

Australian national research priorities are relevant to this notion of moral intelligence. One is that of ‘Smart information use’ and ‘Promoting an innovation culture and economy’. The two relevant sections are ‘Breakthrough sciences‘ and ‘Smart information use’. The goal of those sections is oriented toward providing a means of enhancing the quality of Australian business, and of enhancing the quality of life in general.

One bonus benefit of the development of a means of measuring moral intelligence is the reduction of workplace stress in that a more morally oriented workforce would provide both stability and quality of human relationships. Here one of the resultant issues is ‘Should the immoral be unemployed?’ In the short term it does mean that they will be less readily employable: in the longer term it should have the effect of lifting standards.

The concept proposed here is significant because of growing public concern about massive corporate collapses such as *Enron* and *HIH*, reportedly due in no small part to unethical behaviour, and the importance of sound leadership to the future wellbeing of both business and society. The most recent example of corporate collapse is that of *Opes Prime*, one of the smaller Melbourne stockbroking firms. The discovery of ‘irregularities’, the banks holding of collateral shares as security, and the selling of shares in order to meet margin calls are all decisions that must be invested with ethical considerations.

This whole process has ruined a number of people. It is such crises of confidence, and of transparency and goodwill that ethics so clearly deals. Although one may be able to see some elements of corporate formal legal compliance that is clearly not enough. The reputation of Australian business is tarnished by instances of ‘irregularities’, defalcation, and of patent dishonesty. It inflicts not only reputational damage but is also destructive of the trust that is essential to business.

Among the practical reasons for developing such a test are having a ready means of measuring the ethical personality for professional training and for personnel selection in business. It should also help improve ethical performance thereby enhancing the quality of life. At the macro level it is held that the benefits of being able to identify stable intra-personal characteristics will help lift the level of ethical performance in corporate Australia. It should, thereby, result in an enhanced reputation for Australian business practices, and help advance the quality of life.

Theoretical benefits

The conceptual questions addressed in this proposal concern which approach best characterises moral intelligence? How is moral intelligence related to actual behaviour? To what extent is moral intelligence compounded with other concepts, such as locus of control? and how may moral intelligence be brought to bear in commercial situations of trading and personnel deployment.

The theoretical benefits include its contribution as a research tool in other research projects, and raising the level of understanding of the nature of ethics from an individual differences perspective. At the macro level it is held that the benefits of being able to identify stable intra-personal characteristics will help lift the level of ethical performance in corporate Australia. It should, thereby, result in an enhanced reputation for Australian business practices, as well as helping advance the quality of life. The availability of a test for ethical disposition should contribute to the national business agenda by having an objective measure available to aid the promotion and selection of ethical management. It is seen as vitally important that selection is done on Board members, and senior executives, as they set the tone and standards.

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Governance and Performance: Publicly Listed Companies in Malaysia

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Abstract

This paper investigates the relationship between corporate governance practice (as indicated by corporate governance disclosure) and company's financial performance. Certain corporate structures and practices were examined to determine if they have any effect on company's performance. Corporate governance practices were assessed based on the level of disclosure made in the companies' annual reports. For financial performance, stock price performance and return on equity (ROE) were used as proxies. Results show that there is a positive relationship between the corporate governance practices and company performance. Findings from this research could be used by regulators, investors, corporations and others who contend that good corporate governance is important for increasing firm's performance and investor confidence.

Keywords

Corporate governance, company performance.

Introduction

An important lesson learned from the 1997/98 Asian financial crisis was that poor corporate governance could lead to recklessness and excesses, resulting in severe financial difficulties. The crisis significantly changed the financial and economic landscape of the affected countries in the Asian region including Malaysia. To bring about better corporate governance, crisis-hit countries resorted to stricter securities regulations, reforms in company law, stringent accounting practices and auditing standards, tighter bankruptcy law and stronger judicial enforcement.

A substantial literature has documented general links between corporate governance practices and company performance. The literature suggests that both market and non-market mechanisms could be used to promote the alignment of interests of managers and stakeholders. However, the evidence is mixed. Research on the relationship between corporate governance practices and firms' performance has failed to establish a concrete link between the two variables.

Thus, this study seeks to investigate if there is a relationship between corporate governance practices and companies' financial performance.

Literature Review

Corporate governance and firm's performance

Generally, firms with relatively poor governance are relatively less profitable, less valuable and pay out less to their shareholders (Brown and Caylor, 2004).

In contrast, some studies showed that there is a negative relationship between corporate governance practise and firm's performance. The fact that better-governed firms achieve higher valuations does not necessarily imply that governance quality is fully reflected in firm value. In fact, Gompers et al. (2003) show that firms with higher investor rights outperform firms with lower investor rights by 0.71% per month. Drobetz et al. (2004) calculate that the difference in monthly returns is 1.37% for German firms.

These results suggest that corporate governance ratings contain information not entirely impounded in stock prices. However, Bauer et al. (2004) find that governance-based portfolios yield negligible excess returns in the UK and EMU markets, which suggests that any difference in corporate governance might already be reflected in current stock prices.

Selected corporate governance practices and financial performance

Various studies have been done on the relationship between specific corporate governance attributes and firm's performance.

Rechner and Dalton (1991) examined the relation between CEO duality and organizational performance. Their study supports agency theory expectations about inferior shareholder returns from CEO duality. Rechner and Dalton (1989) also examined the effect of CEO duality on risk-adjusted shareholder returns using stock market data for the same sample and period. They found no significant difference between structures.

Donaldson and Davis (1991) examined the effects of CEO duality on shareholder returns, and recorded exactly the opposite result to that of Rechner and Dalton (1991). Their results show that the average ROE of the board with chairs independent of the CEO was 11.5%, less than the average ROE of those companies with CEO duality at 14.8%. The difference was statistically significant, *i.e.*, dual CEO structures outperform independent chair structures.

Byrd and Hickman (1992) report that tender offer bidders with majority-independent boards earn roughly zero stock price returns on average, while bidders without such boards suffer statistically significant losses of 1.8% on average. You et al. (1986) also report a significant negative correlation between proportion of inside directors and bidder stock price returns. This suggests that independent directors may help restrain the tendencies of CEOs to build larger empires, even if this means overpaying to buy another company.

Denis and Sarin (1997) report that firms that substantially increased the proportion of independent directors had above-average stock price returns in the previous year. In a study to assess investor reaction to the appointment of additional directors, Rosenstein and Wyatt (1990) found that stock prices increase by about 0.2% on average, when companies appoint additional outside directors. This increase was statistically significant, but economically small.

Whereas Bhagat and Black (2002) find no relationship between the proportion of independent directors and various indicators of firm performance, Rosenstein and Wyatt (1990) observe a positive market reaction to the appointment of independent directors. Perry and Shivdasani (2005) explain that firms with a majority of outside directors are more likely to restructure following performance declines, and more determined in doing so.

As regards the relationship between ownership concentration and firm performance, empirical results in the USA are inconclusive. Demsetz and Lehn (1985) found no significant correlation between ownership concentration and profit rates for 511 large corporations. Morck et al. (1988) reported a piecewise linear relationship of Tobin's Q with board member ownership for 371 Fortune 500 firms, and also found evidence of an inverted U-shaped relationship between the degree of ownership concentration and profitability.

Stulz (1988) demonstrates that higher managerial ownership can insulate managers from external takeovers, and by allowing managers to block takeover bids, can lower firm value. Using US data, Morck et al. (1988), McConnell and Servaes (1990; 1995), Hermalin and Weisbach (1991), and Holderness et al. (1999) all find firm value to rise with low levels of managerial ownership and to fall with higher levels of managerial ownership.

Several empirical studies in accounting have focused on the voluntary formation of audit committees to identify factors affecting an entity's decision to create an audit committee directly responsible for overseeing the financial reporting process (Pincus et al., 1989). Collectively, these studies suggest that larger companies, who are audited by the Big Five and who have bigger boards with greater representation of outside directors, are among the companies more likely to voluntarily form an audit committee.

Several studies document that the presence of an audit committee is associated with fewer incidences of financial reporting problems. For example, McMullen (1996) finds that entities with more reliable financial reporting, such as those with absence of material errors, irregularities and illegal acts, are significantly more likely to have audit committees.

DeChow et al. (1996) show that firms subject to Securities Exchange Commission, USA (SEC) enforcement actions are less likely to have standing audit committees. More recent descriptive research shows that 25% of the companies subject to SEC enforcement actions do not have audit committees in place (COSO, 1999). Carcello and Neal (1999) find that the likelihood a company in financial distress will receive a going concern modified auditor's report is lower when the percentage of inside or grey directors on the audit committee is higher.

Research Hypotheses

This study is intended to examine the link between corporate governance practice and firm's performance. It should be noted that there are many factors that affect a firm's performance. It is either internally driven or externally controlled. However, in examining the relationship between corporate governance practice and firm's performance, it is assumed that all factors contributing to firm's performance have same level of influence on the selected sample. Thus, the following hypotheses have been developed:

H1: There is a positive relationship between corporate governance practice and stock price performance

This hypothesis was developed on the basis that investors are willing to put in their money in a well governed company; ultimately will boost investors' sentiments of the stock from bearish to bullish.

$H_{2:}$ There is a positive relationship between corporate governance practice and return on equity.

This hypothesis was developed on the basis that a well governed company always try to maximize shareholder's return which would translate into better bottom line as denoted by return on equity.

Research Method

Corporate governance rating

Generally, corporate governance rating is meant to indicate the relative level to which an organization accepts and follows the codes and guidelines of corporate governance practices. In this research, the rating system constructed by MICG-Uitm-RAM and Biz Aid Technologies Sdn Bhd was employed. The reason for this decision was the rating system is customized to local business corporation environment and addresses the governance issues that are relevant to the Malaysian scenario.

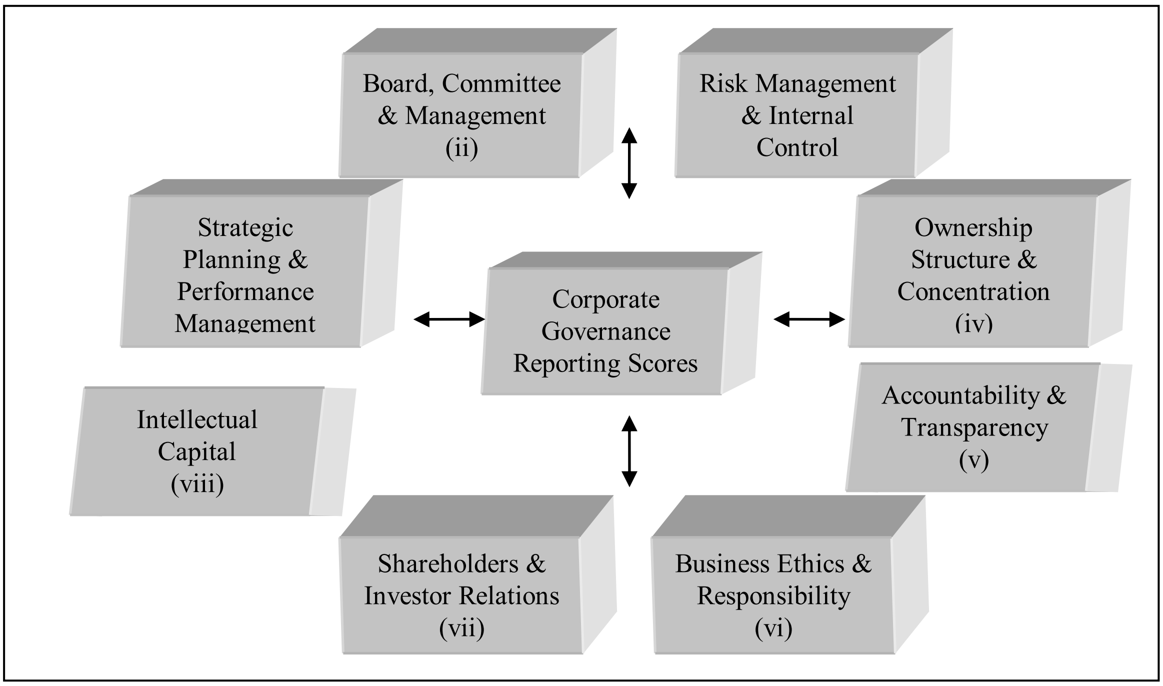
MICG-Uitm-RAM-Biz Aid Technologies Corporate Governance Rating

In developing the corporate governance rating system, the consortium has prepared a Corporate Governance Score Checklist that draws upon the requirement made in Malaysian Code of Corporate Governance, Bursa Malaysia Listing Requirements, The Cadbury Report, the Organisation for Economic Cooperation and Development (OECD) Corporate Governance Principles as well as other prevalent codes, guidelines and research findings.

According to the consortium, the set of corporate governance attributes determined by them does not only representative of Malaysia's corporate reality but also simultaneously emphasis the real life practicability and world-class quality goals. In addition, the proposed corporate governance reporting framework will also be universally applicable to the international markets and acceptable by investment institutions and other relevant bodies.

The figure below depicts the eight principal corporate governance attributes that were used as the Corporate Governance Score Checklist main headings.

Figure 1: Specific Attributes in the Corporate Governance Index



Source: Corporate Governance Reporting of Top 100 Public Listed Companies in Malaysia

The attributes are measured through a 5-point Likert Scale, and the maximum score that could be obtained by each company is 375 points.

The consortium has also assigned weights to each principal attributes based on the relative importance of the attribute. Basically, a higher weighting has been given to those requirements specifically spelt out by Malaysian Code of Corporate Governance. The weighting has been further gauged against other corporate governance studies world wide. Items that are not particularly deliberated by the Code but emphasized in major studies world wide have been assigned slightly lower weighting. A percentage was then computed with 100% being the perfect score.

Below is the detail of the raw score and the weighting applied for each attribute.

Table 1: Raw Score & Weighting of Specific Corporate Governance Attributes

No.	Corporate Governance Attributes	Total Raw	Weighting

		Score	(%)
1.	Strategic Planning & Performance Management	30	5
2.	Board, Committee & Management	85	15
3.	Risk Management & Internal Control	40	15
4.	Ownership Structure & Concentration	35	15
5.	Accountability & Transparency	85	20
6.	Shareholders & Investor Relations	40	15
7.	Business Ethics & Responsibility	30	10
8.	Intellectual Capital	30	5
	Total	375	100

Mathematically, the weighted corporate governance score could be expressed as:

$$TCGSi = \sum RCGS \times w$$

where,

RCGS = ratio of score assigned to each category to total score of each category.

W = weighting assigned for each category in the form of percentage.

Corporate governance disclosure

This research will assess the level of corporate governance disclosure by carefully studying the annual reports of the selected companies. Scores will then be assigned based on the metrics outlined above. This is to measure the level of corporate governance disclosure among the listed companies. Descriptive analysis will be applied to analyse the extent of corporate governance disclosure.

Sample design

The sample companies are drawn from the 100 composite index component companies on Bursa Malaysia. The selection is based on the market capitalization of these companies as at 31 December 2006. The rationale of this selection lies on the fact that these companies make up the composite index, which is the barometer of stock market performance. The companies are also expected to practice a high level of corporate governance disclosure in their annual reports. In addition, these companies are most likely to attract the institutional investors' interest, be it local or international.

Data collection procedure

This research utilizes secondary data, information available in the companies' annual reports. Annual report was chosen due to the fact that it was deemed to be the common communication tool employed by company to disclose relevant information to the shareholders. The level of disclosure made in the annual report is essential to the functioning of corporate governance (Keasey et.al, 1999), enabling management to communicate company's performance and practice to shareholders (Healy and Palepu, 2001).

The Listing Requirements of Bursa Malaysia requires all listed companies to disclose certain information pertaining to corporate governance practice in their annual reports. Hence, this research chose to extract the relevant information from the latest annual reports (2005 and 2006) of the selected companies. The Return on Equity (ROE) and stock prices of the selected companies was obtained from *The Star* online (www.thestar.com my), research reports and annual reports.

Statistical analysis

This research employs the SPSS statistical software for analyzing the data. A descriptive analysis was employed in determining the extent of corporate governance practices disclosure among the selected companies, based on the scores of each corporate governance attribute as well as the total score of the attributes.

In examining the link between corporate governance and firm's performance, correlation analysis was applied.

Table 2: Variables Used For Hypotheses Explanation

Variables	Notation	Definition
Total CG Score (Independent)	TCGS	Conversion of total of each category's score into total raw score
Total weighted CG score	TWCGS	Conversion total of each category's score into total weighted score
Return on equity (Dependent)	ROE	The return of equity of the selected companies as at 31 December, 2006.
Stock Prices	SP	Stock price (2 January to 31 December changes i.e. within one year period of holding)

Where TCGS is total raw score corporate governance score.

Data Analysis and Results

Descriptive analysis

A descriptive analysis was done to describe the level of corporate governance practice of the selected sample. The analysis of total corporate governance scores (raw and weighted) and specific corporate governance attributes are discussed in the ensuing parts.

Overall Disclosure of Corporate Governance Practice

The disclosure level of corporate governance practice is summarized in Table 3.

Table 3: Disclosure Level of Corporate Governance Practice

Measures	Min	Max	Mean	Median
Value (Raw CG Score)	101/375	225/375	172.09	172.50
Percentage (Weighted score)	40.25%	66%	51.15%	52.07%

Figure 2: Raw Corporate Governance Score

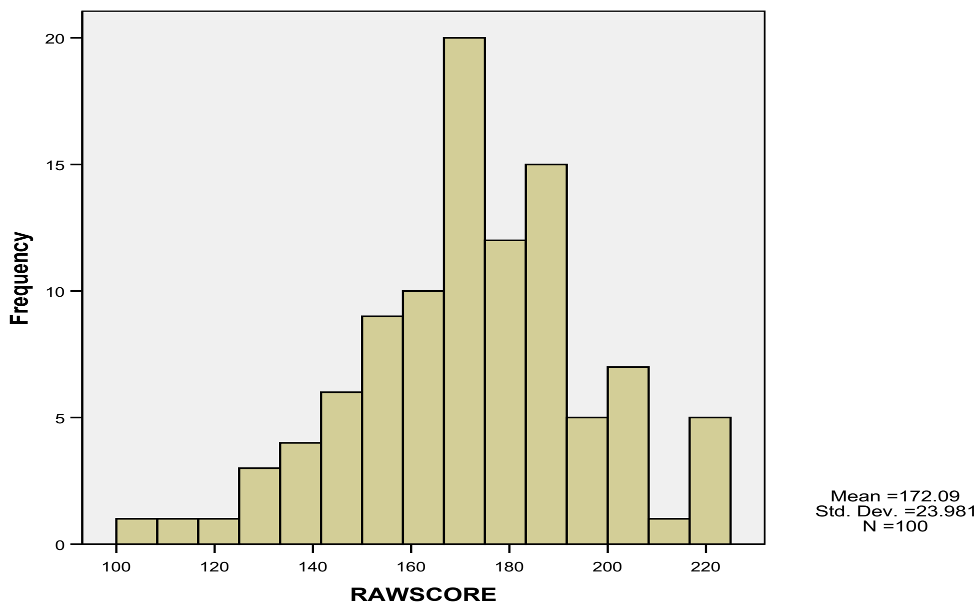
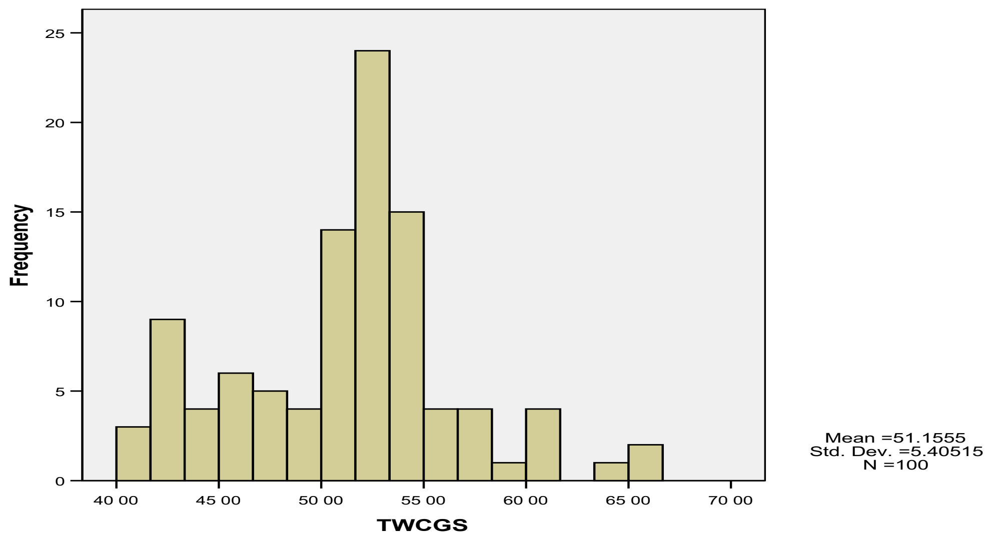


Figure 3: Weighted Corporate Governance Score



Based on Figures 2 and 3 above, it can be concluded that there is not much difference in the level of corporate governance disclosure among the selected companies. In fact, the majority of the companies have about similar scores in terms level of disclosure, which falls within the band of 160 to 180 score and the weighted score of 50 to 55%. This shows companies somehow have developed among themselves an acceptable level of corporate governance disclosure. It was also noted that most companies employed PricewaterhouseCoopers or Ernst & Young as their external auditors, which explains the similar format or corporate governance reporting.

Analysis of specific corporate governance attributes

The followings are the results on the level of disclosure among the specific corporate governance attributes:

Strategic Planning and Performance Management

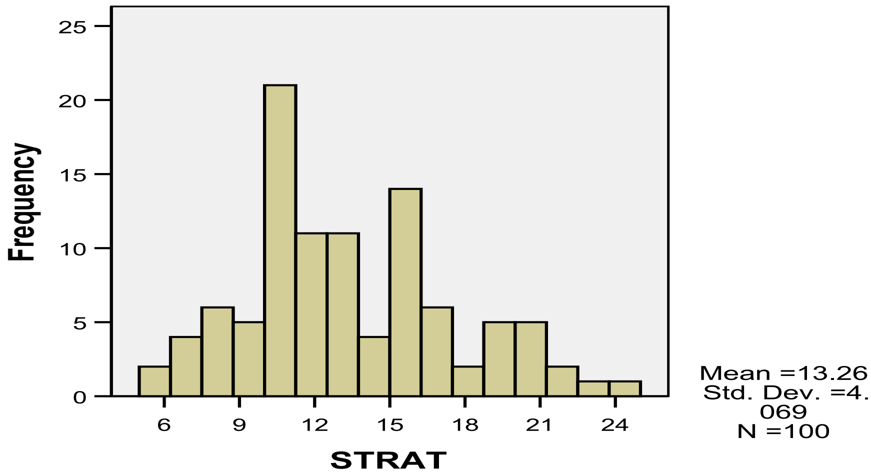
This attribute examines the strategic formulation and implementation of the company's vision, mission and its goals. The measurement criteria of this attribute are specified in Table 4.

Table 4: Measurement Criteria for Strategic Planning and Performance Management Attribute

No.	Measurement Criteria
1.	State the company's vision, mission and organizational goals
2.	Explains on goal congruence
3.	Identify core competencies
4.	Conduct interim review of company's vision and goals
5.	Identifying company's KPI
6.	Distinguish each type of company's business

Score
M n mum: 6/30
Max mum: 24/30
Mean: 13.26
Med an:13
Standard dev at on: 4.06

Figure 4: Disclosure of Strategic Planning and Performance Management



From the above result, it is noticed that many companies did not disclose much information about their strategic planning and performance management. Most companies disclosed their mission and vision only on the surface without much explanation on how to achieve them. Among the companies that made quite an extensive disclosure on their strategic planning and performance management was AMMB Holdings, Public Bank, Maxis and Astro. In terms of business KPIs, most companies tend to disclose only financial ratios, share information and profitability measures. Target forecasts of these indicators were not mentioned, probably the board does not want to be accountable for target goals that could not be achieved.

Board, Committee and Management

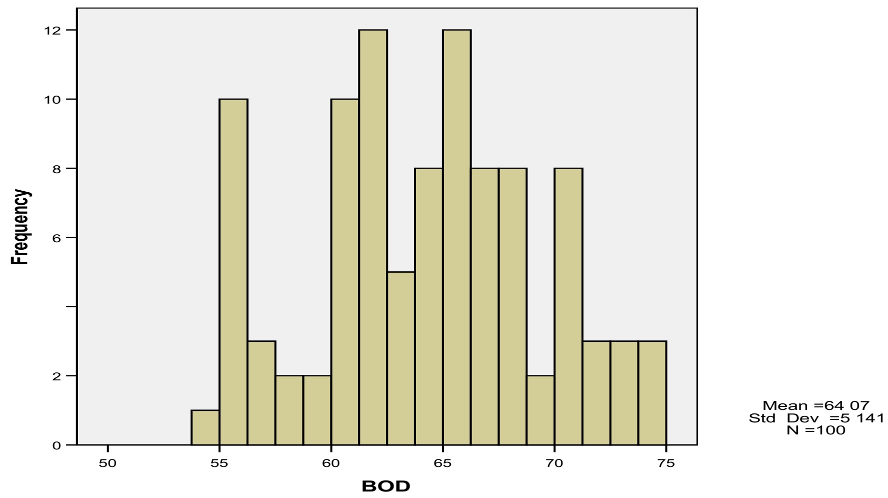
The Board is collectively responsible for the success of the company by directing and supervising its affairs. The board, committee and its management are the governance drivers that must steer the company towards achieving its goals. Table 5 lists out the attribute that measures the effectiveness and efficiency of the Board, Committee and Management.

Table 5: Disclosure of Board, Committee and Management

No.	Measurement Criteria
1.	Disclosure of historical development and significant events taking place within the financial year
2.	Disclosure on major decisions made by the Board, Committee and Management
3.	Disclosure of appointments and re-appointments policies of the Board of Directors and top management
4.	Disclosure on Board size and other pertinent characteristics
5.	Training policies
6.	Disclosure of the Board and management jobs descriptions
7.	Disclosure on the communication policies
8.	Disclosure of significant issues that were raised during AGMs/EGMs
9.	Notes on the various established committees
10.	Evaluation of the Board Members

Score
M n mum: 54/85
Max mum: 75/85
Mean: 64.07
Med an:64
Standard dev at on: 5.14

Figure 5: Disclosure of Board, Committee and Management



Based on the results, it can be noted that on average companies scored between 60-68 points on the disclosure of this attribute. This may be due to the mandatory disclosure required by the Listing Requirements of Bursa Malaysia in this aspect. Hence, there is high level of compliance. Those companies that scored high in this area are also award winners on corporate governance compliance. For example, amongst others, Maybank, IJM , Public Bank, Genting Berhad and Tanjong Plc.

Risk Management and Internal Control

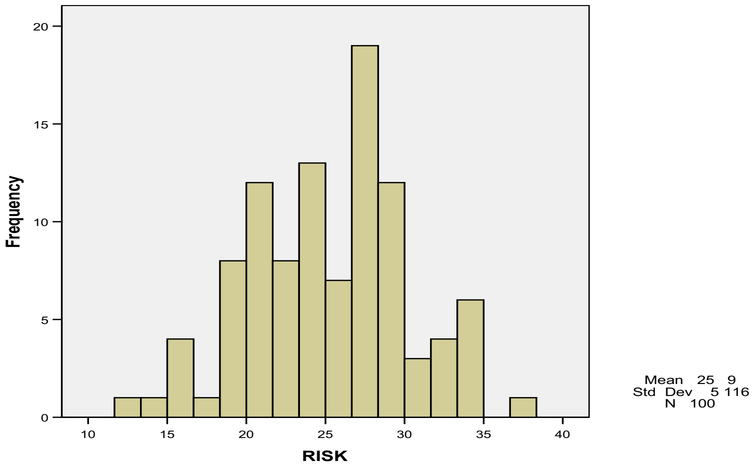
Most codes of corporate governance emphasize the need for a sound system of internal control to be maintained by a company in managing and controlling its principal risks. This attribute measures risk management attitude of the company and steps taken to control and manage the risks. Table 6 explains the measurement criteria for this attribute.

Table 6: Disclosure of Risk Management and Internal Control

No.	Measurement Criteria
1.	Disclosure of risk management framework
2.	Identification of business risks
3.	Disclosure on internal control system and procedures
4.	Disclosure of contingency planning
5.	How the Board inculcate the risk management culture
6.	Audit compliance
7.	Audit adequacy
8.	Internal audit programme

Score
M n mum: 12/40
Max mum: 37/40
Mean: 25.49
Med an:26
Standard dev at on: 5.11

Figure 6: Disclosure of Risk Management and Internal Control



There has been a slight improvement in terms of disclosure of risk management and internal control. Previous studies showed that the level of disclosure in this area is low (less than 50% of the total score). However, in recent years there has been improvement since investors would want companies to disclose their business risks so that an informed decision could be made. This study shows that majority of the selected companies scored more than 50% of the total score (40 points). Nevertheless, there is still a lack of disclosure in areas such as types of contingency planning, internal auditor's findings and review of internal control systems.

Disclosure of Accountability and Transparency

This attribute is central to corporate governance issues and have been dealt extensively by the Malaysian Code of Corporate Governance through three basic principles and at least by six best practices items (MICG, 2004). This attribute looks into the disclosure of information that is pertinent to investors' decision making as well as stakeholders' interests. The measurement criteria are further reflected in Table 7.

Table 7: Disclosure of Accountability and Transparency

No.	Measurement Criteria	Score
1.	Disclosure of external auditor's recommendation	Minimum: 31/85
2.	Calendar of activities	Maximum: 60/85
3.	Disclosure of notes on non-audit fees	Mean: 41.99
4.	Accounting policies	Median:43
5.	Disclosure of interim reviews	Standard deviation: 7.26
6.	Disclosure of industry norm	
7.	Financial forecasts	
8.	Disclosure of regulatory requirements	
9.	Appointment of professional advisor	
10.	Disclosure of key financial ratios	
11.	Segmental reporting	
12.	Directors' remunerations	
13.	Disclosure of risk assessment	

Score

M n mum: 31/85

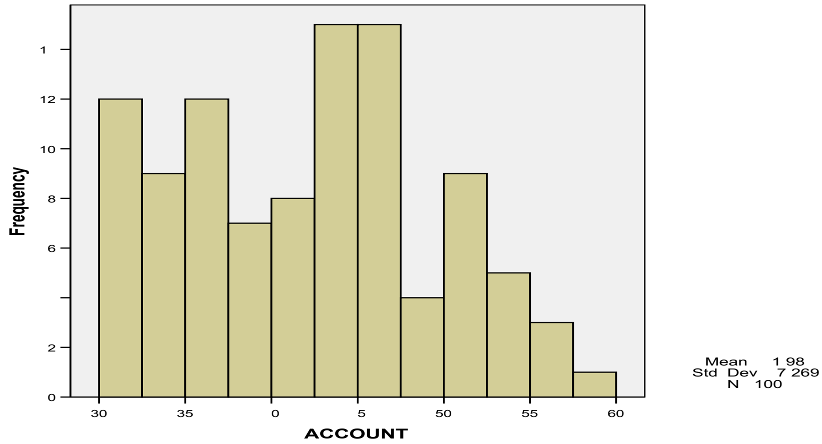
Max mum: 60/85

Mean: 41.99

Med an:43

Standard dev at on: 7.26

Figure 7: Disclosure of Accountability and Transparency



Based on the results, it was noted that most companies on average surpassed the minimum requirements of disclosing this attribute. Majority of the companies tend to disclose the information as per regulatory requirement such as accounting policies adopted and key financial ratios, segmental report and director's remuneration. It was noted that most companies disclosed the salary band of directors rather than which director was paid what amount. In the case where non-audit fees were incurred, there was not much explanation on it except for "paid for consultancy service". There was also lack of disclosure of industry norms and financial forecasts. It could be that management would not want to be tied to the forecast, as there will be a lot of explanation when the forecasts are not met. Overall, there is still room of improvement in this area and it will be more effective if companies are more transparent and accountable in their business dealings.

Disclosure of Ownership Structure and Concentration

The code specifies explicit requirements under this heading, 5 out of the 13 basic principles and 13 of the 33 Best Practices proposed by the Code deal on the issues of board balance and balanced ownership (MICG, 2004).

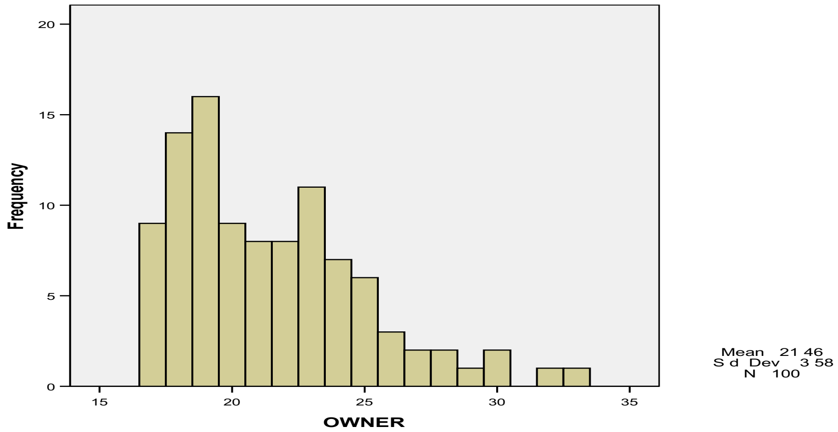
This attribute measures the level of disclosure of directors' and management shareholdings and minority shareholder's participation. The measurement criteria are as in Table 8.

Table 8: Disclosure of Ownership Structure and Concentration

No.	Measurement Criteria
1.	Disclosure of information on major shareholders
2.	Disclosure of shareholdings of the directors and management
3.	Disclosure of minority shareholders' rights and participation
4.	Disclosure of information on nominees shareholdings
5.	Disclosure of share classifications

Score
M n mum: 17/35
Max mum: 33/35
Mean: 21.46
Med an:21
Standard dev at on: 3.58

Figure 8: Disclosure of Ownership Structure and Concentration



The analysis showed that there is a high level of disclosure in this area. The reason could be that companies are required to disclose their largest 30 shareholders and their proportion of shareholdings. Hence, the high level of compliance of corporate governance practices. Not many companies disclosed information on nominee shareholdings as well as minority shareholders' rights and participation.

Disclosure of Information to Shareholders and Investors Relations Functions

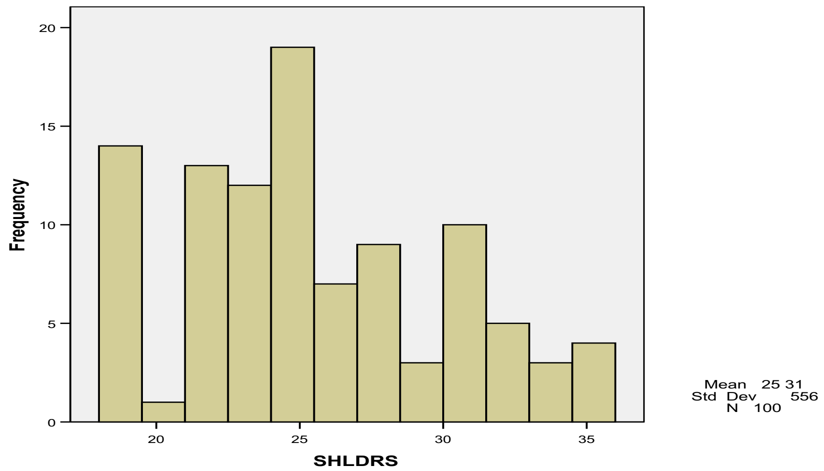
This attribute measures the disclosure of information of shareholders' approval of company's activities, communication platform between board and investors as well as the accessibility to company's information. The measurement criteria are listed in Table 9.

Table 9: Disclosure of Information to Shareholders and Investor Relations Functions

No.	Measurement Criteria
1.	Disclosure of shareholders' approval for major activities, plans and
2.	Communication platform between the companies and their
3.	Disclosure of shareholders' proxies
4.	Accessibility to companies information
5.	Disclosure of dividend policies

Score
Minimum: 18/40
Maximum: 36/40
Mean: 25.00
Median:21
Standard deviation: 3.58

Figure 9: Disclosure of Information to Shareholders and Investor Relations Functions



Based on the figures above, there is a considerable level of disclosures made on shareholder's information and investor relations. Most of the companies scored more than 50% of the assigned total score (40). The reason could be many companies recognized the importance of information need to flow freely and in timely manner so that investors' could make an informed investment decision. Furthermore, most companies realized that to attract foreign institutional investors' participation, high disclosure of information in this area is crucial. Most of the companies have a corporate websites and quite a number of them have a dedicated section on investor relations. Information on company's performance and how to contact them are disclosed in that section. Nevertheless, there seems to be a lack of information on minority shareholders rights and participation in the annual report. This area could be further improved so that a proper check and balance could be placed in the company.

Business Ethics and Board Responsibility

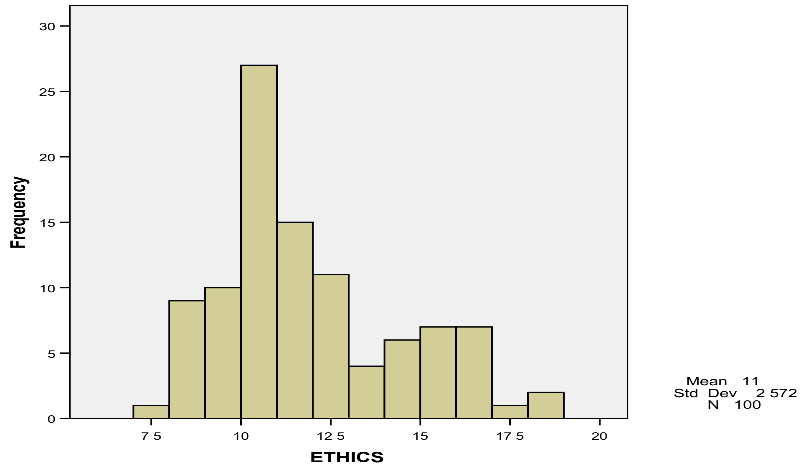
Ideally, a well governed company should have a code of business ethics and conduct which is intended to inform all of its employees of their legal and ethical obligations to the shareholders and stakeholders as well as to promote honest and ethical conduct among the board and employees of the organization. This attributes examines the disclosure of ethical nature of the management and employees as well as the quality related activities of the company. The measurement criteria are listed in Table 10.

Table 10: Disclosure of Business Ethics and Board Responsibility

No.	Measurement Criteria
1.	Disclosure of company code of conduct and business ethics
2.	Disclosure of complaints procedures
3.	Disclosure of the fiduciary duties of the BOD, management and employees
4.	Disclosure of any reprimand issued to the company
5.	Plans for employees' suggestions
6.	Disclosure of disciplinary matters
7.	Value added statement
8.	Quality related policies

Score
M n mum: 8/30
Max mum: 19/30
Mean: 11.45
Med an:11
Standard dev at on: 2.57

Figure 10: Disclosure of Business Ethics and Board Responsibility



Based on the above, it can be concluded that there is a low level of disclosure in this area. Most companies only reported the existence of the code of business ethics in their organization but did not provide much information on how the code is practiced and upheld. As far as disclosure of quality information, many companies, especially Maybank, IJM, Genting, Tanjong Plc and Public Bank, just disclosed the quality awards that they have received from various notable organizations.

Intellectual capital

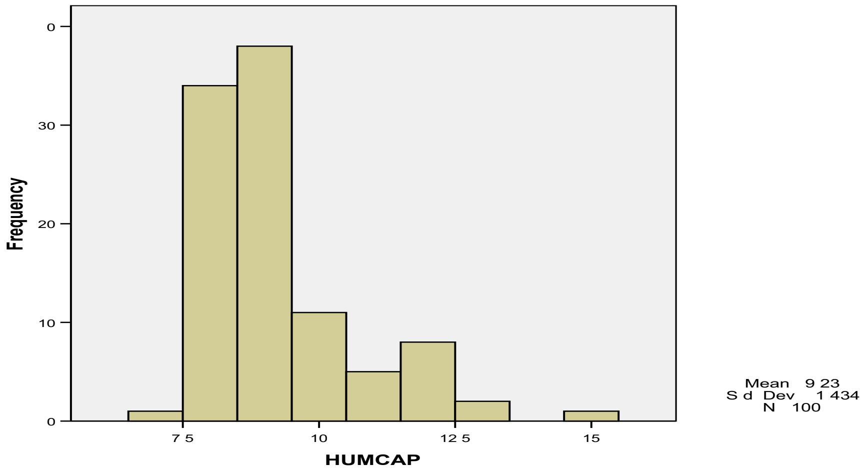
Human capital plays an important role in corporate governance practice (Castanias and Helfat, 2001) and the board must recognize that this capital needs to be protected and upgraded just as tangible assets are. Therefore, it is appropriate to examine the disclosure level of this attribute in order to determine how the companies govern this intangible asset. The measurement criteria for this attribute are specified in Table 11.

Table 11: Disclosure of Intellectual Capital Management

No.	Measurement Criteria
1.	Disclosure of company's training policies
2.	Disclosure of knowledge management system
3.	Disclosure of staff welfare
4.	Disclosure of medical benefits and scholarship
5.	Promotion policies
6.	Disclosure of health and safety measure
7.	Efforts in enhancing intellectual capital efficiency

Score
M n mum: 7/30
Max mum: 15/30
Mean: 9.23
Med an:9
Standard dev at on: 1.43

Figure 11: Disclosure of Intellectual Capital Management



From the above, it can be concluded that most companies did not place importance in disclosing management of human capital. This is evident in the low score in this area. A majority of the companies reported their training policies to enhance employees' capabilities and skills as well as health and safety measures. Knowledge management system was not evident in the reporting as well as efforts in enhancing intellectual capital efficiency.

Summary of Analysis

In brief, the analysis has revealed that most companies tend to disclose information that is required by the Code or the Listing Requirements of Bursa Malaysia. This could be seen in the high scores obtained in the area of mandatory disclosure. This is evident where the attributes such as disclosure of board, committee and management, risk management and internal control, accountability and transparency, ownership structure and concentration and information to shareholders have 50% or higher in the raw score. Thus it can be said that most companies are not willing to disclose more than what is legally necessary.

Corporate governance and financial performance

In order to answer the question, "Is there a relationship between corporate governance practice and firm's performance", statistical test in the form of Pearson's correlation analysis was performed.

A correlation analysis was performed to determine the relationship between the total raw score of corporate governance practices and firm's performance (return on equity), and stock prices performance. The result is presented in Tables 12 and 13 respectively.

Table 12: Correlation analysis between Total Raw Score and Stock Prices Performance

		RAWSCORE	SP
RAWSCORE	Pearson Correlation	1	-.151
	Sig. (2-tailed)		.133
	N	100	100
SP	Pearson Correlation	-.151	1
	Sig. (2-tailed)	.133	
	N	100	100

The result shows that there is minimal or nearly inexistence negative relationship between corporate governance practices and firm's performance (stock prices). The relationship is also insignificant (p-value: .133 >.05). This could be due to the fact that market is always efficient; hence all information has been fully absorbed by the stock prices. Thus, high level of corporate governance practices has little impact on share prices.

This finding is in concurrence with Bernard and Thomas (1990) that stated investors do not fully exploit the information in current earnings to infer future earnings changes. Thomson and Chu (2002) supports the findings that a negative correlation between firm's performance and corporate governance implies that badly governed companies report less conservative earnings. Furthermore, there are a lot of other factors such as economic, political and market that influence stock performance.

Realising that stock price performance is a weak financial performance indicator, this study employs return on equity as the dependent variable to test the relationship with corporate governance practices. The result is shown below:

Table 13: Correlation between Total CG Score and Return on Equity

		RAWSCOR	ROE
RAWSCOR	Pearson Correlation	1	.162
	Sig. (2-tailed)		.108
	N	100	100
ROE	Pearson Correlation	.162	1
	Sig. (2-tailed)	.108	
	N	100	100

The result shows that there is a positive relationship between corporate governance practices and firm's performance (return on equity). The relationship has low significance (p value.162 >.05). This shows that high level of corporate governance practices has little impact on firm's performance (return on equity).

A correlation analysis was also performed on the total weighted corporate governance score (TWCGS) and ROE in Table 14.

Table 14: Correlations between TWCGS and Return on Equity

		ROE	TWCGS
ROE	Pearson Correlation	1	.219(*)
	Sig. (2-tailed)		.029
	N	100	100
TWCGS	Pearson Correlation	.219(*)	1
	Sig. (2-tailed)	.029	
	N	100	100

* Correlation is significant at the 0.05 level (2-tailed).

The result shows that there is a positive and significant relationship (p value-0.029 < 0.05) between return on equity and total weighted corporate governance score (TWCGS). The reason could be that high weighting on the disclosure on the following attributes has given a positive impact on the financial performance (ROE).

Table 15 : Impact on the following attributes on the analysis

Attributes	Weighting
Board, Committee & Management	15
Risk Management & Internal Control	15
Ownership Structure & Concentration	15
Accountability & Transparency	20
Shareholders & Investor Relations	15

The above results for total raw score and weighted score are consistent with Deutsche Bank's research which also showed that there was a positive relationship between the historic governance assessment of the companies and their profitability (ROE) (Deutche Bank, 2005).

Conclusions

This study aimed to investigate the relationship between corporate governance practices (as indicated by corporate governance disclosures) and company's financial performance. Certain corporate structures and practices were examined to determine if they have any effect on company's performance. The corporate governance practices were assessed based on the level of disclosure made in the companies' annual reports. For financial performance, stock price performance and return on equity (ROE) were used as the proxies. The results show a similar pattern emerging in terms of corporate governance disclosure. This could be that majority of the companies have developed an acceptable level of corporate governance disclosure. It also indicates that perhaps most companies have a common format in terms of reporting their corporate governance practices.

The correlation between corporate governance practice and firm's performance as measured by stock prices showed that there is an insignificant negative correlation between the two variables. However, the correlation between corporate governance practice and firm's performance as measured by return on equity showed that there is significant positive correlation between the two variables.

There are two major limitations in this study. The application of the corporate governance index and the assessment of corporate governance ratings are very subjective and open to individual bias. Furthermore, the corporate governance ratings are based on the relevant information in the annual reports, hence the assessment of the corporate governance practices based on what is disclosed. The usage of performance indicators such as financial indicators or return on equity may not be appropriate. Moreover, the study covers only a period of one year on a relatively small sample (100 companies). This may lead to different results if the sample increases or the study period is extended. Furthermore, the sample is selected from big cap companies which are the index components, thus they are expected to practice higher governance standards. In addition, these companies could afford to obtain best advice and services from investment professionals and accountants during the corporate reporting period.

Based on the limitations outlined above, this research could be further enhanced by looking into diversifying the sample selection by including small and medium cap companies. In addition to reviewing the disclosure made in the annual report, future research should include interviews with the top management, board members, relevant regulators and investors to get a more holistic view.

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