The Dutch corporate governance code and its monitoring

seo economic research

Amsterdam, May 2013
Commissioned by the Dutch Ministry of Economic Affairs

The Dutch corporate governance code and its monitoring

A balanced system?

Bert Hof
Marco Kerste
Nicole Rosenboom
Ward Rougoor
Abe de Jong (Rotterdam School of Management, Erasmus University)

Roetersstraat 29 - 1018 WB Amsterdam - T (+31) 20 525 1630 - F (+31) 020 525 1686 - www.seo.nl - secretariaat@seo.nl
ABN-AMRO 41.17.44.356 - Postbank 4641100 . KvK Amsterdam 41197444 - BTW NL 003023965 B01

"The science of knowing"

SEO Economic Research carries out independent applied economic research on behalf of the public and private sectors. This research makes a major contribution to the decision-making processes of our clients. SEO Economic Research is affiliated to the University of Amsterdam. This gives us access to the latest scientific methods. Operating on a not-for-profit basis, SEO continually invests in the intellectual capital of its staff by arranging for them to pursue graduate studies, publish scientific works and participate in academic networks and conferences.

SEO Report no. 2013-26

ISBN 978-90-6733-699-4

Copyright © 2013 SEO Economic Research, Amsterdam. All rights reserved. Permission is hereby granted for third parties to use the information from this report in articles and other publications, with the provision that the source is clearly and fully reported.

Table of contents

Summary i

Abstract ix

1 Introduction 1

2 Research context and analytical framework 3
- 2.1 Hypothetical alternatives 3
- 2.2 The perspective of social welfare 7
- 2.3 Corporate governance 9

3 Compliance and application in the Netherlands 17
- 3.1 The code 17
- 3.2 Compliance with and application of the principles 19
- 3.3 Low rate of compliance or application 23
- 3.4 Increase or decline in compliance and application 24
- 3.5 Best practice provisions 25
- 3.6 Responsibilities of institutional and other shareholders 28
- 3.7 Reflection and conclusions 29

4 International comparison 33
- 4.1 Introduction 33
- 4.2 The Netherlands 36
- 4.3 United States 39
- 4.4 United Kingdom 44
- 4.5 Ireland 48
- 4.6 Germany 50
- 4.7 France 53
- 4.8 Italy 56
- 4.9 Sweden 59
- 4.10 Overview and history of regulatory systems 61
- 4.11 Detailed overviews 64

5 Monitoring 71
- 5.1 Survey of possible effects 71
- 5.2 Occurrence of effects 72
- 5.3 Summary and interpretation 75
- 5.4 A variant and further insights 76

6 Legal embedding of the code 79
- 6.1 Survey of possible effects 79
- 6.2 Occurrence of effects 80
- 6.3 Overview and interpretation 84

7 Incentives and sanctions: naming 87
7.1 Incentives and sanctions in the Netherlands 87
7.2 Naming, shaming and faming 89
7.3 Interpretation 95

8 A balanced system? 97

Literature 101

Appendix A Online survey of listed companies 107

Appendix B Interviewees 125

Summary[1]

The Netherlands has a corporate governance code, which is subject to monitoring by a government-financed committee. The code entered into force, with a statutory basis, in 2004 and was most recently amended at the end of 2008. In the code, corporate governance is described as the complex of relations between the management board, the supervisory board and the shareholders (the general meeting of shareholders).

This report investigates the efficiency and effectiveness of the code and the system of legal embedding and monitoring by assessing each of these aspects in the context of three hypothetical alternatives: terminating monitoring by the government of compliance with and application of the code; repealing the statutory basis of the code; and expanding the system of monitoring with additional incentives or sanctions, in particular 'naming'. The report also includes an international comparison of systems for regulating corporate governance and a survey of trends in compliance with and application of the code in the Netherlands over the years. For the study, an online survey was conducted among listed companies (which are required to comply with the corporate governance code) concerning reporting and costs, the relevance of the code and their views on the hypothetical alternatives. Finally, interviews were held with stakeholders, and the literature was reviewed to gather further information.

Existing system and alternatives: public and private elements

The Dutch corporate governance code is a code of conduct, which co-exists with laws regulating specific aspects of corporate governance. The code is an initiative of private and public parties and has a statutory basis. The regulation of corporate governance in the Netherlands can therefore be described as a mixed public and private system. The code is monitored by a committee with both public and private elements: the committee is appointed and financed by the government and has an official secretariat, but it operates independently and has private members. Neither the legal basis nor the code itself explicitly provides for enforceable sanctions for non-compliance with the code (neither providing for sanctions nor indicating who would have the authority to apply them). Nor are there any public or private parties that impose enforceable sanctions specifically relating to the code. In short, the Dutch system is a hybrid system with private elements (self-regulation) and public elements, with no clear mechanism for imposing sanctions.

The alternative hypothesis that the government would withdraw from the monitoring would diminish the public character of the Dutch system. In the alternative involving the repeal of the code's statutory basis, there would no longer be an obligation for companies to include a statement in their annual report relating to the corporate governance code. Although EU directives would still require the inclusion of such a statement in the annual report, the requirements in the EU directives are less demanding than those in the Dutch code. This alternative would, therefore, also involve a diminution of the public element. The alternative in

[1] This report is the translation of the Dutch report "Het Nederlandse stelsel van corporate governance code en monitoring. Een gebalanceerd systeem?" (December 2012) by the same authors (SEO-rapport nr. 2012-92, ISBN 978-90-6733-681-9).

which monitoring would be expanded to encompass ‘naming’, ‘shaming’ and/or ‘faming’, on the other hand, would increase the public element.

Apply, comply, explain, transparency and corporate governance

The Dutch corporate governance code is based on the principle of ‘apply, or explain*’* (“pas toe, of leg uit”). *Apply* means that a provision of the code is adhered to, in other words, that it is an element of the existing corporate governance policy. In contrast, the code can be *complied with* if provisions are not applied, but reasons are given for departing from them. This gives the system a certain degree of flexibility. If provisions of the code are departed from an *explanation* must be given. Departing from a provision without giving an explanation implies *non-compliance* with the statutory code. The principle of apply, or explain is known generally as “comply, or explain”.

This description identifies two channels by which the code and changes in the Dutch system could have an impact. There could be an impact on *corporate governance* (‘behaviour’) and there could be an impact on *information* about corporate governance (‘transparency’). A change in the volume and quality of information about corporate governance could, in turn, have consequences for corporate governance itself and vice versa. Governance and information about governance are inseparably linked.

This shows that an estimate of the effects of changes in the Dutch system runs via the information provided about corporate governance and via the governance itself. The next question is what value should be assigned to the changes in the provision of information and corporate governance. These are empirical questions about the value of information to shareholders and the effect of corporate governance on profits, shareholder value and other aspects of a company’s business, to which no clear answer can yet be given. What is clear is that they not only relate to ‘the enterprises’, say the existing directors and shareholders of listed companies, to whom the code applies, but is also a factor, albeit less immediately visible, through the operation of the capital market, via suppliers and customers of companies, via the providers of capital, etcetera. This is seen most clearly in the event of flagrant violations of sound corporate governance that have a major social impact (‘scandals’).

Compliance and application in the Netherlands

The monitoring committee publishes aggregated figures (i.e. aggregated over companies) on adherence to the comply or explain principle as it applies to the provisions of the code. Analysis of existing data gives an impression of the compliance with and application of the provisions of the Dutch corporate governance code by listed companies. It shows that the level of compliance has generally been high, at between 90% and 92%, since 2005. However, some principles stand out for the relatively low level of application or compliance. They are the provisions on remuneration of members of the management board and transparency about it; the independence of members of the supervisory board and the possibility that they could have conflicts of interest; and the provision of information to shareholders. In 2010, the most recent year for which data are available, however, compliance was high in relation to the remuneration of board members and the provision of information to shareholders.

Figures on application and compliance must be interpreted with care. They provide a snapshot and indicate trends in the corporate governance of Dutch listed companies. It needs to be borne in mind that the statutory basis of the code and the code itself both leave scope for implicit compliance, with provisions where compliance is difficult or impossible to verify, and the fact that information about application or otherwise does not necessarily provide information about the corporate governance policy that is actually pursued.

International comparison: Netherlands, US, UK, Ireland, Sweden, Germany, France and Italy

Table S.1 provides a summary of the main features of the different systems of regulation, monitoring and supervision (sanctions) of corporate governance in the countries that were surveyed.

Table S.1 Summary of regulation and monitoring of corporate governance and sanctions

	No	Private	Private/public	Public
Regulation of corporate governance		IR, FR, SW	**NL**, UK, GER, IT	US
Monitoring		IR, SW	**NL**, GER, FR, IT, UK	US
Supervision	**NL**, GER, FR, SW	IR	UK	US, IT

Source: SEO Economic Research

None of the countries surveyed has no regulatory system for corporate governance. The Netherlands, the United Kingdom, Germany and Italy have a form of public-private regulation, Ireland, France and Sweden have more self-regulation and the government in the US regulates corporate governance through the Sarbannes-Oxley Act (SOX). Every country has a form of monitoring. The Netherlands, Germany, France, Italy and the UK have public-private monitoring, Ireland and Sweden have private monitoring and the US has a system of government monitoring. The variation is greatest in methods of supervision and sanction. Sweden, the Netherlands, France and Germany do not impose sanctions, in Italy and the US there are public sanctions, in the UK public-private sanctions and in Ireland private sanctions.

Hypothetical alternative: abolition of the government-appointed monitoring committee

The only quantifiable effect in this alternative is the annual cost savings (if there is no longer any monitoring) or a shift in the annual financing from the government to the private sector (if a similar private monitoring initiative is established). Given the total annual budget for the monitoring committee and the work of the secretariat, the costs come to around € 350,000 per annum. If monitoring ends, there will also be minor cost savings for companies, because it will no longer be necessary to check information for the reports of a monitoring committee. The amount mentioned is more likely a maximum than a minimum, since even without monitoring the government will continue to gather information on a more ad hoc basis, for example.

The question then arises whether the negative effects of abolishing monitoring will exceed the savings for the government of € 0.35 million a year. Say that as a consequence the monitoring is *assumed by private parties*. This will not yield any savings for society: it will yield the government

savings of € 0.35 million a year and cost the private sector approximately the same amount. The accompanying risk is that such a move would send a signal to companies that the corporate governance code has become less important. The responses in the interviews and the survey suggest that this risk is not very large. If the consequence of the ending of monitoring by the government is that there is *no monitoring* at all, the savings for society will be € 0.35 million a year. Once again, the risk is that such a move would send a signal to companies that the corporate governance code has become less important. Moreover, the prominence of corporate governance on the corporate and political agenda is likely to abate. There would also be less aggregated information about compliance with and application of the code available.

The question of whether this alternative without government monitoring is socially desirable comes down to an estimate and valuation of increased risks. The principal risk seems to be that without monitoring there will not be enough information to keep corporate governance on the political agenda and to respond in time to relevant developments. This risk could manifest itself in ad hoc policy and in social costs, in the form of 'scandals' with widespread social consequences, for example.

Hypothetical alternative: repealing the legal embedding of the code

Repealing the legal embedding of the corporate governance code would introduce a new system of regulation of corporate governance in the Netherlands. It would in fact mark the end of the system created in the Netherlands. Whether and, if so, how corporate governance codes would be drafted and kept up to date would then depend on private parties. It seems likely that the information provided about corporate governance in annual reports would be less extensive and less uniform, since companies would refer to different codes (or not refer to a code at all). Monitoring would also become more complicated.

A new system of this type can only represent an improvement if the existing system, which has evolved since 2003, has *shortcomings* that will no longer exist if companies are given the *freedom* not to base their reporting on corporate governance on the existing code any longer. Such shortcomings could be related to a lack of customisation for companies, which might lead to a 'box-ticking policy', and the possibility that an explanation of non-compliance with a provision can be perceived as sending a negative signal. To arrive at a positive conclusion in this alternative, the potential *benefits* of greater freedom (more customisation, less risk that explanation will send the wrong signal) would have to be accompanied by *smaller* disadvantages connected with the ultimate changes in the system.

One of the possible drawbacks is that abandoning the legal embedding of the code could send a signal that the government no longer attaches so much importance to transparency and sound corporate governance. This could have consequences for the standard of the information provided in the annual report, and possibly also for corporate governance itself. If, as a result of the repeal of the legal embedding of the code, there is no code at all, shareholders might lose the structure that such a code provides for assessing and drawing attention to companies' corporate governance policies. This could have an impact on relations within the 'triangle' and, once again, on the quality of information and corporate governance. Without a code, or with numerous

codes, or with the option of not referring to a code, monitoring will also be less complete and/or less structured.

A quantitative weighing up of the advantages and disadvantages is impossible on the basis of existing knowledge, but we do make two findings. No evidence was found that this alternative would be socially desirable. Any imperfections in the existing system could be further investigated, especially since there is a grave suspicion that there are better ways of addressing them than by abandoning the legal embedding of the code.

Hypothetical alternative: naming, shaming, faming

The social desirability of introducing *naming* of all listed companies (publishing details of the extent to which individual companies apply, explain non-application or fail to comply with provisions of the code) depends to a significant extent on the value that shareholders assign to information about compliance with and application of provisions in the corporate governance code. In that context, it is important to note that individual shareholders face practical obstacles in assessing a company's corporate governance policies. Introducing naming would not have to involve high costs, but it would be essential to formulate a clear interpretation of what is regarded as an 'adequate' explanation, and companies would have to have the right to defend themselves. Another potential risk associated with naming is that it could also unintentionally introduce shaming (through the publication of the information by other media, for example).

Shaming is intended to have more of a reputational effect. The larger the effect on a company's reputation, the more effective shaming is, but there is also the risk that the effects might be disproportionate. Even more than with naming, for shaming it is essential to have an unambiguous and shared interpretation of what constitutes an adequate explanation. *Faming* is also designed to have an impact on a company's reputation and there seem to be fewer risks associated with it. One aspect that might need to be considered is that faming on the basis of an overall score for compliance with the corporate governance code does not tell the whole story with regard to transparency about corporate governance or the quality of governance.

Naming provides *opportunities* in terms of access to information and could have positive effects on corporate governance and the information about corporate governance in annual reports. It would require more work, and hence increase the costs, compared with the current situation (interpretation of explanation, putting up a defence). There is also the risk of unfair shaming. In themselves, s*haming* and *faming* yield less additional information than naming, but have a larger impact on reputation, and shaming carries the greatest risk of having a disproportionate effect. It was not possible to further quantify these considerations within the remit of this study.

Further research could be carried out among shareholders and other stakeholders in order to make a more specific estimate of the desirability of naming, shaming and faming, specifically in relation to compliance with and application of the corporate governance code. If these parties assign significant value to these instruments, it could then be investigated how they could be designed in such a way as to minimise risks, while retaining the positive effects for information and corporate governance.

Conclusions

Monitoring: retain

On the basis of this study, there is no reason to conclude that abolishing the government financed and regulated monitoring of compliance with and application of the corporate governance code would be socially desirable. The current high level of compliance and application provides no guarantee for the future. Moreover, even now some provisions are not complied with as well as others. Monitoring provides relevant information for the formulation of policies by the government and parliament, as well as information for the general public. It keeps corporate governance on the agenda of policymakers and listed companies and can prevent policies being adopted in an ad hoc manner. On the basis of the findings in this study, the modest savings arising from abolishing the current system would not provide sufficient justification for ending the monitoring.

Legal embedding: retain

Repealing the statutory basis seems a fairly arbitrary solution for *possible* flaws in the existing code. At the same time, abolition embodies the risk of sending a signal that corporate governance does not have to be taken so seriously. A better option would be to conduct further research into the demand among companies for a customised approach and the degree to which this demand is not being met by the 'comply or explain' principle, as well as into possibilities for improving the information provided to shareholders and avoiding a box-ticking approach, including the reasons and remedies for it.

Naming, shaming and faming: additional research

Naming is already practised in relation to corporate social responsibility with the *Transparency Benhcmark*, for instance, and in Portugal with respect to the application of corporate governance recommendations. Publishing information about application, explanation and compliance with the provisions of the Dutch corporate governance code by individual companies would yield more information about corporate governance, particularly for existing and potential shareholders. This would be an improvement, given the existing obstacles facing shareholders in assessing the corporate governance policies of individual companies in practice (naturally assuming that the published information has real value for shareholders), but it would require a greater effort by the monitoring committee and by companies. One benefit might be that companies would be encouraged to further improve their compliance with the provisions of the code. *Shaming* provides less additional information than naming and, because of the risk of damage to reputations, provides a greater incentive for better compliance. The drawback is the risk of disproportionate effects. *Faming* also yields less information than naming, but it creates less risk of disproportionate damage to a company's reputation. At the same time, it provides a weaker incentive to improve compliance. To determine whether naming, shaming or faming would be preferable to the current situation and, if so, in what form, further research is needed into their effects on the disclosure of information, the value of that information and how the risks of disproportionate damage to the reputation of companies would be managed.

Conclusion

The Dutch corporate governance code and its monitoring serve two purposes: to promote *transparency* about the policies pursued by listed companies in relation to corporate governance and to establish *standards* for corporate governance. In reflecting on the corporate governance code, the monitoring, the legal embedding and possible alternatives, making these two goals explicit could provide a clearer view of the various arguments and their consequences. We will

close with an example: the choice – or perhaps it would better to say the balance – between explaining departures from provisions of the code as *normative* or *informative* touches on the fundamental question of the extent to which the code is intended to give shareholders an instrument to use in their dealings with companies, or to influence companies via the government – in the form of the monitoring committee – separately from the shareholders.

Abstract

The compliance of exchange-listed companies with the Dutch corporate governance code is generally high. This research takes three hypothetical changes to the current system as a starting point to investigate the question: is the Dutch system of regulating and monitoring corporate governance balanced in terms of costs and benefits?

Monitoring compliance

Although compliance by companies with the code is generally high, this gives no guarantee for the future, and even now there are specific provisions of the code where compliance is relatively low. The current method of monitoring compliance – giving numbers aggregated over companies – provides government, parliament and the general public with information on trends in corporate governance. This monitoring keeps corporate governance on the agenda of policymakers and companies. It also helps to avoid ad hoc policymaking. Since ending this monitoring of compliance would yield only limited financial savings, there is no convincing case for not continuing monitoring of compliance with the Dutch corporate governance code.

Legal embedding of the corporate governance code

The Dutch corporate governance code is currently embedded in Dutch law. Abandoning this would provide more freedom for companies in reporting on corporate governance. This *could* have certain advantages: companies might become more motivated to provide relevant information on their corporate governance. There are, however, likely to be negative consequences. The existence of a single code provides a clear structure. Without a code, or with many co-existing codes, understanding and assessing companies' corporate governance regimes may become harder. Aggregated monitoring of corporate governance will almost certainly become less complete. There is a risk of less information and lower compliance with provisions of the current code that are regarded as essential to sound corporate governance.

Abandoning the legal embedding of the code seems a rather arbitrary response to possible areas of improvement in the current code. It seems to make more sense to investigate potential improvements, e.g. expanding the possibilities for companies to tailor their information and improving the content of corporate governance reporting for shareholders.

Naming, shaming and faming

Providing publicly available information on compliance with provisions of the corporate governance code at the level of individual companies (instead of only aggregated across all listed companies) makes information on corporate governance more easily accessible, which is especially relevant for (potential) shareholders. This will require an additional effort by the monitoring body and companies, certainly with respect to establishing which explanations for deviating from provisions of the code are considered valid. 'Naming' may provide an additional stimulus for companies to comply with provisions of the code. 'Shaming' yields less information than naming, as well as both a greater stimulus to comply and a risk of disproportionate effects

on companies. 'Faming' also provides less information than naming, but creates less risk of disproportionate effects on companies and a weaker stimulus for increased compliance relative to shaming.

Deciding whether naming, shaming or faming provide net benefits requires additional research into the effects on information provision, the value of information and ways of mitigating the risks of disproportionate effects.

1 Introduction

The Netherlands has a corporate governance code, which is monitored by a government-financed committee. This code entered into force in 2004 and was most recently amended at the end of 2008. The term of office of the current monitoring committee will end in the middle of 2013. The Ministry of Economic Affairs has taken this opportunity to commission an analysis of the costs and benefits of the code and the system of monitoring. This report contains the results of that analysis.

This report uses the definition of the corporate governance of listed companies in the Dutch code: the complex of relations between the management board, the supervisory board and the general meeting of shareholders. The study compares the current situation with hypothetical alternatives: terminating monitoring by the government of compliance with the code; repealing the statutory basis of the code; and expanding the system of monitoring with additional incentives or sanctions, in particular 'naming'. The analysis includes an international comparison of systems of regulating corporate governance. This report provides input for answering the question of whether alternatives to the current system might be more cost efficient and/or effective.

Various methods were used to perform the analysis in this study. We not only compared the Dutch system with systems in other countries, but also identified trends in compliance with and application of the code in the Netherlands. In an online survey, listed companies that are required to comply with the governance code were asked about their reporting and costs, the importance of the code and possible future scenarios. In addition, interviews were held with relevant stakeholders. Finally, the relevant literature was reviewed, both specifically for the Dutch situation and more generally with regard to the possible effects of self-regulation and government regulation and about transparency and corporate governance.

The perspective adopted in this study with regard to cost efficiency and effectiveness is that of 'public welfare'. In principle, this means that we examined the effects for society as a whole and not just for specific parties, including not only effects that can easily be measured in monetary terms (such as costs in euros), but all relevant effects. The question is what changes each hypothetical alternative to the current system would cause in the conduct of relevant parties (such as shareholders and the management boards of companies), the importance of those changes in behaviour and how they relate to society as a whole.

This report is divided into two related parts. The first part provides background information in preparation for analysing the hypothetical alternatives. The second part contains those analyses and the ultimate findings of the study.

Structure

The first part starts in Chapter 2 with a description of the structure and theoretical background of the study. The structure consists of defining alternatives to the current situation and the methods used to measure their effects. We have adopted the analytical framework of the Social Cost-

Benefit Analysis, and the theoretical background essentially consists of a complicated principal-agent model.

Chapter 3 studies the measurable information and presents a broad outline of what is known about the level of compliance with and application of the Dutch corporate governance code. Chapter 4 concludes with a comparison of the regulation of corporate governance in different countries.

In the second part, each chapter reviews one of the defined hypothetical alternatives and its expected effects in terms of cost efficiency and effectiveness. Chapter 5 discusses monitoring; Chapter 6, the statutory embedding; and Chapter 7, incentives and sanctions, particularly 'naming'. The findings are summarised in Chapter 8.

2 Research context and analytical framework

2.1 Hypothetical alternatives

2.1.1 The current situation in brief

The starting point for this study is the current situation in the Netherlands with respect to the regulation of corporate governance and its monitoring. Briefly, the system consists of the following elements.

The Dutch corporate governance code

The Netherlands has a corporate governance code that applies to Dutch listed companies. The code was drawn up in December 2003 by the Corporate Governance Committee, at the request of Euronext Amsterdam, the Nederlands Centrum van Directeuren en Commissarissen (NCD), the Stichting Corporate Governance Onderzoek voor Pensioenfondsen (SCGOP), the Dutch Association of Shareholders (VEB), the Dutch Association of Listed Companies (VEUO) and the employers' organisation VNO-NCW and at the invitation of the Ministers of Finance and Economic Affairs (Government Gazette, 27 December 2004, no. 250). The code was amended in December 2008 by the Corporate Governance Code Monitoring Committee at the request of the same parties (including the successor to the SCGOP, Eumedion), plus the trade union federations CNV and FNV, with the support of the government.[2] Since it is a joint initiative, the code has public and private elements: the code is neither entirely private (not 'purely' self-regulated), nor entirely embodied in laws (not purely a public matter).

The legal embedding: obligation to report

The current code is designated as a code of conduct pursuant to Article 391 (4) of Book 2 of the Dutch Civil Code, which provides that further rules may be laid down regarding the content of the annual report. These rules provide that a listed public company (NV) must include a statement in its annual report concerning the application of the principles and the best practice provisions in the code, insofar as they are directed at the management board or supervisory board. If provisions are not applied, the company must give an explanation of the reasons why.[3]

The monitoring committee

There is an independent Corporate Governance Code Monitoring Committee appointed by the government, whose task is to promote the currency and usefulness of the code, for example by investigating compliance, keeping itself informed of international developments and identifying

[2] Corporate Governance Code Monitoring Committee: The Dutch Corporate Governance Code. Principles of sound corporate governance and best practice provisions, December 2008, entered into force on 1 January 2009.

[3] Decree of 23 December 2004 laying down further rules on the content of the annual report, Government Gazette 2004 747.

gaps or ambiguities.[4] The committee has both public and private elements, being appointed and financed by the government and with an official secretariat, but operating independently and with private members.

2.1.2 Regulation of corporate governance in two dimensions

We will use a table to summarise the elements of the regulation of corporate governance as an aid to understanding the hypothetical alternatives and comparing the Dutch system with systems in other countries[5]. The table consists of two dimensions. The first dimension embraces the elements of a regulatory system for corporate governance, i.e.:

- regulation of corporate governance;
- monitoring;
- supervision with the possibility of imposing sanctions.

The second dimension encompasses the nature of the regulatory elements:

- none;
- self-regulation (by private parties);
- government regulation (public);
- a mixture of public and private.

The Dutch system is summarised in Table 2.1.

Table 2.1 The Dutch system of regulation of corporate governance in two dimensions

	No	Private	Private/public	Public
Regulation of corporate governance			X	
Monitoring			X	
Supervision	X			

Source: SEO Economic Research

The corporate governance code in the Netherlands is a code of conduct that exists alongside laws relating to aspects of corporate governance. Because it is an initiative of private and public parties and embedded in law, the regulation of corporate governance is regarded as a 'public-private' system. The code is monitored by a committee that is also a 'public-private' entity (see subsection 2.1.1). That leaves supervision, which is classified under 'no' in the table, because there is no private or public party that imposes an enforceable sanction specifically relating to compliance with and application of the corporate governance code. The monitoring committee does not specify companies by name, and parties such as accountants and the Financial Markets Authority (AFM) do not focus specifically on corporate governance. The Dutch system is, in short, a mixed system with private, self-regulatory elements and public elements, without a clear element of sanctions.

[4] Decree of 6 December 2004, Government Gazette no. 241, 14 December 2004. The committee doe not have the authority to amend provisions of the code itself, but can provide guidelines for listed companies and their shareholders by expressing its views in the event of uncertainty about certain provisions (explanatory ntoe to Article 5).

[5] See also section 4.1.

This classification is not intended to describe the regulation of corporate governance in an absolute or complete sense. The aim is to provide a convenient tool for comparing different systems.

2.1.3 Hypothetical alternatives

This study analyses three alternatives in relation to the current situation.

Alternative 1: abolishing the government-appointed monitoring committee

In this alternative, the monitoring committee appointed by the government would not continue.[6,7] The tasks customarily carried out by the committee would therefore lapse, such as identifying the manner in which and the degree to which the code is complied with and publishing an annual report of its findings, together with comments on the use of the code and its adequacy.

There are two possible scenarios that might arise if the government committee were abolished: a similar committee could be established by private parties or there would no longer be any committee. Strictly speaking, these are possible effects of a decision by the government to abolish the committee.

With alternative 1, it is assumed that the government would withdraw from the monitoring committee, but would otherwise continue to support efforts to maintain an up-to-date governance code.

Table 2.2 illustrates the impact of the change.

Table 2.2 Alternative 1: abolishing the monitoring committee

	No	Private	Private/public	Public
Regulation of corporate governance			X	
Monitoring	X	X		
Supervision	X			

Source: SEO Economic Research

Alternative 2: repealing the statutory basis

In this alternative, the legal embedding[8] of the code would lapse. There is currently a statutory duty for a listed company to include a statement in its annual report on the application of the principles and best practice provisions of the code, and if they are not applied, to explain why.

[6] The legal embedding is preserved in alternative 1; the abolition of the statutory anchoring is the subject of alternative 2.

[7] In practical terms, this alternative would involve not appointing a new committee when the term of an existing committee ends. Throughout the report, this is referred to as abolishing the monitoring committee, terminating the monitoring, etc.

[8] By repealing the relevant decree.

With the lapsing of the statutory basis, the statutory requirement to publish *a statement concerning the code* would lapse. Directive 2006/46/EC provides, however, that member states must require their listed companies to include a statement concerning corporate governance in their annual report (Article 10).[9] If companies do this on the basis of a code, the comply or explain principle applies (Directive 78/660/EEC, Article 46 bis). If they do not report on the basis of a code, listed companies must include all relevant information about the corporate governance practices that are applied, in addition to the national statutory requirements, in the annual report.

In light of these directives, therefore, alternative 2 is only possible if instead of the current method, an alternative legal form is prescribed for including all relevant information about corporate governance practices that are applied (in addition to the national statutory requirements) in the annual report.

The repeal of the statutory basis of the code would therefore be an alternative in which there would still be a duty to report, but listed companies would not have to refer to the existing code. This is similar to the regulation of corporate governance in countries such as France and Italy (see Chapter 4). An element of this alternative is the assumption that the monitoring committee would also be abolished (as in alternative 1 above). As in that case, the question is whether an entirely private monitoring initiative would emerge, raising the question of what would be monitored, since reporting on compliance with the code would no longer be mandatory.

With this alternative it is also assumed that the government would adopt a passive attitude towards the corporate governance code, in line with the lapsing of its legal embedding. The question then is to what extent private parties would keep the code up to date. An extreme variant could be that the code would slowly disappear because of the absence of any initiative.

At the same time, because of the EU directives, there would still be a duty to report on corporate governance in the annual report. In this alternative, it is assumed that the minimum requirements of the European directives would be complied with.

It should be clear that the regulation of corporate governance in this alternative would be less public. In Table 2.3, this is shown as the disappearance of the public element from the regulation of corporate governance. Literally speaking, this is incorrect, because there will always be rules affecting corporate governance laid down in laws, and the requirement to include a statement on corporate governance in the annual report could – even if there is no longer a code – have an effect on corporate governance. The change could therefore be summarised as the disappearance of any systematic public influence specifically on corporate governance.

[9] This directive in fact dates from after the legal embedding in the Netherlands. See also Chapter 4.

Table 2.3. Alternative 2: abolishing the monitoring committee and repealing the statutory basis of the code

	No	Private	Private/public	Public
Regulation of corporate governance	X	X		
Monitoring	X	X		
Supervision	X			

Source: SEO Economic Research

Alternative 3: introduction of incentives and sanctions

Whereas the two previous alternatives envisage a more limited role for the government compared with the current situation, this alternative would involve an expansion of the government's role. The method of implementing incentives and sanctions (by what mechanisms, when, by whom) would, to a large extent, determine the effect they might have. Because this study is confined to sanctions or rewards in relation to compliance with the code, in other words, 'comply or explain', sanctions and rewards are considered primarily in relation to promoting transparency, but could consequently also influence compliance and application.

The analysis explains which mechanisms are possible, specifically with reference to the disclosure of individual compliance (naming, naming & shaming, naming & faming). One point that needs to be highlighted – mainly because of the possibility of explaining non-application – is that sanctions or incentives are not a trivial matter. In that context, the introduction of mechanisms for imposing sanctions or providing incentives might call for a more precise formulation of what falls under the definition of 'statement' or 'explanation'.

Table 2.4 summarises this alternative.

Table 2.4 Alternative 3: sanctions and incentives

	No	Private	Private/public	Public
Regulation of corporate governance			X	
Monitoring			X	
Supervision			X	X

Source: SEO Economic Research.

2.2 The perspective of social welfare

Our estimates of the effects of the alternatives described in section 2.1 will be viewed from the perspective of their effect on social welfare. We will use the *analytical framework* of social cost-benefit analysis, which is an instrument for evaluating policy with roots in economic welfare theory. The objective is to show all of the consequences of a policy change: the accompanying costs and both the positive and the negative effects. The aim of a social cost-benefit analysis is to express all of these effects in a single unit: money ('monetarisation'). Where this is impossible, an effect is expressed in its own unit of measurement ('quantification'), and if that is not possible, a qualitative estimate is made of the effect.

In this study, no actual social cost-benefit analyses were carried out, because it was anticipated in advance that most effects could not be expressed in monetary or other quantitative terms. The *perspective* of a social cost-benefit analysis does, however, provide a clear structure in terms of costs, positive and negative effects, alternatives and actors.

The framework of a social cost-benefit analysis is based on a wider valuation of social effects than merely financial effects or effects on companies or shareholders. The steps in a social cost-benefit analysis are, briefly, defining the problem, identifying alternatives (to the current situation), estimating the costs of a policy change, listing and classifying possible effects (and relevant actors), establishing the scale of positive and negative effects, estimating the value (weight) of those effects and presenting the resulting statement of the overall costs and effects for various actors. This section explains what these steps mean for our analysis of the costs and benefits of the governance code and monitoring.

Statement of the problem

The problem addressed in this study is the question of whether the current system of the governance code and its monitoring is the most desirable system in social terms, or whether there are alternatives that would be more cost efficient or more effective.

Alternatives

The alternatives to the current situation are described in section 2.1: (i) no monitoring of compliance by the government (as there is now), (ii) a code without legal embedding (as there is now) and (iii) expansion of the system with incentives and sanctions, particularly 'naming' (which do not exist at present). Costs and effects are analysed in relation to the operation of the existing system.

Costs of policy change

These are the costs of actually amending and applying a policy, for example, the costs of monitoring: would there be savings for the government if monitoring ended.

Identification of effects

This step involves identifying all the *possible* effects of the policy changes that might follow from the alternatives. In the social cost-benefit analysis, two aspects are considered particularly carefully: Were any effects forgotten? And are any effects counted twice?

To determine the social importance of compliance with and application of the governance code, it is important to ask who will experience an effect. Corporate governance issues mainly involve the relationship between the management board, the supervisory board and the shareholders of listed companies (see section 2.3). For shareholders, special attention could be given to the role and position of minority shareholders and of institutional investors. As regards the influence of changes on the conduct of the management board, the supervisory board and shareholders, the next question is: Who experiences the positive and negative effects of that conduct? This could be the management board, the supervisory board and the shareholders themselves, but could also

be other parties, such as the company's employees, suppliers, customers, providers of capital, business service providers (such as accountants and tax advisors), consumers and the government.

Size and weight of effects

Naturally, it is not enough to identify *possible* effects. The next question is whether effects will actually occur and whether it can be determined what size those effects will have. This refers to the *causal* effect of a policy change. Effects can be estimated in various ways; for example, on the basis of theory and models, on the basis of previous research and on the basis of interviews and/or surveys. Because dissimilar effects cannot simply be compared with each other, a social cost-benefit analysis uses a variable in which different effects (which are felt to reflect social value) can be expressed: specifically 'euros'. As mentioned above, however, the research question does not lend itself to a complete calculation and monetarisation of the effects. For effects whose scale and/or value cannot be clearly indicated, it is still necessary to make an estimate of the effects. For this, the previously mentioned combination of research methods will be used.

Overview

The aim of this analysis is to estimate the costs and possible positive and negative effects of alternatives to the existing Dutch governance code and monitoring system: ending monitoring by the government; abolishing the statutory obligation to report on corporate governance; and introducing incentives or sanctions. Reducing costs means greater cost efficiency; higher costs reduces cost efficiency. Positive effects mean greater effectiveness, while negative effects represent less effectiveness. The possible consequences of each alternative are highlighted and discussed, as well the various roles the government could play in each one.

2.3 Corporate governance

As background to answering the research questions, this section describes several important elements in the complex issue of corporate governance. Section 2.3.1 discusses the Dutch 'corporate governance triangle' (i.e., the relationship between shareholders, supervisory boards and management boards of listed companies) in the context of the principal-agent theory. Section 2.3.2 reviews how effects are measured in this study and their relationship with the role of the government.

2.3.1 The corporate governance triangle

A sound corporate governance structure provides certainty about the division of authority and control in a company designed to ensure that decisions and activities are based on the business objectives. Without it, the various stakeholders will pursue their own objectives.[10] For listed companies in the Netherlands (the principal subject of this report), corporate governance is

[10] This applies especially if there are multiple owners, if there is a separation of ownership and management or if there are interests other than solely maximising profits. The need for transparent corporate governance therefore increases in relation to the size of a company, the number and types of owners, and the number of objectives.

largely concerned with the triangular relationship between the shareholders, the management board and the supervisory board.

For natural persons, the implementation of governance is relatively straightforward, the extreme being the sole trader, where ownership, control and execution are in the hands of one and the same person. With legal entities, and particularly larger legal entities, governance is more complex and therefore more relevant. Accordingly, a lot of attention is devoted in the literature to the issue of governance instruments in companies with a shareholder structure, with the focus generally on the separation of ownership and management that characterises most listed companies.[11] Although shareholders have ultimate control, they delegate the day-to-day management to the management board. The conduct of the management board (the 'agent') must then be aligned with the objective of the owners (the 'principal'), which is to maximise shareholder value. However, because it is impossible to compel ideal behaviour through contracts, shareholders incur costs for monitoring the decisions and actions of the management board. The managers also incur costs (so-called 'bonding' costs), which are borne by the shareholders, in order to convince the principal of their efforts. One example would be the publication of an annual report. If monitoring and bonding do not solve the principal-agent problem, there can be residual costs, such as suboptimal decision-making.

Box 2.1 Principal-agent theory and corporate governance

In neoclassical theory, the emphasis is on 'the market', and 'the company' is regarded as a given. In that context, it is assumed that the owner is driven solely by a desire to maximise value and that everything in the company is dedicated to achieving that objective. In the post-war literature, in addition to neoclassical theory, more attention is devoted to the operations of the company itself,[12,13] with the focus on individual decisions and the costs of reaching agreements and monitoring compliance with them.[14] Jensen and Meckling (1976) conclude that "[t]he firm is not an individual. It is a legal fiction which serves as a focus for a complex process in which the conflicting objectives of individuals (some of whom may 'represent' other organizations) are brought into equilibrium within a framework of contractual relations."
The right of control and the right to residual earnings could be vested in different parties. It is, however, logical for the party that is entitled to the profits to also want the right of control in order to maximise value. In principle, therefore, the owner of a company has both the right of control and the right to residual earnings.[15] Although parties can make agreements on this, the transaction costs of providing for every possible situation that could arise in the future and

[11] The reason for the separation is that there are many, usually small, shareholders, for whom it is difficult to conduct day-to-day management. But even with a private company (BV), which will normally have fewer shareholders, there may be a separation between ownership and management. One reason for this could be that an investor cannot or does not want to be involved in day-to-day management.

[12] Furubotn et al. (1972) contains a lucid overview of the literature up to the early 1970s. Authors such as Jensen et al. (1976), Klein et al. (1978), Demsetz (1983), Hansmann (1988) and Putterman (1993) have made contributions in subsequent years.

[13] In general, it is not the objective of this literature to replace neoliberal theory. The theory is generally regarded as successful in achieving its objective, which is to explain the allocation of means of production and of products among consumers.

[14] Another important distinction, compared with neoclassical theory, is that transaction costs are greater than 0.

[15] See, for example, Putterman, L. (1993).

prescribing how the parties should act in those circumstances are high.
More specifically, the basic principle in neoclassical theory - that all parties within a company pursue the owner's objective - is set aside in the principal-agent theory.[16] The 'agents' (for example, the manager or employees) usually have different objectives to the 'principal' (the owner) and will not be guided in their efforts by the owner's objective. Another complication is that the agents know more about their own preferences and efforts than the principal: there is information asymmetry. In theory, it would be possible to make enforceable contracts in which the objective of the agents is aligned with the objective of the principal through 'incentive' structures. In practice, however, it is too expensive to lay down rules on how agents should conduct themselves in pursuit of the principal's objective in every possible scenario (transaction costs). The combination of disparity in objectives, asymmetric information and the impossibility of concluding contracts that cover every eventuality calls for a solution in the form of corporate governance.[17] Governance is necessary to enable an owner to translate his or her control into achieving the defined objectives. Consequently, the quality of corporate governance partially determines the success with which equity capital can be raised, and the costs of doing so.[18]

Source: SEO Economic Research, see the footnotes mentioned in the box.

An additional problem is that, where there are a great many owners, free-rider behaviour can arise in monitoring the management board. This occurs when some shareholders feel the efforts of other shareholders make their own efforts unnecessary, possibly resulting in inadequate monitoring. Consequently, part of the control of the management of listed companies is delegated to the supervisory board.

The supervisory board has traditionally played an important role in the Netherlands. In 'agency' terms, the board is an organ that represents the interests of shareholders by monitoring the managers, but in practice, the mandate of the supervisory board is formulated more broadly in the Netherlands, specifically in terms of the company's interests. However, this structure does not guarantee optimal monitoring either. For example, members of the supervisory board do not always benefit financially when the company performs well. In addition, members of the supervisory board are not always involved closely enough in the day-to-day affairs of a company, because they have other positions elsewhere, for example.

In addition to the more 'traditional' corporate governance triangle, there is another issue that arises, particularly in continental Europe. Whereas ownership of listed companies in the US and the UK is usually divided among a substantial number of smaller or larger shareholders, as a rule companies in continental Europe have a dominant shareholder in addition to a group of smaller

[16] Jensen and Meckling (1976) are generally regarded as the first authors to link *agency theory* to the *theory of the firm*. See, for example, Hart (1995) for the linking of agency theory to corporate governance. For more information about the rise of the agency theory, see Mitnick (2012), for example.

[17] Hart (1995) expresses this as follows: "Corporate governance issues arise in an organisation whenever two conditions are present. First, there is an agency problem, or conflict of interest, involving members of the organisation - these might be owners, managers, workers or consumers. Second, transaction costs are such that this agency problem cannot be dealt with through a contract."

[18] In fact, similar reasoning applies for borrowed capital.

minority shareholders.[19,20] The interests of the two parties do not always coincide and the dominant shareholder can impose his or her interests at the expense of the latter group.

In principle, dominant shareholders can exert more pressure on management to represent shareholders' interests, which enhances governance.[21] At the same time, however, there are fewer possibilities to 'discipline' the dominant shareholder in the wider interests of all the owners – via a vote by shareholders to dismiss the supervisory board or a hostile takeover, for example. That is to the detriment of governance. In this version of the principal-agent issue, the focus is on a larger group of 'insiders', comprising the management board and the dominant shareholder. Corporate governance is required to protect 'outsiders' (the minority shareholders) against the 'insiders', and in that context it is not only the separation between ownership and management that plays a role, but also the differences in the interests of the dominant shareholder and the other shareholders.[22]

Box 2.2 provides an overview of the principal actors in the governance of companies. The previous analysis shows that in any solution for the original problem, there are various dimensions to consider, arising from the disparity of interests, asymmetric information and the impossibility of concluding exhaustive contracts, in addition to relevant factors such as monitoring, monitoring costs, free riding, imperfect delegation of monitoring and a heterogeneous group of shareholders (dominant versus minority). This study covers a complex field.[23]

---

[19] 'Dominant shareholder' refers here to shareholders with a controlling vote, apart from their right to the fruits of the enterprise. In many cases, they are families that control a company, either through ownership of the majority of the shares or ownership of shares with specific controlling rights

[20] More than 90% of the companies in the Netherlands have a dominant shareholder (Van der Elst et al. 2007).

[21] In fact,these two groups are sometimes the same, if the dominant shareholder provides some or all of the members of the management board.

[22] For an in-depth analysis of the background to and consequences of dominant shareholders, see R. Morck et al. (2005), for example. For a further analysis of the agency problem in continental Europe as a result of dominant shareholders, see, for example, Enriques and Volpin (2007).

[23] In this playing field, the agency theory is the dominant economic theoretical framework and is an aid to expressing the costs and benefits of govenrnance structures in economic terms. It is relevant to note that other theoretical models provide explanations for governance structures but are less well-equipped to define them in terms of costs and benefits.

Box 2.2 Main actors in the governance of listed companies

Shareholders: shareholders are the owners of a company and have a right to the residual earnings and to control. The right of control is partially delegated to others and is peformed in part by the General Meeting of Shareholders (see below). The General Meeting of Shareholders also decides what portion of the residual earnings will actually be distributed to the shareholders.

Management (also referred to as directors or Management Board): the management represents the company and, subject to specified powers, makes decisions and is accountable to the shareholders in the General Meeting of Shareholders.

The Supervisory Board: the Supervisory Board supervises the management's policies and provides the management with advice. A supervisory board is not mandatory, except for companies with a two-tier structure (see below).

General Meeting of Shareholders: within the limits laid down by the law and the articles of association, the General Meeting of Shareholders possesses all of the powers that are not vested in anyone else. More specifically, the General Meeting of Shareholders has the power to appoint and dismiss the management and the Supervisory Board (not in companies with a two-tier structure) and to amend the articles of association.

Works Council: a Works Council is mandatory for companies with more than 50 employees and consists of elected representatives of the employees. The Works Council can be seen as a body for consultation between the employer and the employees, but it also has some statutory rights. Important rights are the right to give advice on specific planned decisions and the right, subject to certain conditions, to appeal against a decision by the company to the Enterprise Chamber of the Court of Appeal in Amsterdam.

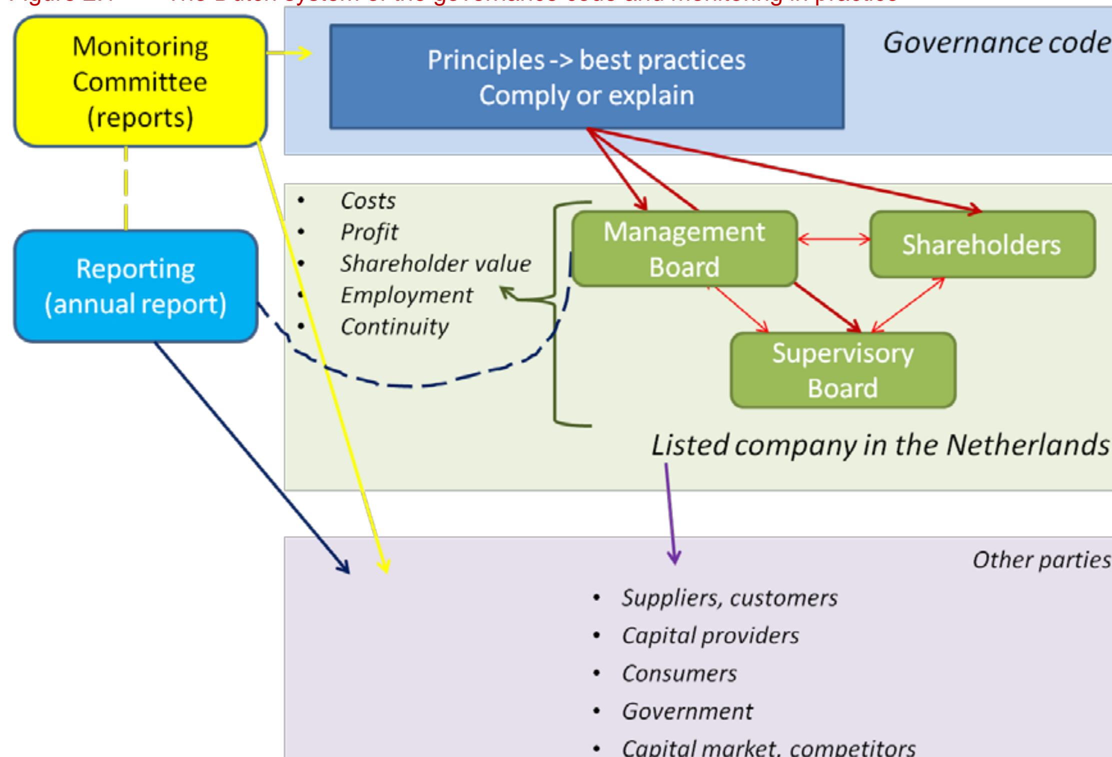
Specific rules apply for relatively large companies. Whether a company must have a so-called 'two-tier structure' depends on the size of its shareholders' equity and the number of employees. These alternative rules are designed to enable larger companies to operate effectively. The large number of shareholders might constitute an obstacle to effective operations, and would result in high monitoring costs. This is addressed by assigning a greater role to the Supervisory Board by law, for example with regard to the appointment and dismissal of the management board. In 2004, partly under the influence of the Corporate Governance Code, the rights of the General Meeting of Shareholders (and Works Council) were strengthened at the expense of the Supervisory Board and the management board, because the latter two bodies were felt to have too much influence. Under the new system, for example, new members of the Supervisory Board are no longer appointed by the board itself but by the General Meeting of Shareholders. In addition, the management board can no longer make recommendations for appointments and the right of the Works Council to make recommendations has been strengthened.

Source: SEO Economic Research.

2.3.2 Effects and the role of the government

Figure 2.1 illustrates how the system of the governance code and monitoring works in practice.

Figure 2.1 The Dutch system of the governance code and monitoring in practice



Source: SEO Economic Research

In the top right corner of the figure, in blue, is the *governance code*, with its principles and best practice provisions, an important element of which is the 'comply or explain' principle in relation to reporting by listed companies. Below that, in green, is the *Dutch listed company* that is bound by the code, with the triangle of management board – shareholders – supervisory board at its centre. The governance code influences the relations between the parties in this triangle and their conduct and, hence, also variables that affect the company, such as costs, profits and employment. The management board is responsible for *reporting*, including the annual report. The *monitoring committee* scrutinises the reporting as the basis for its reports. At the bottom, in purple, are the other parties that are affected.[24]

Changes in the system of the corporate governance code and its monitoring (at the top) could have consequences for the *conduct* of the management board, the shareholders and the supervisory board (corporate policy). The *transparency* of corporate policy (the information) could also be influenced by the annual report, for example. The first question to ask, therefore, is what consequences changes in the system might have for the conduct of 'the triangle' (corporate policy) and for its transparency (information in the annual report). The next question is what

[24] The provision of information by a company might ultimately have consequences for the operation of the capital market (the supply of capital and its allocation among companies, sectors, etc.)and for competition in markets for goods and services. This has consequences for society as a whole.

significance any such changes in corporate governance and transparency might have in terms of costs and effects (for the 'triangle' and for other parties) and in terms of variables such as profits and shareholder value.

The figure shows, for example, that the government's withdrawal from the monitoring committee could have consequences for the governance code (in terms of keeping it up to date) (*yellow arrow to the right*), for corporate governance (*yellow arrow to the triangle*) and transparency (*reporting,* including the annual report). Abandoning the legal embedding of the governance code might have consequences for conduct in the triangle (*red arrows from the governance code*) and for reporting. The introduction of *naming,* by the monitoring committee, for instance, could also have consequences for corporate governance (*yellow arrow to the triangle*) and transparency (the annual report). All of these aspects raise the question of how changes in corporate governance should actually be 'valued'.

Corporate governance and financial performance

A company's financial performance should, in general, be enhanced if corporate governance prevents a particular group from prejudicing the interests of the shareholders by pursuing its own interests. Financial performance (which can be measured in terms of variables such as profitability, the company's market value or earnings per share) is ultimately the key to the interests of the (outsider) shareholders.

There is a wide range of literature devoted to this relationship. Its importance is obvious: if there is a positive correlation, improving corporate governance pays off. Despite the widespread conviction based on theory that there must be a positive correlation between the quality of corporate governance and the financial performance of companies, the empirical literature on the subject provides no conclusive answer. Generally, a positive correlation is found between corporate governance and benchmarks of financial performance, but the *causality* of this relationship has not yet been persuasively established.[25] In other words, better corporate governance might lead to better financial performance, but the relationship might be the reverse.[26] This leaves open the question of the extent to which it pays for shareholders to exert pressure on management to implement sound corporate governance.[27]

The obstacles to arriving at a firm conclusion on causality are partly empirical in nature (endogeneity problems), but are also connected with the challenge of producing benchmarks to measure the quality of corporate governance and financial performance.[28] At the same time, there

25 See, for example, I. Love (2010).

26 An argument for this might be that companies regard corporate governance as a 'luxury', so it is given more prominence by companies with better results.

27 A positive causality could in fact also create incentives for the management. Better results could also be in their interests, for example because it enhances the possibilities for raising additional capital and making additional investments.

28 In this context, Bebchuk et al. (2012) refer to the temporary nature of the correlation with stock returns. The authors feel that the correlation between indicators of corporate governance and stock returns that was found for the period 1991-1999 no longer existed in the period 2000-2008. This could be because the market expected a better performance, resulting from better corporate governance, and discounted it in the share price. So although there is still a correlation between the operating results of a company and corporate governance, that no longer applies for stock returns.

is still the possibility that there *is* a causal relationship between the quality of corporate governance and operating results.

Corporate governance and the government

In principle, the prime responsiblity in relation to corporate governance rests with the shareholders and plays out in the triangular relationship: through their right of control, shareholders can compel sound corporate governance aimed at maximising shareholder value. From economic welfare theory, it can be reasoned that government interventions might be considered if 'the market' is not deemed to be fully capable of ensuring the efficient allocation of scarce resources. It is clear from the analysis above, and from practical experience, that there are various reasons why corporate governance will not 'automatically' be taken up by private parties: they include asymmetric information, free riding, etc.,[29] meaning that there might therefore be a role for the government in this respect.

In this context, it is important to realise that sound corporate governance can also have effects that extend beyond 'the triangle' and also beyond the actors within the relevant companies.[30] One example is the impact of sound corporate governance on the operation of the capital market. The financing of listed companies is easier and cheaper if the central actors are clear about the mutual rules. If there is certainty about governance, rules can be enforced more easily (by the courts), thus reducing transaction costs. The other side of the coin is that the absence of corporate governance (or instruments to enforce it) can lead to excesses by companies. Well known examples are scandals involving fraud, as in the case of Enron, which have led to wider economic problems.[31] Chapter 4 will address the various ways in which countries regulate corporate governance.

[29] In addition to underlying arguments for regulation, some of the literature also considers the impact of the regulation of corporate governance on operating results and a company's value. See, for example, D.F. Larcker et al. (2010).

[30] For an analysis of the relationship between corporate governance and economic development, see, for example, Claessens and Yurtoglu (2012).

[31] Although it is not certain that these problems would have been prevented with sound corporate governance, they touch very directly on elements of the relationships in the corporate governance triangle.

3 Compliance and application in the Netherlands

This chapter provides an overview of the application of and compliance with the principles and best practices in the Dutch corporate governance code since its introduction in 2004. The survey gives an impression of the effectiveness of the code, as well as trends and noteworthy findings in relation to corporate governance in the Netherlands and the reporting on it. Current levels of compliance and application determine the scope for improving corporate governance and transparency, and trends could give an indication of what to expect with or without a change in the system.

Section 3.1 provides an introduction to the structure of the existing code. In section 3.2, the record in terms of compliance with and application of the 22 principles in the code is sketched in broad terms. Section 3.3 zooms in on the principles with respect to which the level of compliance or application is relatively low. Section 3.4 discusses the trends over time. Specific best practice provisions that largely determine the level of compliance with and application of individual principles are discussed in section 3.5. Section 3.6 presents the findings of the monitoring committee regarding shareholders and conclusions are given in section 3.7.

3.1 The code

The Dutch Corporate Governance code contains 22 principles and 128 best practice provisions that are intended to regulate the relationship between the management board, the supervisory board and the general meeting of shareholders.[32] Box 3.1 contains a summary of the contents of the code. Each principle is named according to the chapter of the code that contains that principle (for example, Principle II.1). The only exceptions are Chapters II.2 and IV.4, because each of these chapters introduces two principles. Each principle is accompanied by a number of best practice provisions, which are then numbered II.1.1, II.1.2 and so on (in the case of provisions accompanying principle II.1).

[32] Corporate Governance Code Monitoring Committee (2008a).

Box 3.1 The principles in the Dutch corporate governance code

I. The Code		
Principle I	-	Compliance with and enforcement of the Code
II. Management Board		
Principle II.1	-	Role and procedure
Principle II.2.1	-	Amount and composition of remuneration
Principle II.2.2	-	Determination and disclosure of remuneration
Principle II.3	-	Conflicts of interest
III. The Supervisory Board		
Principle III.1	-	Role and procedure
Principle III.2	-	Independence
Principle III.3	-	Expertise and composition
Principle III.4	-	The chairman of the supervisory board and the company secretary
Principle III.5	-	Composition and role of key committees
Principle III.6	-	Conflicts of interest
Principle III.7	-	Remuneration
Principle III.8	-	One-tier management structure
IV. The Shareholders		
Principle IV.1	-	Powers
Principle IV.2	-	Depositary receipts for shares
Principle IV.3	-	Provision of information
Principle IV.4.1	-	Responsibility of institutional investors
Principle IV.4.2	-	Responsibility of shareholders (introduced in the code in 2008)
V. The audit of the financial reporting		
Principle V.1	-	Financial reporting
Principle V.2	-	Role, appointment, remuneration and assessment of the external auditor
Principle V.3	-	Internal audit function
Principle V.4	-	Relationship and communication of the external auditor with the organs of the company

Source: Corporate Governance Code Monitoring Committee (2008a).

Each of the 22 principles is fleshed out in one or more best practice provisions. Every year, the Corporate Governance Code Monitoring Committee evaluates compliance with and application of these provisions (on behalf of the government). Under the 'apply or explain' regime, compliance with the code is defined as the application of a provision or an explanation in the annual report of why the provision was not applied. A public company can therefore comply with the code without applying all of the best practices, provided it explains why it did not do so in its annual report.[33] These terms are used throughout the report for the Dutch case: compliance is applying or explaining; non-compliance is neither applying nor explaining why.[34]

33 RiskMetrics (2009).

34 This regime is commonly referred to as "comply or explain". Strictly speaking, in the Netherlands the regime is "apply or explain" (*pas toe of leg uit*). We will use the more common term comply or explain, except in situations where confusion may arise.

3.2 Compliance with and application of the principles

Figure 3.1 shows the annual figures for compliance with 19 of the 22 principles set out in the code. Figure 3.2 shows the extent to which the principles were applied. The difference between the figures for compliance and application is related to principles or best practices where an explanation was given for non-application of the provision. Unfortunately, there are no figures available for the 2008 financial year[35] providing a similar level of detail. Because of their nature, principles IV.2, IV.4.1 and IV.4.2 are not covered in the studies carried out by the University of Groningen.[36]

Box 3.2 Explanation of the calculations

The graphs were produced on the basis of the reports produced annually by the University of Groningen for the monitoring committee.[37] Compliance and application rates were calculated as the percentage of the total number of observations that were deemed to constitute compliance or application.[38] For example, suppose there are two principles that are aggregated and for one principle there is one company that complies, and for the other principle, there are 100 companies, of which 90 comply. The average compliance is then calculated as: (1+90)/(1+100).

It should be noted here that the number of observations per best practice or principle can differ greatly and that not every observation necessarily corresponds with one specific company. For example, it is possible that a best practice provision is divided into a number of subsections and that compliance with each subsection was analysed. It is then possible for a company to comply with six of the ten points in a particular best practice. The graphs should be read as the percentage of compliance or application in relation to the maximum possible figure (100%) and not as the percentage of companies that complied with a particular element of the code.

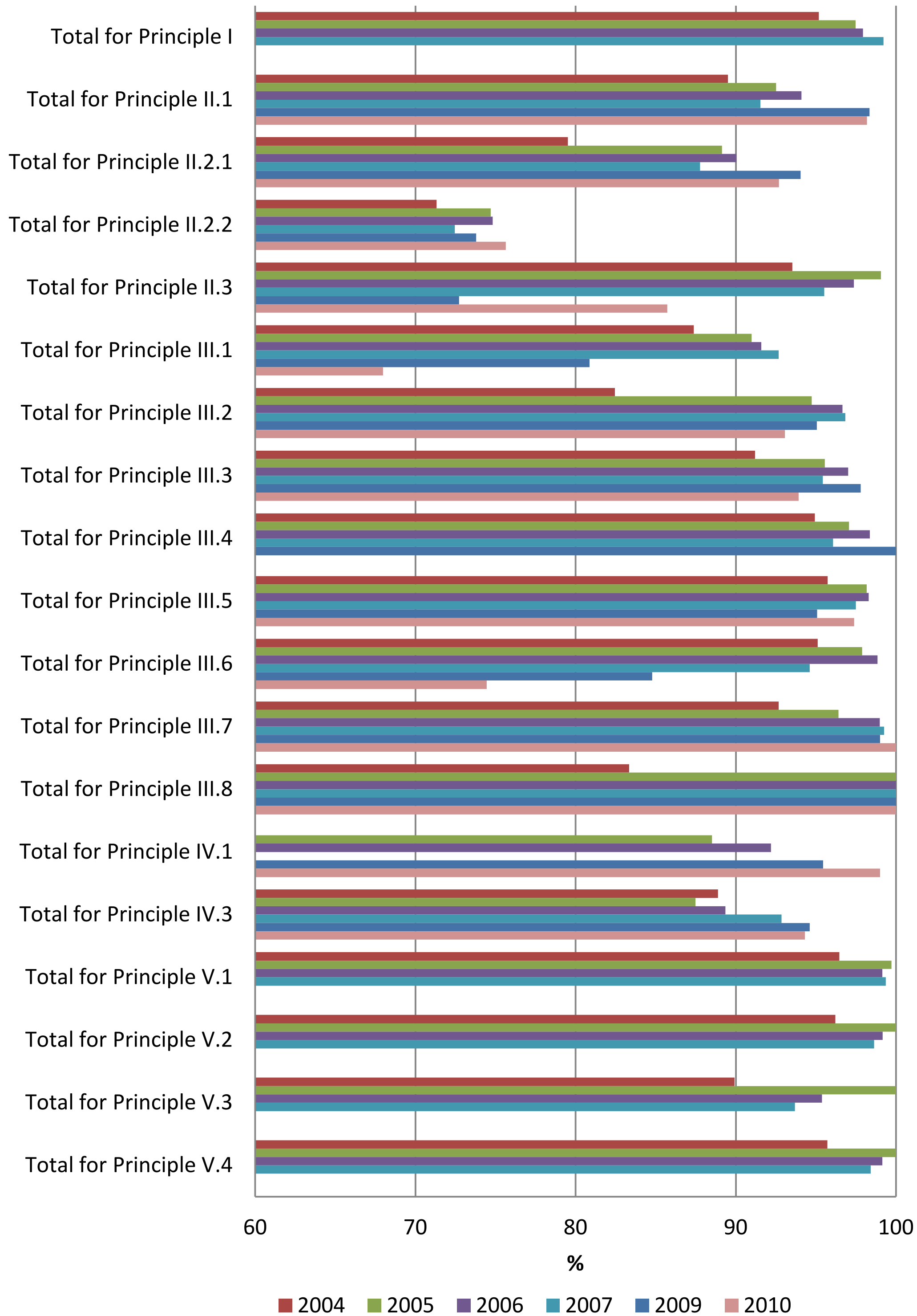
When the code was updated in 2008, a number of best practices lapsed or came to fall under another heading. In one case, a best practice was inserted under another principle. In the figures that are presented here, best practice provisions in the former code are linked to their counterparts in the new code. If there is a reference to a specific best practice provision, the heading in the most recent version of the code is used. If, for any reason, that was not possible, with the result that compliance figures were no longer comparable, that is mentioned. To keep the compliance rates in different years as comparable as possible, so-called 'international companies' were ignored for 2004. These companies have their registered office in the Netherlands, do not have a stock exchange listing in the *Netherlands*, but do fall under the code. The compliance rate among these companies was lower than among other companies. The monitoring committee did not include these companies in its reports after 2004.[39] If these companies were included, the compliance rate would be lower in 2004, and probably also in subsequent years.

Source: SEO Economic Research, see the footnotes mentioned in the box.

---

35 The years mentioned in this chapter are the financial years.
36 Section 3.6 discusses the responsibilities of the shareholders described in these principles in more detail.
37 University of Groningen (2005, 2006, 2007, 2008, 2010 and 2011).
38 It should be noted that until the end of the 2009 financial year, the University of Groningen's compliance reports used the reverse of the terms adopted by the monitoring committee. This report uses the terms as they are used by the monitoring committee: compliance is apply or explain.
39 Corporate Governance Code Monitoring Committee (2006).

Figure 3.1 With just a few exceptions, the *compliance* rate is over 90%[40]

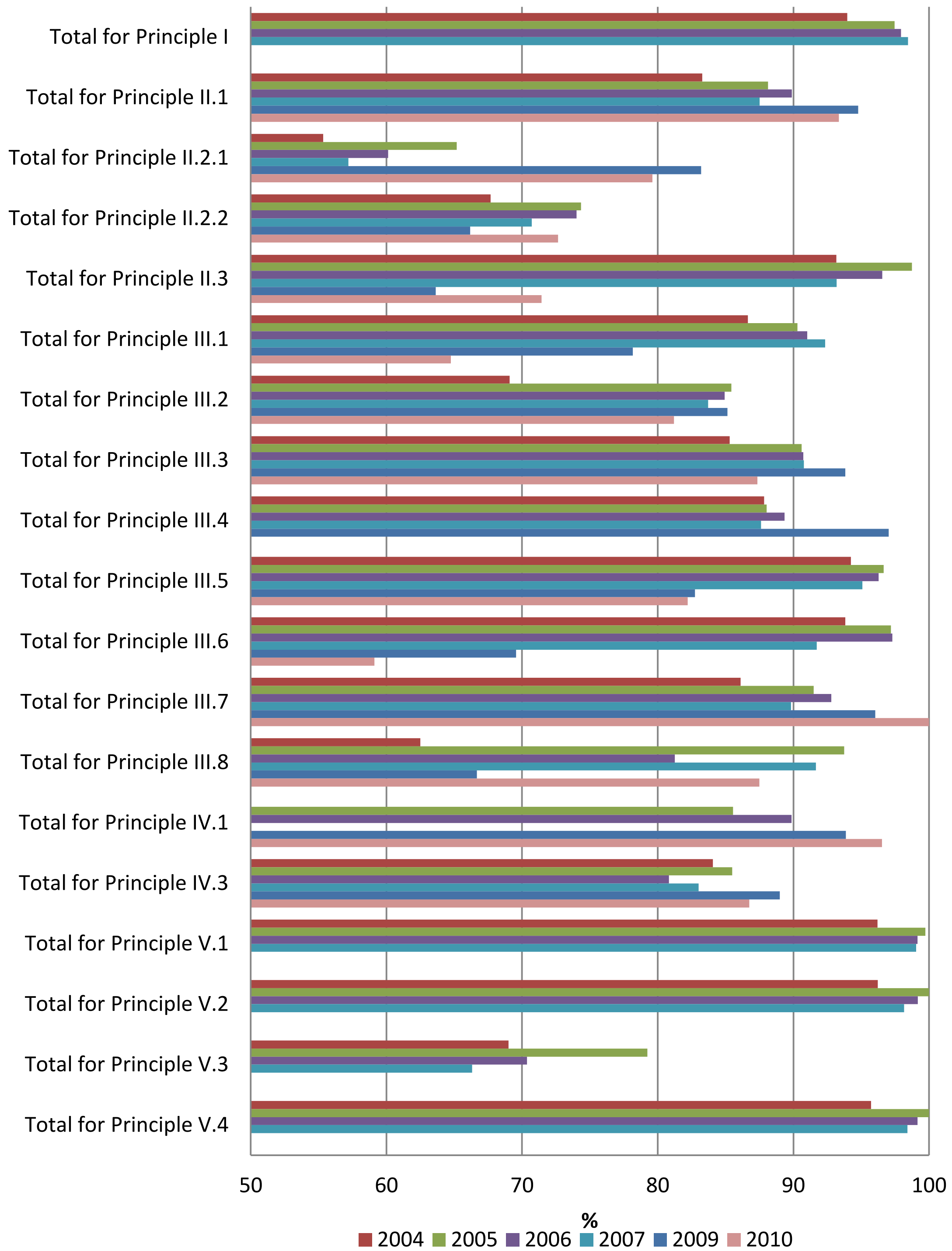


Source: SEO Economic Research, on the basis of University of Groningen 2005, 2006, 2007, 2008, 2010 and 2011a.

---

40 For the principles, see Box 3.1.

Figure 3.2 For roughly half of the principles, the *application* rate is 90% or more[41]



Source: SEO Economic Research, on the basis of University of Groningen 2005, 2006, 2007, 2008, 2010 and 2011a.

What stands out is that the compliance rate for most principles is 90% or more, with compliance being lowest, on average, in 2004, the year that the code entered into force but was still not

41 For the principles, see Box 3.1.

embedded in law. In other words, with a few exceptions, compliance with the code is generally high. That the definition of compliance and the quality of the explanations given has an impact on this was shown by the surveys conducted by RiskMetrics (2009) and the Dutch Association of Shareholders (VEB) (2009), see Box 3.3. The committee has stated that there is room for improvement in the quality of the explanations given,[42] and also points out every year that, in view of the legal embedding of the *comply or explain* principle, compliance should be 100%.

Box 3.3 Other research has found lower rates of compliance and application

In 2009, RiskMetrics divided 65 explanations given by 15 Dutch companies for non-application of the code into five categories. Only explanations in the categories 'specific' (tailored to the company's particular situation) or 'transitional' (the provision will be applied at a later stage) are accepted as *informative* explanations. They represent 68% of the explanations given. Consequently, the Netherlands is one of the countries, along with the United Kingdom, France, Belgium and Sweden, where the explanations given are regarded as most informative. With an average of four explanations per company, the number of explanations given by individual companies in the Netherlands is also relatively high. The subjects on which explanations were given most frequently were severance payments and the maximum period of appointment for directors, the independence of members of supervisory boards and performance criteria for options that have been granted.

Category of explanation given	**%**
Invalid	9
General	14
Limited	6
Specific	54
Transitional	14
Total informative	**68**

The VEB reviewed the application of the Dutch code during the period 2004-2008 (VEB, 2009). In its survey, the association assigned greater weight to provisions relating to remuneration policy and participation by shareholders in decision-making. The VEB studied the application of the 64 most specific best practice provisions by 45 listed companies and arrived at an application rate of 65% in 2008, slightly higher than in the three preceding years (63%), but significantly lower than the figures of the monitoring committee. The points on which the companies diverged most from the best practice provisions were, according to the VEB, the remuneration policy, the assessment of the strategy and risks by the supervisory board and the independence of the supervisory board.

Source: SEO Economic Research, on the basis of RiskMetrics (2009) and VEB (2009).

42 Corporate Governance Code Monitoring Committee (2011).

3.3 Low rate of compliance or application

Principles II.2.1 and II.2.2 (level, composition and disclosure of remuneration)

Principles II.2.1 and II.2.2 relate to the level and composition of remuneration of the members of the management board and disclosure of their remuneration, respectively. Since chapter II.2 of the code contains two principles, a distinction has to be made between the best practice provisions falling under principle II.2.1 (best practice provisions II.2.1 to II.2.9) and principle II.2.2 (best practice provisions II.2.10 to II.2.15).

Compliance with principle II.2.1 had risen to above 90% in 2010. The application rate for the principle had lagged behind for a long time, but was 80% in 2010. The committee felt that one reason for the higher application rate was a drop in the number of times that an explanation was given for non-compliance with best practice provision II.2.8, which prescribes the maximum severance payment for board members. In previous years, a relatively large number of companies had said they wanted to honour existing contracts. In fact, that is only a valid explanation for contracts that were concluded before the introduction of the code in 2004. In 2010, this explanation was not given by any company in relation to new appointments.[43] Explanations were also given relatively frequently for the non-application of provision II.2.6 in the 2004 code. However, this provision, which describes how companies should deal with board members' ownership of and transactions in securities other than securities issued by their own company, was no longer included in principle II.2.1 in the updated code in 2008 and is therefore not included in the figures for 2010.[44]

Principle II.2.2 had the worst record of compliance and application, with little disparity between the level of compliance and application. Accordingly, relatively little explanation was given for the non-application of this principle in the code. The low compliance and application rates for this principle are due to the low rate of compliance with best practice provision II.2.13, which specifies ten points that must be included in the remuneration report, in which the supervisory board presents an overview of its remuneration policy. The compliance rate with this best practice was only 66% in 2010. Provisions II.2.12 (the content of the supervisory board's remuneration report) and II.2.14 (disclosure of the main elements of the contract concluded with a new board member) are also among the provisions least frequently complied with.

Principles III.2 (Independence of the Supervisory Board), III.8 (One-tier management structure), IV.3 (Provision of information) and V.3 (Internal audit function)

Explanations are frequently given for the non-application of principle V.3 on the internal audit function. Whereas compliance fluctuated around 95%, application stalled at 70% in most years. The most frequent explanation given was that the company concerned did not employ an internal accountant and could therefore not comply with the provision. There were also significant differences between compliance and application with respect to principles III.2 and III.8. For

43 Corporate Governance Monitoring Committee (2011).

44 Corporate Governance Monitoring Committee (2008a).

principle III.8, this can be attributed to the relatively small number of companies with the one-tier management structure to which the provision applies, which could also explain the heavy fluctuation. For principle III.2 on the independence of the members of the supervisory board, a number of companies initially opted for a high degree of engagement by the member of the supervisory board with the company, if necessary through share ownership, over that member's independence.[45] The application of the principle increased in later years.

Finally, the relatively low application rate of principle IV.3 (provision of information to shareholders) is also noteworthy. Provision IV.3.1 is largely responsible for this. It provides that presentations or meetings must be announced in advance on the company's website and that facilities should be provided for shareholders to follow these meetings remotely by telephone or webcasting. A frequently mentioned reason for non-application of this principle, particularly by small companies, is that the associated costs are too high.[46]

3.4 Increase or decline in compliance and application

In addition to the lower than average rate of compliance or application with the principles referred to above, a number of widespread trends can be observed in terms of general compliance with and application of the principles. On the one hand, there are principles for which compliance and application have risen steadily over the years. That trend is most evident in the case of principles with which compliance was already high from the outset. Examples include principle I on compliance with and enforcement of the code and principle II.1 on the role and procedure of the management board.

On the other hand, there are also some principles for which the rate of compliance and application, after peaking (usually in 2005 or 2006), abated in subsequent years. Examples include principles II.3, III.5, III.6 and V.3.

Principles II.3 (Conflicts of interest in the management board), III.1 (Role and procedure of the Supervisory Board), III.5 (Composition and role of key committees), III.6 (Conflicts of interest in the Supervisory Board) and V.3 (Internal audit function)

In the case of principle II.3 (conflicts of interest of management board members), the observed decline is connected with the very small number of observations (seven) on which the figures for 2009 and 2010 were based. In those years, only companies where a conflict of interest (as described in provision II.3.4) had actually occurred were studied. In addition, compliance with provisions II.3.1 to II.3.3 was no longer measured in those years, which means few conclusions can be drawn from the decline in compliance with principle II.3 shown in Figure 3.1. A similar situation applies for principle III.5 (drawing up terms of reference for committees): the number of observations for 2009 and 2010 is roughly half the number in earlier measurements. Moreover, the analysis of compliance with provision III.5.1 now considers not only the comprehensiveness of the committee rules, but also public access to them. Consequently, the rate of application is

45 University of Groningen (2005).
46 Corporate Governance Code Monitoring Committee (2008b).

lower, but the rate of compliance compared with earlier years was not affected. Principle III.1 (role and procedure of the supervisory board) stands out because of a visible decline in compliance and application following the amendment of the code in 2008. This is connected with an addition that was made to best practice provision III.1.7. The revised code not only requires the supervisory board to discuss its own functioning and the functioning of the management board every year, but also requires it to report on how the evaluation was carried out in the annual report. The University of Groningen regards the greater complexity of this provision as the principal reason for the lower compliance.[47]

A minor, but relevant, change made in provision III.6.5 when the code was updated in 2008 also affected principle III.6 (conflicts of interest in the supervisory board). This provision now contains provision II.2.6 from the former code concerning ownership of and transactions by members of the management or supervisory board in securities other than those issued by their own company. The greater compliance with principle II.1 is therefore partially artificial, since it is at the expense of compliance with principle III.6 in the years following the updating of the code. As regards principle V.3 (the internal audit function), the lower application rate is in itself difficult to explain, although the committee suggests that the reason is the lower rate of application among local, relatively small companies.[48]

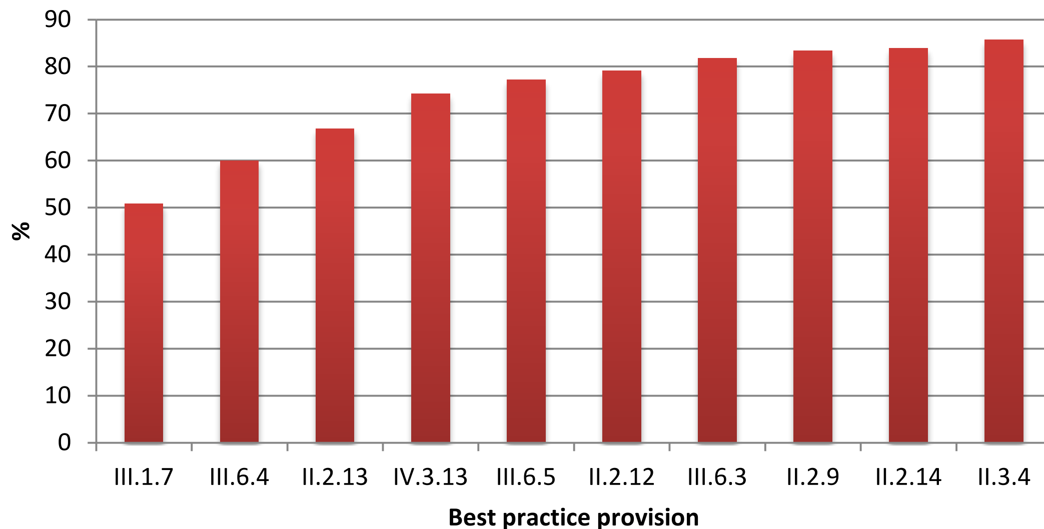
There is no clear upward or downward trend with respect to slightly more than half of the principles. The compliance rate for these principles is high and fluctuates around 95%, with a correspondingly high application rate. Companies never seem to have had any objections to the terms of these principles.

3.5 Best practice provisions

Every principle is fleshed out with a number of best practice provisions. Compliance with a principle therefore depends on compliance with the underlying best practices. It is clear from the preceding sections that compliance with a best practice provision can have an impact on the level of compliance with the principle as a whole. However, it is also possible for compliance with or application of the principle as a whole to be high, but for this not to be reflected with respect to one or more of the underlying best practices. An example of this is provision II.1.1 (period of appointment of board members), which has an application rate of 46%, while principle II.1 (role and procedure of the management board) as a whole is applied in 93% of cases. Because it is possible that best practice provisions such as II.1.1 actually have the greatest impact, it is also interesting to look at the level of compliance with individual provisions. Figure 3.3 and Figure 3.4 show best practice provisions with the lowest compliance and application rates in 2010, the most recent year for which data were available at the time this report was written.

[47] University of Groningen (2010).
[48] Corporate Governance Code Monitoring Committee (2008b).

Figure 3.3 Lowest compliance rate with provisions is at least 50%[49]

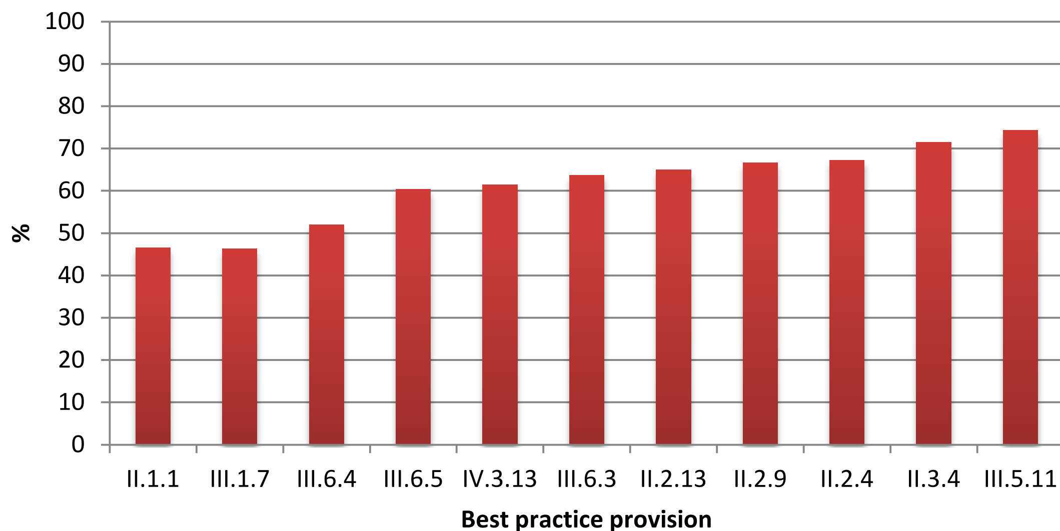


Source: SEO Economic Research, on the basis of the University of Groningen 2005, 2006, 2007, 2008 and 2011a.

The majority of the best practice provisions in these graphs have already been discussed, since many of them fall under the principles that stand out because the compliance rate is low (II.2.1 and II.2.2) or has declined over time (II.3, III.1 and III.6). The strong correlation between compliance and application is also noteworthy. Seven of the ten best practices that are least frequently applied are in the top ten of the provisions that are least often complied with. The exceptions are II.1.1, II.2.4 and III.5.11 (see below). Although compliance with these three provisions is high (>90%), explanations for non-application are also given relatively often (53% of cases with respect to II.1.1 and 25% and 24% of cases for II.2.4 anmd III.5.11, respectively).

49 II.2.1: Level and composition of the remuneration of management board members; II.2.2: Disclosure of the remuneration of management board members; II.3: Conflicts of interest of management board members; III.1: Role and procedure of the Supervisory Board; III.6: Conflicts of interest; IV.3: Provision of information.

Figure 3.4 Application remains below 50% in a couple of instances[50]



Source: SEO Economic Research, on the basis of the University of Groningen 2005, 2006, 2007, 2008 and 2011a.

Best practice provisions II.1.1 (Role and procedure of management board), II.2.4 (Level and composition of remuneration) and III.5.11 (Remuneration committee)

Best practice provision II.1.1 provides that a board member may be appointed for a maximum period of four years and reappointed for a maximum period of four years. One reason why an explanation is given for non-application of this provision so frequently is the relatively large number of board members that had been appointed for an indefinite period before 2004 (prior to the introduction of the code). Other reasons given for not applying the code on this point were the interests of preserving continuity in the board, the company's long-term perspective and the undesirability of changing the terms of employment for new board members.[51] Unfortunately, there is no similar breakdown available of the reasons given for not applying provision II.2.4 on the conditions and period for exercising options. This provision is one of the best practices for which an explanation of non-compliace has been given most frequently since 2004. For the 2008 financial year, it was found that a reason given relatively frequently was that the company had its own rules on this subject.[52] Provision III.5.11 prescribes that the remuneration committee may not be chaired by the chairman of the supervisory board or by a former member of the management board of the company concerned. The individual concerned may also not perform either of these functions at another company. Compliance with this provision has been high from the outset, with application fluctuating between 70% and 75%. Although non-compliance with this provision is explained relatively often, the reports of the University of Groningen and the monitoring committee provide no further breakdown of the reasons given.

50 II.1: Role and procedure of management board; II.2.1: Level and composition of the remuneration of board members; II.2.2: Disclosure of the remuneration of board members; II.3: Conflicts of interest in the management board; III.1: Role and procedure of the Supervisory Board; III.2: Independence of the Supervisory Board; III.5: Composition and role of key commitees of the Supervisory Board; III.6: Conflicts of interest in the Supervisory Board; IV.3: Provision of information.

51 University of Groningen (2011b).

52 University of Groningen (2009).

Newly inserted best practice provision IV.3.13 (Provision of information)

Of the new provisions added in the updated code in 2008, provision IV.3.13 is the only one to be found among the provisions that were complied with and applied least often in 2010. This provision states that a company shall formulate an outline policy on bilateral contacts with shareholders, which must also be posted on its website. Unfortunately, no analysis of the arguments put forward for not applying the principle is available. What is noticeable in this particular case is that it is mainly small companies (local or listed on the AMS index) that do not apply or explain their non-compliance with this provision. Among the 20 companies listed in the AEX index that were studied by the University of Groningen, compliance was 100% and application was 95%.

3.6 Responsibilities of institutional and other shareholders

Principle IV.4.1 is concerned with the responsibilities of institutional shareholders. Principle IV.4.2 is directed at all shareholders and is one of the new provisions in the updated code. Because compliance with principles IV.4.1 and IV.4 is not reported in annual reports, it is not possible to give an overview of compliance with them, as was done for the other principles in the preceding sections, or to make similar judgments regarding compliance with these principles.

In some years, however, the committee has analysed compliance with them and there are a number of observations that can be made on the subject. The most important finding made by the committee concerns the wide disparity in compliance between large institutional investors (assets of more than € 1 billion) and smaller institutional investors. Overall compliance with the best practice provisions under principle IV.4.1 (institutional shareholders) is between 55% and 66%. Among investors with invested capital of more than € 50 billion, the compliance rate is 88%. The compliance rate is also significantly higher than average among investors with invested capital of between € 1 billion and € 50 billion. The situation is similar with respect to principle IV.4.2 (all shareholders), which means that compliance among small institutional investors will be lower than average, which is already low.[53] The most recent report, for the 2010 financial year, once again showed that the compliance rate was high among large institutional investors. The only exception to this is provision IV.4.4, concerning the time within which the management board must repond if subjects raised by shareholders could lead to a change in the company's strategy. The response time of 180 days is frequently felt to be too long; a period of between 30 and 59 days is generally regarded as reasonable. For 2010, the smaller institutional shareholders were not assessed, so it is not possible to ascertain whether there was any improvement or deterioration in terms of compliance with principles IV.4.1 and IV.4.2.

[53] Corporate Governance Code Monitoring Committee (2010).

3.7 Reflection and conclusions

Compliance and application

The general level of compliance with the code has fluctuated between 90% and 92% since 2005 and can therefore be described as high. The compliance and application rates are also high for most of the individual principles and best practice provisions and have been relatively stable over the years. Accordingly, on average, there seems to be little room for improvement.

A number of principles stand out, however, in terms of the relatively low rate of compliance or application. These are the provisions relating to the remuneration of board members and transparency about it, the independence and conflicts of interest of members of the supervisory board and the provision of information to shareholders (II.2.1, II.2.2, III.2, III.6 and IV.3). These seem to be the areas where there is the greatest room for improvement, although in the most recent year, 2010, compliance with principles II.2.1 and IV.3 was in fact high.

Compliance could be increased (as would the transparency of corporate governance) if clear and valid explanations were provided more often when a best practice provision is not applied.[54] This is particularly true for the provisions of principle II.2.2, where transparency should in any case automatically play a central role (disclosure of the level and composition of remuneration). The absence of an explanation for non-application means that the grounds on which companies decide not to apply a principle cannot be identified, which makes it difficult to interpret trends in compliance with and application of best practice provisions. More and better explanations would therefore not only enhance transparency, but potentially also the quality of monitoring. On the other hand, providing clearer explanations might create additional costs or other disadvantages for the companies concerned.

In addition to further explanation, *application* could also be improved, i.e., a change in corporate governance itself. For example, a desire to honour agreements concluded before 2004 was put forward relatively often as a reason not to apply provisions concerning the length of a contract or remuneration. Insofar as new employment contracts take account of the code, it seems to stand to reason that the application of those provisions where prior agreements are a factor will increase further.

Transparency and corporate governance

The two key elements of the operation of the corporate governance code are information about corporate governance ('transparency') and corporate governance itself ('conduct'). There is a relationship between the application of best practice provisions and corporate governance (since the provisions concern corporate governance). Whether or not they are applied says something about a company's corporate governance. It is not a one-to-one relationship, however, which also applies for the relationship between compliance and explanation, on the one hand, and transparency, on the other.

[54] University of Groningen (2011b).

Limits to what can be measured

As explained above, some principles are not covered by the monitoring because they are not included in the statement by the management board in the annual report (principles IV.2, IV.4.1 and IV.4.2). In 2010, the University of Groningen wrote the following in relation to the 2009 financial year: "the code also contains provisions that reflect an intention, or recommend a particular formulation of the articles of association. The [application] of such best practice provisions cannot be explicitly surveyed through verifiable actions. These provisions were ignored in this study ...". This raises the question of precisely where the line should be drawn between a provision that is just capable of being surveyed and a provision that is not quite capable of being surveyed.

Is what is said what actually happens?

The compliance reports produced by or for the monitoring committee are, in principle, based on annual reports, annual accounts and websites. With some best practice provisions, therefore, it can be established in fact whether a provision has been applied or not. (Think of a provision such as "The arrangements for whistleblowers can be found in public sources".) With other provisions, this is less likely, if possible at all. Appendix 2 of the University of Groningen's compliance report on the 2009 financial year (2010, Appendix 2, page 1) says on this point that if application cannot be explicitly established ('in fact'), but no information can be found to indicate the opposite, 'implicit' application of a best practice provision is assumed. This introduces an uncertainty, because it is not clear whether the provision was *actually* applied.

A related question is whether what is *not* stated actually happened. According to the preamble to the code, listed companies are obliged to report on compliance with the code in their annual report and must also explain why principles and best practice provisions directed at the management board and the supervisory board have not been applied. The preamble states: "The company should state each year in its annual report how it applied the principles and best practice provisions in the code in the past year and should, where applicable, carefully explain why a provision was not applied."[55] The explanatory memorandum to the Order in Council in which the code was designated as a code of conduct (the legal embedding of the code) states: "the company does not have to state for each individual provision that it is [applying it]. But a company that departs from a provision must state that it is doing so and explain its reasons." All things considered, there does seem to be room for implicit application of the code.

Ambiguity of provisions

Most of the provisions are not unambiguous. The reason for this is that the purpose of the code of conduct is not to lay down comprehensive rules of behaviour, but to provide guidance. The consequence is that information about whether or not principles are applied is not complete enough to draw definite conclusions about corporate governance. If a member of the management board is appointed for a period of a maximum of four years, it is not immediately clear for precisely how many years that board member is being appointed. And vice versa, if a board member is *not* appointed for a period of a maximum of four years, it is not clear for how

[55] Article 3 of the Order in Council of 30 December 2004, in which the code was designated as a code of conduct within the meaning of Article 2:391 paragraph 5 of the Dutch Civil Code (DCC), reads: "The company shall report in the annual report on the [application] of the principles and best practice provisions [...] that are addressed to the management board or the supervisory board of the company. If the company has not [applied] those principles or best practice provisions or does not intend to [apply] them in the current or succeeding financial year, it shall disclose that with a statement of the reasons in the annual report".

many years the board member is being appointed. No two whistleblower regulations are the same, to give just one other example. Giving an explanation (reasons) of why a provision has not been applied does not necessarily imply that precisely what is being applied has been explained.

Conclusion

The value of these findings regarding compliance with and application of best practice provisions lies in the impression they give of the current situation and trends in corporate governance among Dutch listed companies. This information provides indicators for identifying strengths and weaknesses of the system, showing where there is room for improvement, and making international comparisons, etcetera.

Although analyses of application and compliance are valuable, they do not provide a uniform impression of corporate governance practices and transparency about them: the code and its statutory basis leave room for implicit compliance; compliance with some provisions is difficult or impossible to verify; and information about adherence or otherwise to the comply or explain regime does not necessarily provide information about the corporate governance policies that are actually pursued. As mentioned above, this follows in part from the code's structure as a self-regulating code of conduct. The importance of this for stakeholders such as shareholders depends on what information in the annual reports and from the monitoring is relevant to them. On which elements of corporate governance is specific information useful for making a judgment about a company?

4 International comparison

4.1 Introduction

This chapter compares the system of regulation and monitoring of corporate governance in the Netherlands with the systems in seven other countries, to give an indication of where the Netherlands stands in international terms and what alternatives there are. The United States (US) is the only non-European country included in this comparative survey and the only one that does not have a code. Rather, it has a law that governs a range of subjects that includes corporate governance. The United Kingdom (UK) is regarded as a front runner within the EU in terms of corporate governance regulation. In Sweden and Ireland, private parties play a relatively large role in relation to the code. In France and Italy, companies are not obliged to refer to a code. The situation in Germany is most similar to the Netherlands. An overview of the regulation of corporate governance in these countries is presented in the tables at the end of this chapter.

European Directive 2006/46/EC and amending legislation such as Directive 78/660/EEC (see Box 4.1) are applicable in EU member states. By virtue of these directives, member states must oblige listed companies to provide information about corporate governance in their annual reports. If companies refer to a code, the comply or explain principle applies. If they do not, then “all relevant information about corporate governance practices applied beyond the requirements under national law” must be published. The directive says nothing about monitoring compliance with the code and contains no specific provisions on sanctions.

Box 4.1 The EU Directives on statements about corporate governance

Directive 2006/46/EC of the European Parliament provides that listed companies in the EU are obliged to include a corporate governance statement in their annual report (Recital 10):
“*Companies whose securities are admitted to trading on a regulated market and which have their registered office in the Community should be obliged to disclose an annual corporate governance statement as a specific and clearly identifiable section of the annual report. That statement should at least provide shareholders with easily accessible key information about the corporate governance practices actually applied, including a description of the main features of any existing risk management systems and internal controls in relation to the financial reporting process. The corporate governance statement should make clear whether the company applies any provisions on corporate governance other than those provided for in national law, regardless of whether those provisions are directly laid down in a corporate governance code to which the company is subject or in any corporate governance code which the company may have decided to apply.*”

The amendment to Directive 78/660/EEC states as follows (Article 46a):
“*A company whose securities are admitted to trading on a regulated market within the meaning of Article 4(1), point 14, of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments shall include a corporate governance statement in its annual report. That statement shall be included as a specific section of the annual report and shall contain at least the following information: a) a reference to: (i)the corporate governance code to which the company is subject, and/or (ii) the corporate governance code which the company may have voluntarily decided to apply, and/or(iii) all relevant information about the corporate governance practices applied beyond the requirements under national law. Where*

points i) and ii) apply, the company shall also indicate where the relevant texts are publicly available; where point iii) applies, the company shall make its corporate governance practices publicly available."

Article 50 then reads:
"*Member states shall ensure that the members of the administrative, management and supervisory bodies of the company have collectively the duty to ensure that the annual accounts, the annual report and, when provided separately, the corporate governance statement to be provided pursuant to Article 46a are drawn up and published in accordance with the requirements of this directive.*"
If there is a code, the directive also imposes the comply or explain principle (Article 46a(1)(b)):
"*To the extent to which a company, in accordance with national law, departs from a corporate governance code …[it shall give] an explanation as to which parts of the corporate governance code it departs from and the reasons for doing so. Where the company has decided not to apply any provisions of a corporate governance code … it shall explain its reasons for doing so.*"
Another obligation arising from this directive is for the statutory auditor to check that the corporate governance statement has been produced.

Source: European Parliament and the Council (2006)

For the purposes of making a broad comparison of the various regulatory systems of corporate governance, the elements are grouped under three main aspects: regulation, monitoring, and supervision of corporate governance (see also subsection 2.1.2). For each of these aspects, it is shown whether they exist and whether they are privately regulated, publicly regulated (in laws) or involve a combination of public and private regulation. These aspects are assessed seperately, with the exception of the hypothetical situation where there is no regulation of corporate governance (no code, no law) and, therefore, no compliance or application to monitor or to exercise supervision over. This situation does not arise in any of the countries investigated.

Box 4.2 Notes to the classification of corporate governance regulation

For aspect 1, *regulation*, where there is no government regulation that *specifically* and *systematically* addresses corporate governance and there is also no self-regulation (regulation by private parties), it is referred to as 'no regulation'. If there is a governance code that has been drawn up by private actors but which has no statutory basis and involves no other explicit government intervention, it is referred to as 'private' regulation. A combination, for example of legal embedding and/or a public-private initiative, is referred to as 'public-private'. A law, as in the US, is designated 'public'. Aspect 2, *monitoring,* is defined as the collection and disclosure of information regarding compliance with and application of corporate governance. This monitoring can be performed by private parties, by public parties or by a combination of the two. A monitoring committee with private members, an official secretariat and research financed by the government, as in the Netherlands, is referred to as a mixed committee. Finally, *supervision* is regarded as the possibility of imposing *sanctions specifically* in relation to corporate governance (by virtue of a law or a code). *Naming* is considered the mildest form of sanction. The question is which party has the authority to impose sanctions (private or public).

Source: SEO Economic Research

The classification described in Box 4.2 is intended to show the regulatory framework for corporate governance in a country at a glance. Countries may also differ in other respects, so the classification is used to provide a *summary* of the system in each country. Before coming to that, however, countries are compared on the following aspects:

- the existence of a monitoring committee;
- the content of a code or law (see Table 4.19 at the end of this chapter): which companies are obliged to comply with it and which parties initiate and monitor compliance;
- the definition of compliance;
- the legal embedding of codes: is there a reference to a corporate governance code in national legislation? This does not mean that compliance with every provision in the code is required by law, since that would contradict the principle of comply or explain, which facilitates a tailored approach;
- the date of publication of the first code or law. In some countries a later code or law has been adopted, in which case that is mentioned in the text.

Differences between regulatory systems in the countries investigated could also arise from different management models. The majority of countries, including the US and the UK (and Ireland), have a *one-tier* management model. The Netherlands and Germany are the only two countries that predominantly employ a *two-tier* management model. However, in the Netherlands a law allowing for the adoption of the one-tier model by private (BV) and public (NV) companies was expected to be introduced from 1 January 2013. Listed companies in France, Italy and Sweden can use both models, but usually adopt a one-tier system. In the one-tier model, there are not two separate boards (the management board and the supervisory board), but a single board with both *executive* and *non-executive* directors. These two types of directors correspond with the executive members of the management board and the supervisory members of the supervisory board in the Dutch system. In the one-tier system, the non-executive board members are more closely involved in the organisation's policy than is the case with the supervisory board in the two-tier system. In other words, in the one-tier system there is a single board with two separate tasks. In the two-tier model, the supervisory board exercises supervision.

The individual countries are discussed in sections 4.2 to 4.9. Section 4.10 provides a brief summary and concludes with a history of the creation of the different regulatory systems. Section 4.11 contains the two tables with details of the systems.

4.2 The Netherlands

Table 4.1 Corporate governance regulation in the Netherlands

Regulation	
Existence of corporate governance code	Yes. Dutch corporate governance code
First published	9 December 2003[56]
Content of the current code	22 principles, 128 best practices[57]
Initiators and monitors of the code	Private and public[58]
Legal embedding	Yes
Date of legal embedding	30 December 2004[59]
Which parties are subject to the code	All companies whose registered offices are in the Netherlands and which are listed on a stock exchange and all large companies whose registered office is in the Netherlands and whose shares or depositary receipts for shares have been admitted to trading on a multilateral trading facility or a comparable system[60]
Board structure	Two-tier[61] and – from 1 January 2013 – one-tier model are regulated by law
Monitoring and supervision	
Monitoring committee	Yes, a public-private committee
Date of introduction	Monitoring: 6 December 2004[62]
Frequency of monitoring	Annual report on compliance[63]
Monitoring: what is reported?	Statistics on compliance
Definition of compliance	'Apply or explain' principle
Sanctions, including:	Not applicable
Publication of individual compliance	Not applicable
Fines	Not applicable

Source: SEO Economic Research, on the basis of the sources footnoted in the table.

Regulation

In June 1997, the first Dutch corporate governance committee (the Peters Committee) published a report containing recommendations designed "to increase the transparency regarding corporate policy and improve the reporting on it and to give shareholders more control, so that they can correct inadequacies in policies or their implementation."[64] The committee was established under an agreement reached between the Dutch Association of Listed Companies (VEUO) and Euronext Amsterdam in 1996.[65] They called for a system of self-regulation through voluntary compliance and monitoring without enforcement. The first version of the Dutch corporate governance code was published by the Tabaksblat Committee in December 2003, and it was

56 Corporate Governance Code Monitoring Committee (2012a).
57 Corporate Governance Code Monitoring Committee (2008a).
58 RiskMetrics (2009), p 24.
59 Corporate Governance Code Monitoring Committee (2008a), recital 13.
60 Corporate Governance Code Monitoring Committee (2008a), recital 2. There is also a chapter devoted to shareholders, including institutional investors (recital 14).
61 Galle (2012).
62 Corporate Governance Code Monitoring Committee (2004).
63 Corporate Governance Code Monitoring Committee (2012b).
64 Corporate Governance Code Monitoring Committee (2012c).
65 Jong, De Jong, Mertens and Wasley (2005).

most recently amended on 10 December 2008.[66] The code contains 22 principles and 128 best practices (see Box 4.3). The monitoring committee comprises private members, with an official secretariat and public financing.

Box 4.3 Content of the Dutch corporate governance code[67]

The code is divided into chapters and principles covering the following subjects:

- Compliance with and enforcement of the code
- The management board
  - Role and procedure
  - Level and composition of remuneration
  - Determination and disclosure of remuneration
  - Conflicts of interest
- The supervisory board
  - Role and procedure
  - Independence
  - Expertise and composition
  - The chairman of the supervisory board and the company secretary
  - Composition and role of the three key committees of the supervisory board
  - Conflicts of interest
  - Remuneration
  - One-tier management structure
- The shareholders and the general meeting of shareholders
  - Powers
  - Depositary receipts for shares
  - Provision of information to and logistics of the general meeting
- Responsibility of shareholders
  - Responsibility of institutional investors
  - Responsibility of shareholders
- The audit of the financial reporting and the position of the internal audit function and the external auditor
  - Financial reporting
  - Role, appointment, remuneration and assessment of the functioning of the external auditor
  - Internal audit function
  - Relationship and communication of the external accountant with the organs of the company

Source: Corporate Governance Code Monitoring Committee (2008).

The code was embedded in the law on 30 December 2004.[68] With this statutory embedding and the private input in the drafting of the code, the Netherlands has a public-private regulatory system (see Table 4.2 above). The preamble indicates which parties have to comply with the code: "The Code applies to all companies whose registered offices are in the Netherlands and whose shares or depositary receipts for shares have been admitted to listing on a stock exchange,

66 Corporate Governance Code Monitoring Committee (2012a).
67 See also Chapter 3.
68 Corporate Governance Code Monitoring Committee (2008).

or more specifically to trading on a regulated market or a comparable system, and to all large companies whose registered offices are in the Netherlands (balance sheet value > € 500 million) and whose shares or depositary receipts for shares have been admitted to trading on a multilateral trading facility or a comparable system."[69]

Monitoring[70]

There is a monitoring committee, the Corporate Governance Code Monitoring Committee, which comprises members from the private sector and has an official secretariat. The committee was established by the Dutch government on 6 December 2004.[71] Every year it publishes a report on compliance with and application of the code by listed companies on the basis of research it has commissioned.[72] The report discloses the compliance and application rates for some of the best practices or subsections of the code. The committee also writes reports of a more qualitative nature on topics such as the conduct of shareholders, the functioning of members of supervisory boards and risk management. The code itself does not provide for the imposition of sanctions on companies that do not adhere to it. Accordingly, the Dutch code follows the apply or explain principle. Compliance with the corporate governance code is deemed to mean:

- Application of the best practices in the code (apply); or
- Departure from the best practices in the code with an explanation (explain).

Departure from the provisions of the code without an explanation is regarded as non-compliance. Listed companies are obliged to include a statement in their annual report concerning the application of the principles and best practice provisions that are addressed to the management board or the supervisory board.

Table 4.2 The Netherlands has a public-private corporate governance system without sanctions

	No	Private	Private/Public	Public
Regulation of corporate governance			X	
Monitoring			X	
Supervision	X			

Source: SEO Economic Research.

[69] Corporate Governance Code Monitoring Committee (2008a), Recital 2.
[70] See also Chapter 3.
[71] Corporate Governance Code Monitoring Committee (2004).
[72] Corporate Governance Code Monitoring Committee (2012b).

4.3 United States

Table 4.3 Corporate governance in the US

Regulation	
Existence of corporate governance code	No. There is the Sarbanes-Oxley Act (SOX)
First published	The law took effect on 29 July 2002
Content of the current law	The law has 11 titles, 66 sections
Initiators and monitors of the law	Public
Legal embedding	Yes. It is a statute
Date of legal embedding	29 July 2002
Which parties are subject to the law	Accountants, listed companies and foreign subsidiaries with a listing in the US.[73]
Board structure	One-tier[74]
Monitoring and supervision	
Monitoring committee	Monitoring of accountancy firms by PCAOB
Date of introduction of supervision	2002
Frequency of monitoring	Annual[75]
Monitoring: what is reported?	The activities of the Public Company Accounting Oversight Board (PCAOB)
Definition of compliance	No comply or explain principle; compliance is mandatory.
Sanctions	A stock exchange listing also requires internal controls
Disclosure of individual compliance	Yes, if criticism has not been addressed (accountants)[76]
Fines	Yes (accountants and directors)[77]
Other	Prison sentence and ban on performance of audits[78]

Source: SEO Economic Research, on the basis of the sources footnoted in the table.

Regulation

The United States does not have a corporate governance code. Corporate governance is regulated at two levels: the national level and at the level of the individual states. At the latter level, Delaware is an influential state. It offers a safe haven for listed companies because the *Delaware General Corporation Law* (DGCL) is flexible. A large number of them consequently have their registered offices in Delaware.[79] This section focuses on the national legislation.

At the national level, the *Sarbanes-Oxley Act* (SOX) has been in force since 2002. A large part of this law is devoted to disclosure and the role of accountants. Jackson (2010) refers to five main aims of the law: to strengthen the independence of accountancy firms; to improve the quality and transparency of financial statements in company reports; to improve corporate governance; to

73 IT Governance (2012).
74 Bohinc (2011).
75 Public Company Accounting Oversight Board (2011).
76 Public Company Accounting Oversight Board (2005), Title VIII of the act (Corporate and Criminal Fraud Accountability).
77 Public Company Accounting Oversight Board (2005).
78 SOX, Section 802 Title VIII: Corporate and Criminal Fraud Accountability.
79 For more information about the law in Delaware, see http://delcode.delaware.gov/title8/c001/index.shtml.

increase the objectivity of research; and to strengthen enforcement of federal securities law, including the imposition of sanctions.[80]

The Sarbanes-Oxley Act shifts part of the oversight of company audits from accountancy firms to the *Public Company Accounting Oversight Board* (PCAOB), with a view to preventing accounting irregularities. The law is based on the risk of conflicts of interest for accountants (as *gatekeepers*)[81] and therefore prohibits this professional group from providing other services to companies whose accounts they audit. The act does not address perverse incentives for board members and contains no provisions relating to the remuneration of board members or share options.[82] The law does contain formal rules concerning the systems of internal controls, designed to prevent fraud, that companies must adopt to ensure that the figures they report are correct. For example, the law requires the management of a listed company to make a declaration that its financial reports are correct. The internal controls must also be audited by both the management and an external accountant.[83] Companies that do not comply with the requirements of the law may not be listed on a stock exchange.[84] Section 302 requires listed companies to include a statement in their annual report, the requirements for which are similar to those for the mandatory statement in the Netherlands.

Box 4.4 The content of the SOX Act

The SOX Act contains 11 titles and 66 sections. The main points are as follows:

I. Public Company Accounting Oversight Board (PCAOB)
II. Auditor Independence
III. Corporate Responsibility
IV. Enhanced Financial Disclosures
V. Analyst Conflicts of Interest
VI. Commission Resources and Authority
VII. Studies and Reports
VIII. Corporate and Criminal Fraud Accountability
IX. White Collar Crime Penalty Enhancement
X. Corporate Tax Returns
XI. Corporate Fraud Accountability

Source: Sarbanes-Oxley Act.

Part of the SOX Act covers the supervision by the PCAOB of external accountants and aspects of corporate policy that are unrelated to sound corporate governance (Titles 1, 5, 6, 7, 10 and 11). In contrast with the Dutch code, in the US sanctions can be imposed for non-compliance with the SOX Act. Title 8 and Section 305 cover these sanctions and the rules relating to whistleblowers. (There is also a whistleblower regulation in the Dutch code; best practice II.1.7.) The relationship between the internal audit committee, which must be part of the management board, and the external accountant is laid down in Section 301. The SOX Act has not expanded the rights and duties of shareholders (in terms of voting rights, the possibility of appointing

80 Jackson (2010).
81 Gatekeepers are external parties whose role is to provide transparency about a listed company (Bainbridge & W. D. Warren, 2012).
82 J. C. Coffee Jr. (2004).
83 IT Governance (2012).
84 SOX Act, Title III.

board members or legal liability, for example).[85] The law only addresses shareholders in their role as possible victims of fraud by the company (Sections 308 and 807). Title 4 and Section 302 of the act lay down the requirements for financial reporting (see Box 4.5). A relatively heavy emphasis is placed on the presentation of complete and accurate information, while in the Dutch code the emphasis is more on who is responsible for reporting.

In conclusion, the SOX Act does not address the responsibilities of shareholders, the remuneration of board members or the role of the management board; rather, it places more emphasis on the accuracy of financial and other business information.[86] Accordingly, the scope of the SOX Act is narrower than that of the Dutch corporate governance code.

Box 4.5 The most important sections in the SOX Act for listed companies

Section 302 (Title III, 'Corporate Responsibility for Financial Reports')
Periodic statutory financial reports are to include certifications that:

- The signing officers have reviewed the report
- The report does not contain any untrue statement of a material fact or omit to state a material fact in order to mislead
- The financial statements and related information fairly present the financial condition and the results in all material respects
- The signing officers are responsible for internal controls and have evaluated these internal controls within the previous 90 days and have reported on their findings
- The signing officers have disclosed a list of all deficiencies in the internal controls and information on any fraud that involves employees who are involved with internal activities
- The signing officers have indicated any significant changes in internal controls or related factors that could have a negative impact on the internal controls

Section 401 (Title IV (Enhanced Financial Disclosures), 'Disclosures in Periodic Reports')
Financial statements published by issuers [*listed companies*] are required to be accurate and presented in a manner that does not contain incorrect statements or omit to state a material fact. These financial statements shall also include all material off-balance sheet liabilities, obligations or transactions. The Securities and Exchange Commission (SEC) is required to study and report on the extent of off-balance transactions, resulting in transparent reporting to investors. The SEC is also required to determine whether generally accepted accounting principles or other regulations have resulted in open and meaningful reporting by issuers.

Section 404 (Title IV (Enhanced Financial Disclosures), 'Management Assessment of Internal Controls')
Issuers are required to publish information in their annual reports concerning the scope and adequacy of the internal control structure and procedures for financial reporting, as well as the effectiveness of such internal controls and procedures. In the same report, the registered accounting firm shall attest to and report on the assessment of the effectiveness of the internal control structure and procedures for financial reporting.

Section 409 (Title IV (Enhanced Financial Disclosures), 'Real Time Issuer Disclosures'.)

[85] Jackson (2010).
[86] Jackson (2010).

Issuers are required to immediately disclose to the public any information on material changes in their financial condition or operations. These disclosures are to be presented in plain language and should be supported by such information as the SEC deems appropriate.

Source: A Guide to Sarbanes-Oxley, 2006.

The SOX Act created the *Public Company Accounting Oversight Board* (PCAOB),[87] which monitors compliance with the law by accountants and the relationship between listed companies and accountants. In this regard, the US differs from countries like the Netherlands and the UK, where the code is targeted at the companies. In the US, the law applies mainly to accountants.

Passed on 29 July 2002, thanks to the Senators Sarbanes (Democrat) and Oxley (Republican), the act covers domestic companies and foreign subsidiaries that are listed on an American stock exchange.[88] The Securities and Exchange Commission (SEC) supervises listed companies, with the focus on the publication of market-related information by companies.[89] The SEC differs from the Financial Markets Authority (AFM) in the Netherlands in that it does have the power to prescribe the standards for reporting.[90]

Monitoring

Accountancy firms that produce audit reports for listed companies must be registered with the PCAOB and are monitored for compliance with the SOX Act.[91] The PCAOB publishes an annual report on its monitoring acitivities and inspects these accountancy firms every three years (with the exception of those firms that produce audit reports for more than 100 companies, which are inspected every year). The inspection encompasses two aspects: how the accountants maintain the quality and professionalism of their audits and how they handle specific auditing assignments for listed companies. Following the inspection, the PCAOB writes a report describing the results. If the accountant has failed to address criticism made by the PCAOB within 12 months, the PCAOB can make the criticism public.[92]

In addition to this monitoring function, the PCAOB also has the authority to impose sanctions. It can levy fines and, in extreme cases, it can prohibit accountancy firms or individual accountants from performing audits.[93] Under the SOX Act, if the conduct of an accountant or a director disrupts a legal investigation, he or she can also be fined or face a prison sentence of up to 20 years. Such conduct would include altering, destroying or falsifying documents. A fine or a prison sentence of up to 10 years can be imposed if an accountant consciously prevents the

87 The PCAOB describes itself as follows: "*The PCAOB is a nonprofit corporation established by Congress to oversee the audits of public companies in order to protect investors and the public interest by promoting informative, accurate, and independent audit reports*."
88 IT Governance (2012).
89 Coates (2007) and SEC (2012).
90 Camfferman (2008).
91 Public Company Accounting Oversight Board (2011).
92 Public Company Accounting Oversight Board (2005), Title VIII of the act (Corporate and Criminal Fraud Accountability).
93 Public Company Accounting Oversight Board (2005).

retention of all audit reports for a period of five years.[94] Compliance with the SOX Act is mandatory. The comply or explain principle is not adopted.[95]

Table 4.4 The US has a publicly regulated system with monitoring of accountants

	No	Private	Private/Public	Public
Regulation of corporate governance				X
Monitoring				X (accountants)
Supervision				X (accounts, directors and, via listing, companies)

Source: SEO Economic Research.

94 SOX, Section 802 Title VIII: Corporate and Criminal Fraud Accountability.
95 I. X. Zhang (2007).

4.4 United Kingdom

Table 4.5 Corporate governance in the United Kingdom

Regulation	
Existence of corporate governance code	Yes, the UK Corporate Governance Code[96]
First published	1 December 1992[97]
Content of the current code	18 principles and 52 provisions[98]
Initiators and monitors of the code	Public-private[99]
Legal embedding	Yes, in the Listing Rules of the London Stock Exchange
Date of legal embedding	December 1992[100]
Which parties are subject to the code	Companies with a Premium Listing of shares, regardless of the location of their registered office.[101]
Board structure	One-tier[102]
Monitoring and supervision	
Monitoring committee	Yes, Financial Reporting Commission (public-private)
Date of introduction	1 April 2004[103]
Frequency of monitoring	Since 2011,annual study
Monitoring: what is reported?	Percentage of companies that apply the provisions in the code, among other things
Definition of compliance	Comply or explain principle
Sanctions, including:	
Disclosure of individual compliance	Not applicable
Fines	FSA can issue fines to companies and board members[104]

Source: SEO Economic Research, on the basis of the sources footnoted in the table.

Regulation

In 1991, the *Financial Reporting Council* (FRC), the *London Stock Exchange* and accountants established the *UK Committee on the Financial Aspects of Corporate Governance.*[105] This combination of public and private parties published the *Cadbury Report* in December 1992, which was the first corporate governance code based on the comply or explain principle and originally involved a system of self-regulation. Under the *Listing Rules* of the *London Stock Exchange*, listed companies were obliged to disclose whether they complied with the recommendations in the report (comply or explain statement).[106] In addition, an external accountant had to evaluate the compliance report. Companies that failed to comply with the guidelines faced the risk of disputes.[107] The *Cadbury Report* was followed by various revisions of the code, the most recent being the *UK Corporate Governance Code* of September 2012. Since the *Cadbury Report,* the code has been

[96] Galle (2012).
[97] Galle (2012).
[98] Galle (2012), p. 121.
[99] RiskMetrics (2009), p. 24.
[100] Galle (2012), p. 12.
[101] Financial Reporting Council (2010a, p. 1).
[102] Bohinc (2011).
[103] Financial Reporting Council (2005).
[104] Galle (2012, p. 130).
[105] Arcot and Brunoy (2006).
[106] Financial Reporting Council (2012a).
[107] Jong et al. (2005).

embedded in law, with voluntary application, given the adoption of the comply or explain principle in the code.[108]

The *UK Corporate Governance Code* consists of 18 principles and 52 provisions.[109] The main points of the British code concern *non-executive directors*[110], the procedure for appointing board members and determining their remuneration, internal controls and financial reporting, and the meeting of shareholders. For the main points of the code, see Box 4.6.

Box 4.6 Content of the *UK Corporate Governance Code*

- Leadership
    - The role of the board
    - Division of responsibilities
    - The chairman
    - Non-executive directors
- Effectiveness
    - The composition of the board
    - Appointments to the board
    - Commitment
    - Development
    - Information and Support
    - Evaluation
    - Re-election
- Accountability
    - Financial and business reporting
    - Risk management and internal control
    - Audit committee and auditors
- Remuneration
    - The level and components of remuneration
    - Procedure
- Relations with shareholders
    - Dialogue with shareholders
    - Constructive use of the AGM

Source: Financial Reporting Council, 2010a.

In contrast with the Dutch corporate governance code, the main points of the UK corporate governance code do not address the responsibilities of the shareholders.[111] The UK code is also addressed almost entirely to the management board, while the Dutch code also includes chapters devoted to the shareholders and the external accountant[112]. The relationship with the institutional shareholders is governed by the *Stewardship Code* (see Box 4.7).

[108] Galle (2012).
[109] Financial Reporting Council (2010a).
[110] *Non-executive directors* are members of the board with no executive function. They are not officially employed by the company. The one-tier system applies in the UK, so their function can be compared with that of members of the supervisory board in the Netherlands.
[111] There is only a discussion of the *engagement principles* for institutional shareholders in *schedule C*.
[112] However, additional requirements were laid down for the audit committee in the updated version of the UK code in 2012.

Because of the major focus on the management board in the UK code, the relevant chapter lays down more rules than its counterpart in the Dutch code. The UK code contains principles relating to subjects such as evaluation of the board, the role of the chairman and the composition of the board. This is connected with the one-tier structure in the UK, whereas in the Dutch code such subjects are divided between the provisions relating to the management board and the supervisory board. In contrast with the British code, the Dutch code does include a principle on conflicts of interest of board members. Another difference is that, since 2004, shareholders in the Netherlands may vote on remuneration policy. In the UK, the government recently published a consultation document on this subject, in which it proposed introducing a binding vote for shareholders on remuneration policy and golden handshakes of more than one year's salary. It also proposes giving shareholders a non-binding vote on the application of the remuneration policy.[113]

Box 4.7 Aim and content of the *UK Stewardship Code*

The *UK Stewardship Code* was published in July 2010. It is targeted mainly at companies that manage the shares of institutional investors and its aim is to increase the engagement of institutional investors with listed companies. The code contains seven principles that institutional investors should adhere to. They should:

- publicly disclose their policy on how they will discharge their stewardship responsibilities. If use is made of proxy voting, the institution should say how it is applied;
- have a robust policy to prevent conflicts of interest and publicly disclose it;
- monitor companies in which they invest;
- establish clear guidelines on how shareholder value will be protected and enhanced;
- cooperate with other investors, where appropriate;
- have a clear policy on voting and disclosure of voting activity;
- report periodically on their stewardship and voting activities.

Source: See footnote[114].

The corporate governance code applies to companies with a *Premium Listing* of shares, regardless of where the company is incorporated.[115] These companies must include the following information in their reporting:

- A statement on how the company has applied the main principles. This must be verifiable by shareholders.
- A statement in which the company explains:
  - which provisions in the code have been complied with;
  - which provisions in the code have not been complied with; and
    - a specification of the relevant principles;
    - in the case of provisions containing continuing obligations, specify the period during which the provision was departed from;
    - the reason for not complying.[116]

113 Department for Business Innovation & Skills (BIS) (2012).
114 Financial Reporting Council (2012b) and Financial Reporting Council (2010b).
115 Financial Reporting Council (2010a, p. 1).
116 Galle (2012, p. 128).

Monitoring

Since March 2004, monitoring has been carried out by the *Financial Reporting Commission (FRC)*. Since 2011, the commission has published an annual report with statistics on compliance. The FRC is an independent body whose authority in relation to corporate governance is derived from the Listing Rules of the London Stock Exchange, but it does have connections with the government. For example, the government co-finances the FRC and appoints its chairman. Because of this link, we classify the monitoring as private/public.

Since 2000, the *Financial Services Authority* (FSA) has possessed the authority to impose fines on companies and directors.[117] The FSA is not a government body, but this power was delegated to it by the *Financial Services and Markets Act 2000* and it reports to the Chancellor of the Exchequer.[118] Sanctions can be imposed if the FSA finds that a company has not included a statement in the correct form in its annual report. However, the FSA only verifies that the statement is present; it makes no judgment on the accuracy or adequacy of the statement.[119] Neither the FSA nor the FRC publish information regarding compliance by individual companies.

Table 4.6 The UK has a public/private code with public/private monitoring and sanctions

	No	Private	Private/Public	Public
Regulation of corporate governance			X	
Monitoring			X	
Supervision			X	

Source: SEO Economic Research.

117 Galle (2012).
118 Financial Service Authority (2012).
119 RiskMetrics (2009).

4.5 Ireland

Table 4.7 Corporate governance in Ireland

Regulation	
Existence of corporate governance code	Yes. The UK Corporate Governance Code, supplemented by the Irish Corporate Governance Annex
First published	1999
Content of the current code	18 principles and 52 provisions,[120] supplemented by 6 principles and 20 provisions[121]
Initiators and monitors of the code	Private (Irish part)
Legal embedding	No
Date of legal embedding	Not applicable.
Which parties are subject to the code	Irish listed companies with a primary listing on the Main Securities Market
Board structure	One-tier
Monitoring and supervision	
Monitoring committee	Irish Stock Exchange. Grant Thornton conducts the research for the purposes of the monitoring
Date of introduction	Monitoring: 1999
Frequency of monitoring	Annually since 2007
Monitoring: what is reported?	Compliance with the code in general and conduct in relation to specific provisions[122]
Definition of compliance	Comply or explain principle
Sanctions	Yes
Disclosure of individual compliance	Not applicable.
Fines	Not applicable.
Cancellation of stock market listing	Irish Stock Exchange has the authority to suspend or cancel the listing if the code is not complied with[123]

Source: SEO Economic Research, on the basis of the sources footnoted in the table.

Regulation

For a long time, Ireland did not have its own corporate governance code. Instead, from December 1999, the country used the *Combined Code* adopted from the UK. The *Irish Stock Exchange* (ISE) adopted the provisions of this code, so that Irish listed companies had to report on compliance with that code. The *Combined Code* employed the comply or explain principle, which meant that Irish companies were also required to justify any departures from the code.[124] In 2010, the ISE published a consultation document with a view to drafting an Irish corporate governance code, which would be broadly similar to the *UK Corporate Governance Code* but supplemented with recommendations arising from an earlier study by the ISE and the *Irish Association of Investment Managers* (IAIM).[125] In 2010, this led to the adoption of new *Listing Rules* for the ISE and the *Irish Corporate Governance Annex*. Since 2010, listed companies in Ireland have

120 Galle (2012, p. 121).
121 Irish Stock Exchange (2010).
122 Grant Thornton (2011).
123 RiskMetrics (2009).
124 Office of the director of corporate enforcement (2012).
125 Irish Stock Exchange (2012).

had to comply with both the *UK Corporate Governance Code* and the *Irish Corporate Governance Annex*, both of which are based on the comply or explain principle.

For the content of the *UK Corporate Governance Code,* which focuses on the management board, see section 4.4. The *Irish Corporate Governance Annex* contains six additional principles (see Box 4.8), which also relate to a large extent to the management board. The principle concerning the composition of the board explicitly requires companies to explain why a particular board size and structure has been chosen, and the principle relating to the audit committee requires an explanation of the committee's activities in relation to risk management.

Box 4.8 The content of the *Irish Corporate Governance Annex*

- Board Composition
- Board Appointments
- Board Evaluation
- Board Re-election
- Audit Committee
- Remuneration

Source: Irish Stock Exchange (2010).

Monitoring

The comply or explain principle is the same as in the UK code (see section 4.4).[126] Compliance is monitored by the ISE, which has the authority to suspend or cancel a company's listing, according to its Listing Rules.[127] It may do so if the company does not comply with the provisions of the code (see Table 4.8). The *Irish Financial Services Regulatory Authority,* which is a government body, supervises the functioning of the ISE and has the power to revoke the ISE's authority. Accordingly, there is supervision of the private regulation by the ISE.[128]

Table 4.8 Ireland has a system of self-regulation

	No	Private	Private/public	Public
Regulation of corporate governance		X		
Monitoring		X		
Supervision		X		

Source: SEO Economic Research.

[126] Irish Stock Exchange Listing Rules, Chapter 6, Continuing Obligations, 6.8.3 (7).
[127] Irish Stock Exchange Listing Rules, Chapter 1, section 1.5.
[128] RiskMetrics (2009).

4.6 Germany

Table 4.9 Corporate governance in Germany

Regulation	
Existence of corporate governance code	Yes, German Corporate Governance Code[129]
First published	26 February 2002[130]
Content of the current code	73 recommendations
Initiators and monitors of the code	Private and public[131]
Legal embedding	Yes[132]
Date of legal embedding	26 February 2002[133]
Which parties are subject to the code	Listed German companies[134]
Board structure	Two-tier[135]
Monitoring and supervision	
Monitoring committee	Yes, public[136]
Date of introduction	Monitoring: September 2001[137]
Definition of compliance	Comply or explain principle from 15 May 2012. Previously indirectly via an article of the law[138]
Frequency of monitoring	Annual[139]
Monitoring: what is reported on?	The chance that companies will depart from the standards in the code in the future, as well as the efficacy of the recommendations and proposals in the code.
Sanctions	Not applicable[140]
Disclosure of individual compliance	Not applicable
Fines	Not applicable.

Source: SEO Economic Research, on the basis of the sources footnoted in the table.

Regulation

Germany has had a corporate governance code, the *Cromme Code,*[141] since 25 February 2002. Based on 150 recommendations by a government panel, the code was embedded in law by Article 161 of the *German Stock Corporation Act (AktG)*. It was a voluntary code in the sense that companies could depart from it if they disclosed that they had done so *(comply or disclose)*.[142] The most recent code is the *German Corporate Governance Code* of 26 May 2010,[143] which applies to

129 Commission of the German Corporate Governance Code (2012b).
130 European Corporate Governance Institute (2002).
131 Galle (2012, p. 155).
132 Galle (2012, p. 162, 170: Article 161 AktG).
133 Commission of the German Corporate Governance Code (2012).
134 Commission of the German Corporate Governance Code (2012b).
135 Galle (2012).
136 Commission of the German Corporate Governance Code (2012a). Carried out by the Berlin Center of Corporate Governance.
137 Commission of the German Corporate Governance Code (2012a).
138 Galle (2012), p. 163-164, Commission of the German Corporate Governance Code (2012b).
139 Performed by the Berlin Center of Corporate Governance.
140 "*Those who dare not comply with the code will be punished by the capital market*" (Galle, 2012, p. 166).
141 European Corporate Governance Institute (2002).
142 Galle (2012, p. 155).
143 European Corporate Governance Institute (2010).

German public limited companies with a stock market listing.[144] See Box 4.9 for the main points of the code.

Box 4.9 The content of the *German Corporate Governance Code*

- Shareholders and the general meeting of shareholders
  - Shareholders
  - General meeting
  - Invitation to the general meeting
- Cooperation between the management board and the supervisory board
  - Role and responsibilities
  - Composition and remuneration
  - Conflicts of interest
- Supervisory board
  - Role and responsibilities
  - Role and authority of the chairman of the supervisory board
  - Formation of committees
  - Composition and remuneration
  - Conflicts of interest
  - Analyses of efficiency
- Transparency
- Reporting and the audit of the annual financial report
  - Reporting
  - Audit of the annual financial report

Source: German corporate governance code (2010).

The German and Dutch codes are similar, except for the description in the Dutch code of the responsibility of shareholders, which does not appear in the German code, and the fact that the German code contains eight additional recommendations on transparency.

Monitoring

The code is monitored by the *Commission of the German Corporate Governance Code,* a public commission with members from the private sector, which was established in September 2001.[145] It monitors developments in the field of corporate governance and reviews the code at least once a year.[146] It cannot impose sanctions on companies that do not adhere to the code. It is assumed that companies that are guilty of misconduct will be punished by 'the capital market'.[147] Every year, the *Berlin Center of Corporate Governance* carries out a monitoring study for the commission.[148] This annual report includes a survey in which companies are asked to indicate how likely it is that they will depart from the standards in the code in the future. The Center also analyses the

144 Galle (2012) and Commission of the German Corporate Governance Code (2012b).
145 Commission of the German Corporate Governance Code (2012a).
146 Commission of the German Corporate Governance Code (2012).
147 Galle (2012).
148 Commission of the German Corporate Governance Code (2012) and Berlin Center of Corporate Governance (2012a).

usefulness of the recommendations and proposals in the code on the basis of the experience of directors and members of supervisory boards.[149]

Until the version of 15 May 2012, the German code did not explicitly contain the comply or explain principle, although it did adopt a *comply or disclose* principle, which meant that a company could depart from the provisions of the code but had to report that it had done so every year.[150] In practice, there was uncertainty about whether simply mentioning non-compliance was sufficient or whether an explanation had to be given. On 29 May 2009, therefore, a law amending Article 161 of the AktG entered into force, since when the comply or explain principle has applied under the new article.[151] The revised version of the code of 15 May 2012 also includes the comply or explain principle.[152]

Table 4.10 Germany has a public/private code without a system of sanctions

	No	Private	Private/Public	Public
Regulation of corporate governance			X	
Monitoring			X	
Supervision	X			

Source: SEO Economic Research.

[149] Berlin Center of Corporate Governance (2012b).
[150] Commission of the German Corporate Governance Code (2012b, foreword).
[151] Galle (2012, p. 164).
[152] Commission of the German Corporate Governance Code (2012b, foreword).

4.7 France

Table 4.11 Corporate governance in France

Regulation	
Existence of corporate governance code	Yes. Corporate Governance of Listed Corporations [153]
First published	October 2003
Content of the current code	22 recommendations, 47 criteria[154]
Initiators and monitors of the code	Private[155]
Legal embedding	No
Date of legal embedding	Not applicable
Which parties are subject to code	Legal entities that have their registered office in France and whose financial securities have been admitted to trading on a regulated market [156]
Board structure	One-tier and two-tier systems are possible, but the majority of companies adopt the one-tier structure
Monitoring and supervision	
Monitoring committee	Yes, public and private[157]
Date of introduction	AMF: 1 August 2003[158]
Frequency of monitoring	Annual
Monitoring: what is reported on?	Extent to which comply or explain principle is applied, as well as extent of compliance with specific provisions.
Definition of compliance	Comply or explain principle on a voluntary basis since 2009[159]
Sanctions, include:	No
Publication of individual compliance	Not applicable
Fines	Not applicable

Source: SEO Economic Research, on the basis of the sources footnoted in the table.

Regulation

France has had a corporate governance code - the *Corporate Governance of Listed Corporations*[160] - since 2003. The code applies to legal entities with their registered offices in France and whose financial securities are admitted for trading on a regulated market.[161] Most recently revised in April 2010, the code contains 22 recommendations and 47 criteria (see Box 4.10 for the principles laid down in the code).

---

153 Association Française des Entreprises Privées (Association of French Private-Sector Companies) and Mouvement des entreprises de France (French Business Confederation)(2003). Most recent version dates from April 2010.

154 Association Française des Entreprises Privées (AFEP) and Mouvement des entreprises de France (MEDEF) (2010).

155 RiskMetrics (2009), p. 24.

156 Autorité des marchés financiers (2010a).

157 Autorité des marchés financiers, Association Française des Entreprises Privées and Mouvement des Entreprises de France.

158 Autorité des marchés financiers (2012).

159 Autorité des marchés financiers (2010b) and European Corporate Governance Forum (2009).

160 Association Française des Entreprises Privées & Mouvement des entreprises de France (2003). Most recent version dates from April 2010.

161 Autorité des marchés financiers (2010a).

Box 4.10 The content of the *Corporate Governance of Listed Corporations*

- The board of directors: a collegial body
- The board of directors and the market
- Separation of the offices of chairman of the board of directors and chief executive officer
- The board of directors and strategy
- The board of directors and the meeting of shareholders
- Membership of the board of directors: guiding principles
- Representation of specific groups or interests
- Independent directors
- Evaluation of the board of directors
- Meetings of the board and of the committees
- Directors' access to information
- Duration of directors' terms of office
- Committees of the board
- The audit committee
- The appointments or nominations committee
- The compensation committee
- Deontology for directors
- Director's compensation
- Termination of employment in case of appointment as executive director
- Compensation of executive directors
- Information concerning compensation of executive directors
- Implementation of the recommendations

Source: Association Française des Entreprises Privées and Mouvement des entreprisies the France (2010).

The French *Corporate Governance of Listed Corporations* focuses heavily on the board of directors. As in some other countries, the supervisory board is not mentioned in the main points of the code because most listed companies adopt the one-tier management system. As a result, the subjects relating to the supervisory board in the Dutch code are covered in the provisions relating to the board of directors. The responsibilities of shareholders and the general meeting of shareholders are not extensively covered. There is only one recommendation relating to the meeting of shareholders. The auditing of financial reporting and the position of the internal audit function and of the external accountant are covered in a single recommendation in the French code. The code was drawn up by two private parties: the *Association Française des Entreprises Privées* (*Association of French Private-Sector Companies*, AFEP) and the *Mouvement des Entreprises de France* (*French Business Confederation*, MEDEF).[162] There is no statutory basis for the code.

Monitoring

Since 1 August 2003, the *Autorité des marchés financiers* (Financial Markets Authority, AMF) has produced an annual report based on information disclosed by listed companies.[163] The AMF reports on the extent to which the comply or explain principle is applied, as well as analysing compliance with specific provisions in more detail.[164] The AMF does not impose sanctions for

162 Association Française des Entreprises Privées and Mouvement des entreprises de France (2010).
163 Autorité des marchés financiers (2010a, 2012).
164 Autorité des marchés financiers (2010b).

non-compliance with the *Corporate Governance of Listed Corporations*. The private parties AFEP and MEDEF analyse the application of the French code and, if companies fail to comply with the recommendations without giving a good reason, they contact the company.[165]

France was one of the last EU member states to implement the comply or explain regime, doing so after 2009, and it is enforced less strictly than in other countries. Listed companies may comply with a code according to the comply or explain principle, but they are not obliged to refer to a specific code. However, any code that is referred to must have been drawn up by a representative trade association. From this it can be concluded that companies may decide for themselves which code they will comply with, although the legislature did have the codes drafted by the AFEP and MEDEF in mind.[166] If no code is referred to, a company has to make a statement to that effect and must explain its own corporate governance policy. Duhamel et al. (2012) describe the French comply or explain principle as "*apply or explain, and if you apply, comply or explain*."[167] When they refer to a code, companies must report any derogations from it in their annual report, but notice of compliance is not mandatory. Compliance can therefore be assumed if companies do not report any exceptions. Companies are, of course, free to provide more information about the application of a code or a further explanation of their non-compliance in their annual reports.[168]

Table 4.12 summarises the features of this system. Because of the private nature of the French codes and the fact that companies have the option of not referring to a code (but must then publish a statement and explain their corporate governance policy), the regulation of corporate governance is shown as private in the table below.

Table 4.12 France has a public-private corporate governance system without sanctions

	No	Private	Private/public	Public
Regulation of corporate governance		X		
Monitoring			X	
Supervision	X			

Source: SEO Economic Research.

165 RiskMetrics (2009).
166 Other possibilities are the codes of Association Française de Gestion 2008, Institut Français des Administrateurs 2007, Institut Montaigne 2003 and MiddleNext 2009.
167 Duhamel et al. (2012).
168 Duhamel et al. (2012).

4.8 Italy

Table 4.13 Corporate governance in Italy

Regulation	
Existence of corporate governance code	Yes, Corporate Governance Codes and Principles[169]
First published	October 1999[170]
Content of the current code	26 principles, 46 criteria[171]
Initiators and monitors of the code	Public and private[172]
Legal embedding	Yes[173]
Date of legal embedding	2006[174]
Which parties are subject to code	Listed companies
Board structure	Both one- and two-tier systems are possible, but the one-tier system is most common[175]
Monitoring and supervision	
Monitoring committee	Yes, public and private[176]
Date of introduction	4 June 1985[177]
Frequency of monitoring	Quarterly and half-yearly[178]
Monitoring: what is reported?	Number of companies that say they adopt the code, with specific focus on aspects such as the size of remuneration[179]
Definition of compliance	Comply or explain principle on a voluntary basis since 2006, legally embedded since 2009[180]
Sanctions	Disciplinary measures[181]
Publication of individual compliance	Yes, in the event of fines[182]
Fines	Yes[183]

Source: SEO Economic Research, on the basis of the sources footnoted in the table.

Regulation

The first Italian corporate governance code, the *Report & Code of Conduct* (the Preda Code), was published in 1999.[184] This code was drawn up by private parties under the guidance of the chairman of *Borsa Italia* (the Italian stock exchange).[185] The code has been embedded in law since

169 The most recent version is the Corporate Governance Codes and Principles from December 2011 (European Corporate Governance Institute, 2011).
170 The first code was the Report & Code of Conduct (The Preda Code) from October 1999.
171 Comitato per la Corporate Governance (2011).
172 Galle (2012), p. 175.
173 "The code has found a legal base in national legislation" (Galle, 2012, p. 185).
174 Galle (2012).
175 Galle (2012).
176 Comitato per la Corporate Governance, *Associazione fra le società italiane per azioni* (Assonime, the association of listed companies), *Borsa Italia* (the Italian stock exchange) and Commissione Nazional per le Società e la Borsa (Consob, the regulatory authority of the Italian securities market).
177 Commissione Nazionale per le Società e la Borsa (CONSOB) (2012).
178 See footnote 177.
179 Associazione fra le società Italiane per azioni (2012b).
180 RiskMetrics (2009) and Bianchi, Ciavarella, Novembre, & R. Signoretti (2010).
181 Galle (2012), p. 187.
182 Consolidated Law on Finance 2012 Article 192-bis.
183 See footnote 182.
184 The first code was the Report & Code of Conduct (The Preda Code) from October 1999.
185 Galle (2012, p. 175-176).

2006.[186] The most recent amended version of the code is the *Corporate Governance Codes and Principles,* dating from December 2011.[187] The code applies to listed companies.

The code includes 26 principles and 46 criteria (see Box 4.11 for the main points in the code).

Box 4.11 The content of the *Corporate Governance Codes and Principles*

- Role of the Board of Directors
- Composition of the Board of Directors
- Independent directors
- Internal committees of the Board of Directors
- Appointment of directors
- Remuneration of directors
- Internal control and risk management system
- Statutory auditors
- Relations with the shareholders
- Two-tier and one-tier systems

Source: Corporate governance codes and principles (2011).

The Italian *Corporate Governance Codes and Principles* are based on a management system without a supervisory board (one-tier). Only the last principle in the code addresses the issue of compliance with the principles in the code by companies with a two-tier system. The responsibilities of shareholders are not covered in the main points of the code. Relations with shareholders are only described from the perspective of the role of the board of directors.

Monitoring

The *Associazione fra le società italiane per azioni* (Assonime, the association of listed companies) analyses compliance every year.[188] The *Borsa Italia* (the Italian stock exchange) also publishes reports on listed companies.[189] The public institution, *Commissione Nazionale per le Società e la Borsa* (Consob) (the Italian Companies and Stock Exchange Commission), has been the regulator of the Italian financial products market since 4 June 1985.[190] One of its tasks is to examine the *accountancy* documents of listed companies.[191] It frequently publishes reports.[192]

Since 2006, the Italian code has also incorporated the comply or explain principle.[193] As in France, the principle is formulated slightly differently in Italy than in the other countries that were surveyed. The first sentence of the code states: "*Adoption of and compliance with this Corporate*

[186] "The code has found a legal base in national legislation" (Galle, 2012, p. 185 and p. 175).
[187] The most recent version is the Corporate Governance Codes and Principles from December 2011 (European Corporate Governance Institute, 2011).
[188] Galle (2012), p. 188.
[189] Associazione fra le società Italiane per azioni (2004).
[190] Commissione Nazionale per le Società e la Borsa (Consob), 2012.
[191] Commissione Nazionale per le Società e la Borsa (Consob), since 2007.
[192] Reports are published every quarter, including a half-yearly report. It is not clear whether every report includes details of compliance with the corporate governance code. (Commissione Nazionale per le Società e la Borsa (Consob), since 2007).
[193] RiskMetrics (2009) and Bianchi et al. (2010).

Governance Code (the "Code") is voluntary".[194] Companies therefore have the choice of adopting it and the comply or explain principle applies only if they adopt the code. In that case, they must provide the following information:

- clear information about how each recommendation in the code is applied;
- additional information about the reason for departing from a recommendation if it has not been complied with.[195]

Since 2009, the code has been laid down in Article 123-bis of the *Consolidated Law on Finance* (CLF), *implementing Directive 46/2006* (Section 2). This section leaves open the possibility of choosing other codes (although the code mentioned here is the only one at the moment) and says that, as a minimum, companies must report on corporate governance practices that do not follow from national legislation.[196]

If directors, members of auditing bodies and members of the board of directors do not comply with the disclosure requirements laid down in Article 123-bis, section 2 of the *Consolidated Law on Finance*, sanctions may be imposed. Fines can range between € 10,000 and € 300,000 and notices that they have been imposed are published in at least two national newspapers, including one financial newspaper.[197] This applies both for companies that have voluntarily adopted a code and companies that have not done so and are therefore required to provide information about their corporate governance practices that are not related to a code.

Table 4.14 Italy has a public/private code with a system of sanctions by a public party

	No	Private	Private/public	Public
Regulation of corporate governance			X	
Monitoring			X	
Supervision				X

Source: SEO Economic Research.

194 Comitato per la Corporate Governance (2011, p. 6).
195 Associazione fra le società Italiane per azioni (2012a).
196 The section reads (in part) as follows: "[...] information shall be provided regarding: a) adoption of a corporate governance code of conduct issued by regulated stock exchange companies or trade associations, giving reasons for any decision not to adopt one or more provisions, together with the corporate governance practices actually applied by the company over and above any legal or regulatory obligations. The company shall also indicate where the adopted corporate governance code of conduct may be accessed by the public; b) the main characteristics of existing risk management and internal audit systems used in relation to the financial reporting process, including consolidated reports, where applicable; c) the operating mechanisms of the shareholders' meeting, its main powers, shareholder rights and their terms of exercise, if different from those envisaged by legal and regulatory provisions applicable as supplementary measures".
197 Consolidated Law on Finance 2012, Article 192-bis.

4.9 Sweden

Table 4.15 Corporate governance in Sweden

Regulation	
Existence of corporate governance code	Yes, the Swedish Corporate Governance Code[198]
First published	1 July 2005
Content of the current code	10 principles, 49 criteria[199]
Initiators and monitors of the code	Private[200]
Legal embedding	No
Date of legal embedding	Not applicable.
Which parties are subject to code	All Swedish companies whose shares are traded on a regulated market in Sweden.[201]
Board structure	One-tier[202]
Monitoring and supervision	
Monitoring committee	Yes, private[203]
Date of introduction	Monitoring: 2005; Supervision: 1986
Frequency of monitoring	Annual
Monitoring: what is reported?	Compliance with code, number of explanations of non-compliance, quality of explanations[204]
Definition of compliance	Comply or explain principle[205]
Sanctions	No
Publication of individual compliance	Not applicable
Fines	Not applicable

Source: SEO Economic Research, on the basis of the sources mentioned in the table.

Regulation

Sweden has had a corporate governance code since 1 July 2005. The last revised version is the *Swedish Corporate Governance Code* of February 2010.[206] The code was produced by private parties. Before 2005 there were already rules, guidelines and recommendations on corporate governance drafted by organisations such as the *Swedish Industry and Commerce Stock Exchange Committee*, the *Swedish Securities Council* and the *Stockholm Stock Exchange*. In 2005, the private *Swedish Corporate Governance Board* was established to monitor and analyse the application of the code in practice. This board is authorised to make any changes to the code that may be required. On 1 July 2008, a new code entered into force, extending the application of the code to more companies. As a result, the current version of the code applies to Swedish companies whose shares are traded on the NASDAQ OMX Stockholm and NGM Equity exchanges.[207] The code is not embedded in law. It contains 10 principles and 49 criteria (see Box 4.12 for the main points of the code).

---

198 Swedish Corporate Governance Board (2010).
199 Swedish Corporate Governance Board (2010).
200 Swedish Corporate Governance Board (2012a).
201 Swedish Corporate Governance Board (2012c).
202 "*Boards of Swedish listed companies are composed entirely or predominantly of non-executive directors*" (Swedish Corporate Governance Board, 2010).
203 Lekvall (2009).
204 Swedish Corporate Governance Board (2011, p. 15 ff.).
205 Swedish Corporate Governance Board (2012b).
206 Swedish Corporate Governance Board (2010).
207 Swedish Corporate Governance Board (2012a).

Box 4.12 The content of the *Swedish Corporate Governance Code*

- The shareholders' meeting
- Appointment and remuneration of the board and statutory auditor
- The tasks of the board of directors
- The size and composition of the board
- The tasks of directors
- The chair of the board
- Board procedures
- Evaluation of the board of directors and the chief executive officer
- Remuneration of the board and executive management
- Information on corporate governance

Source: Swedish Corporate Governance Code, February 2010.

Because the one-tier system is adopted, the emphasis in the *Swedish Corporate Governance Code* is on the role of the board of directors of listed companies. The supervisory board is not discussed, nor (as stated in the introduction to the code) is the relationship with other stakeholders, the rules and operation of the stock market or the interaction between shareholders. The authors of the code felt that those topics fell outside the scope of a "*strictly owner-orientated view of corporate governance*".[208] Consequently, there is no mention of the responsibilities of shareholders, although there are provisions covering the general meeting of shareholders.

Monitoring

The Swedish code is based on the *comply or explain* principle, so companies do not have to apply every rule in the code to avoid the risk of non-compliance with the code. If a company derogates from the code, it must clearly state that it has done so and explain and substantiate the alternative policy it has adopted.[209]

Every year since 2005 the *Swedish Corporate Governance Board*[210] has monitored compliance with the code and reported on how the code has been complied with in practice, the number of times companies have chosen to explain non-compliance rather than apply the code, the information provided on the websites of the companies and the quality of the explanations.[211] The *Swedish Corporate Governance Board* does not have the authority to impose sanctions (see Table 4.16). The Swedish system can be characterised as self-regulation by the stock market.

Table 4.16 Sweden has private self-regulation without a system of sanctions

	No	Private	Private/public	Public
Regulation of corporate governance		X		
Monitoring		X		
Supervision	X			

Source: SEO Economic Research.

208 Swedish Corporate Governance Board (2010), section 1.5.
209 Swedish Corporate Governance Board (2012b).
210 Lekvall (2009) and Swedish Corporate Governance Board (2011).
211 RiskMetrics (2009).

4.10 Overview and history of regulatory systems

Overview

Table 4.17 summarises the systems discussed here and shows that all of the countries investigated have some system of regulation of corporate governance. The Netherlands, the United Kingdom, Germany and Italy have a public-private system of regulation; Ireland, France and Sweden have self-regulation; and the US has government regulation (SOX). Every country also has a form of monitoring. The Netherlands, Germany, France, Italy and the UK have public-private monitoring; Ireland and Sweden have private monitoring; and the US has government monitoring. The greatest variation lies in supervision and sanctions. Sweden, the Netherlands, France and Germany do not impose sanctions; in Italy and the US there are public sanctions; the UK has public-private sanctions; and Ireland has private sanctions.

Table 4.17 Summary of regulation, monitoring and sanctions in relation to corporate governance

	No	Private	Private/public	Public
Regulation of corporate governance		IR, FR, SW	**NL**, UK, GER, IT	US
Monitoring		IR, SW	**NL**, GER, FR, IT, UK	US
Supervision	**NL**, GER, FR, SW	IR	UK	US, IT

Source SEO Economic Research.

History

This survey shows that there are various types of codes and laws governing corporate governance. The question is why these differences exist. This section reviews whether the histories of the codes and/or laws reveal anything about the final choice of regulatory system.

In October 2001, the Enron scandal surfaced in the *United States*. This American energy company had hidden enormous debts. The board of directors was misled and the external accountant was persuaded to ignore the debt. The company ultimately failed, bringing down a major accountancy firm with it. A year later, WorldCom also went bankrupt. These events were an important driver of the Sarbanes-Oxley Act, which was passed by Congress in 2002.[212]

The debate about corporate governance in the *United Kingdom* arose following scandals involving companies such as Coloroll (1990), Polly Peck (1990), Maxwell Communications Corporation (1991) and BCCI (1991). The collapse of these companies shared a number of things in common. They had all recently been given a clean bill of financial health by their accountant, no action was taken by the non-executive directors, the companies had a powerful director and there was little involvement by institutional investors. These events prompted the creation of a commission by the *Financial Reporting Council* (FRC), the *London Stock Exchange* (LSE) and accountants. The FRC was concerned about the lack of accurate reporting, which meant the functioning of the company was not transparent for shareholders. The LSE was worried about harm to the City's reputation among investors. The accountants had a system of self-regulation and did not want to lose it and

212 J. C. Coffee Jr. (2004).

were also fearful of liability as a result of signing an audit report. The commission wrote the *Cadbury Report* in 1992.[213] In the mid-1990s, the UK was characterised by widespread share ownership, the presence of institutional shareholders, strong financial markets, influential financial media and a tradition of self-regulation, all of which led to the creation of a self-regulating corporate governance system. Monitoring and enforcement were left largely to the board of directors and the shareholders.[214]

For a long time *Ireland* had no corporate governance code of its own. Instead, the Irish Stock Exchange adopted the code drawn up in the United Kingdom. The country therefore has a self-regulating system on the initiative of a private party and implemented by a private party without further statutory rules. Supervision is also carried out by the private Irish stock exchange, which also has the authority to impose sanctions. A similar trend can been seen in *Sweden,* whose corporate governance code was drafted by private parties in 2005. The code is not embedded in law, supervision is exercised by a private party and - in contrast with Ireland - the private regulator has opted not to impose sanctions if companies do not adhere to the code.

In *France* the code was established by public and private parties but, in contrast to the Netherlands, Germany and Italy, it is not embedded in law. This might be related to the relatively late introduction of the comply or explain principle, which, even since its introduction, has been applied differently than in other countries.

In *the Netherlands* the Peters Committee advocated self-regulation via voluntary compliance and monitoring without enforcement.[215] The committee was set up by public and private parties, who were influenced by the developments with respect to corporate governance in the UK and the bankruptcy of DAF in 1994.[216] The government, however, felt that self-regulation was ineffective in some respects and, therefore, in 1999 it proposed a number of changes in the law designed to "*i) enhance the transparency of information provided by the company and the management board; ii) increase the control exercised by shareholders and iii) increase the possibilities for shareholders to participate in the decision-making at the general meeting of shareholders*".[217] Following the Ahold accounting scandal in 2003, the code was laid down in law in 2004 and a public committee was established to monitor compliance with it.

As in the Netherlands, the initiators and monitors of the code in *Germany* are both public and private parties. A public monitoring commission was also established to evaluate compliance with the code. The difference compared with the Netherlands is that the first German code in 2002 was immediately embedded in law, while this took a year in the Netherlands.

In *Italy* the debate about corporate governance was prompted by the privatisation of state-owned companies at the end of the 1990s, which raised problems with the separation of ownership and control. A voluntary code was regarded as inadequate. In contrast with the Netherlands and Germany, compliance with the code is monitored by public and private parties. Furthermore, sanctions can be imposed for non-compliance with the statutory requirements of disclosure.

---

213 Jones and Pollitt (2001).
214 RiskMetrics (2009).
215 Jong et al. (2005).
216 Galle (2012).
217 Corporate Governance Code Monitoring Committee (1999).

In conclusion, the codes in the US, the UK and, to a lesser extent, the Netherlands were established following one or more corporate-governance scandals. The UK has played a leading role in Europe and has influenced Ireland and the Netherlands, among others. In Germany, Italy, France and Sweden, however, this type of crisis management was not the pretext for the formulation of codes. There are many examples of systems with legal embedding and with monitoring by at least a public institution, as well as systems with no statutory embedding and with private monitoring. There are also intermediate forms. For example, a code that is not embedded in law can still be monitored by a public institution (France). In countries where self-regulation was not regarded as adequate, the code is laid down in law. In two of the three countries with only private initiators, the monitoring is performed by a private party (the exception is the UK).

4.11 Detailed overviews

Table 4.18 Comparison of the eight countries that were surveyed

	Netherlands	US	UK	Ireland	Germany	France	Italy	Sweden
Existence of corporate governance code	Yes. Dutch corporate governance code	No. Sarbanes-Oxley Act (SOX)	Yes. UK Corporate Governance Code	Yes. The UK Corporate Governance Code, supplemented by the Irish Corporate Government Annex	Yes. German Corporate Governance Code	Yes. Corporate Governance of Listed Corporations	Yes. Corporate Governance Codes and Principles	Yes. Swedish Corporate Governance Code.
First published	9 December 2003	29 July 2002	1 December 1992	1999	26 February 2002	October 2003	October 1999	1 July 2005
Content of the current code	22 principles,128 best practices	Act has 11 Titles, 66 Sections	18 principles and 52 provisions	18 principles and 52 provisions, supplemented by 6 principle s and 20 provisions	73 recommendations	22 recommendations, 47 criteria	26 principles, 46 criteria	10 principles, 46 criteria
Initiators and monitors of the code	Public and private	Public	Private/public	Private	Private and public	Private	Public and private	Private
Legal embedding	Yes	Yes	Yes	No	Yes	No	Yes	No
Date of legal embedding	30 December 2004	29 July 2002	December 1992	Not applicable	February 2002	Not applicable	2006	Not applicable
Which parties are subject to the code	All listed companies with registered offices in the Netherlands	Accountants, listed companies and foreign subsidiaries with a listing on an American stock exchange	Companies with a Premium Listing of shares, regardless of where they are established	Irish listed companies with a primary listing on the Main Securities Market	Listed German companies	Legal entities with their registered office in France and whose financial securities are admitted to trade on a regulated market	Listed companies	All Swedish companies whose shares are traded on a regulated market in Sweden
Board structure	Two-tier and one-tier	One-tier	One-tier	One-tier	Two-tier	Majority one-tier	Majority one-tier	One -tier

	Netherlands	US	UK	Ireland	Germany	France	Italy	Sweden
Monitoring committee	Yes, public-private committee	Yes, public, for accountants	Yes, private-public	Yes, private	Yes, public	Yes, public and private	Yes, public and private	Yes, private
Date of introduction	6 December 2004	2002	April 2004	1999	September 2001	2003	June 1985	2005, Supervision: 1986
Frequency of monitoring	Annual report on compliance	Annual	Annual study since 2011	Annual since 2007	Annual	Annual	Quarterly and half-yearly	Annual
Monitoring: what is reported	Data on compliance	The activities of the Public Company Accounting Oversight Board (PCAOB)	The percentage of companies that apply the provisions of the code	Compliance with the code in general and conduct in relation to specific provisions	The chance that a company will depart from the standards in the code in future	Degree to which comply or explain is applied	Number of companies that say they adopt the code and specific focus on the level of remuneration	Compliance with the code, number of explanations, quality of explanations
Definition of compliance	Apply or explain	No comply or explain principle. Compliance is mandatory	Comply or explain principle	Comply or explain principle	Comply or explain principle since 15 May 2012. Previously only indirectly through article of the law	Comply or explain principle since 2009 on a voluntary biasis	Comply or explain principle on a voluntary basis since 2006, but legally embedded since 2009	Comply or explain principle
Sanctions	No	Yes	Yes	Yes	No	No	Yes	No
Publication of individual compliance	n.a.	Yes	n.a.	n.a	n.a	n.a.	Yes	n.a.
Fines	n.a.	Yes	FSA may issue fines to companies and directors	n.a.	n.a.	n.a.	Yes	n.a.
Other	n.a.	Prison sentence (accountants) Listing depends on internal controls	n.a.	Irish Stock Exchange has authority to suspend or cancel listing if the code is not complied with	n.a.	n.a.	n.a.	n.a.

Table 4.19 Comparison on the basis of the principles in the Dutch Corporate Governance Code[218]

The Netherlands	United States	United Kingdom	Ireland	Germany	France	Italy[219]	Sweden
		Almost entire code refers to board	See UK code. All Irish provisions were included here		Almost entire code refers to board of directors (BOD)		
Compliance and enforcement of the code.					Implementation of the recommendations		Information on corporate governance
The board. Tasks and duties Size and composition of remuneration Adoption and publication of remuneration Conflicts of interest	306: Insider trades during pension fund blackout periods. 403: Disclosures of transactions involving management and principal stockholders 806: Protection for employees of publicly traded companies who provide evidence of fraud 402: Enhanced conflict of interest provisions	The role of the board Divisions of responsibilities The chairman Non-executive directors The composition of the board Appointments to the board Commitment Development Information and Support Evaluation Re-election The level and components of remuneration Procedure (of remuneration)	Board composition Board appointment Board evaluation Board re-election Remuneration	Cooperation between Management Board and Supervisory Board Tasks and Responsibilities Composition and Compensation Conflicts of Interest	The BOD: a collegial body The bod and the market Separation of the offices of chairman of the BOD and chief executive officer The BOD and strategy The BOD and the meeting of shareholders Membership of the BOD: guiding principles Representation of specific groups or interests Independent directors Evaluation of the bod Meetings of the board and of the committees Directors' access to information Duration of directors' terms of office Committees of the	Composition of the Board of Directors Independent directors Internal committees of the Board of Directors Appointment of directors Role of the Board of Directors Remuneration of directors	Appointment and remuneration of the board and statutory auditor The tasks of the board of directors The size and composition of the board The tasks of directors The chair of the board Board procedures Evaluation of the board of directors and the chief executive officer Remuneration of the board and executive management

218 The shaded cells show that the relevant element in the Dutch code is not contained in the code of the country in question.
219 Only articles are shown. Each article may cover various principles.

The Netherlands	United States	United Kingdom	Ireland	Germany	France	Italy[219]	Sweden
The board (continued)					BOD The appointments or nominations committee The compensation committee Deontology for directors Director's compensation Termination of employment in case of appointment as executive director Compensation of executive directors Information concerning executive directors' compensation		
The supervisory board	One-tier system	One-tier system Included under **Management**	One-tier system Included under **Management**	Examination of Efficiency	One-tier system Included under **Management**	One-tier system Included under **Management**	One-tier system Included under **Management**
Tasks and duties				Tasks and Responsibilities			
Independence							
Expertise and composition							
The chairman of the supervisory board and the company secretary				Tasks and authority of the Chairman of the Supervisory Board			
Composition and role of three key committees of the supervisory board				Formation of Committees			
Conflicts of interest				Conflicts of Interest			
Remuneration				Composition and Compensation			
One-tier board structure						Two-tier and one-tier systems	

The Netherlands	United States	United Kingdom	Ireland	Germany	France	Italy[219]	Sweden
The (general meeting of) shareholders	308. Fail funds for investors: civil penalties added to disgorgement funds for the relief of victims. 807: Criminal penalties for defrauding shareholders of publicly traded companies	Dialogue with shareholders Constructive use of the AGM		Shareholders General meeting Invitation to the General Meeting, Postal Vote, Proxies		Relations with the shareholders	The shareholders' meeting
Powers							
Depository receipts of shares							
Provision of information/logistics general meeting							
Responsibilities of shareholders.							
Responsibilities of institutional investors		Schedule C discusses the engagement principles for institutional shareholders					
Responsibilities of shareholders							
The audit of the financial reporting and the position of the internal audit function and of the external accountant. Financial reporting Role, appointment, remuneration and evaluation of the functioning of the external accountant Internal audit function Relations and communication of the external accountant with the organs of the company	303: Improper influence on conduct of audits. 304: Forfeiture of certain bonuses and profits 305: officer and director bars and penalties. 404: Management assessment of internal controls 401: Disclosures in periodic reports. 408: Enhanced review of periodic	Accountability Financial and business reporting Risk management and internal control Audit committee and auditors	Audit committee	Audit of Annual Financial Statements Reporting	The audit committee	Internal control and risk management system Statutory auditors	

The Netherlands	United States	United Kingdom	Ireland	Germany	France	Italy[219]	Sweden
	disclosures by issuers 802: Criminal penalties for altering documents 906: Corporate responsibility for financial reports. 301: Public company audit committees 407: Disclosure of audit committee financial expert. 302: Corporate responsibility for financial reports.						

Source: SEO Economic Research, on the basis of the Dutch corporate governance code (2008), the Sarbanes-Oxley Act, UK corporate governance code (2010), German corporate governance code (2010), Corporate governance of listed companies (France, 2010), Corporate governance code and principles (Italy, 2011) and the Swedish corporate governance code (2010).

5 Monitoring

This chapter considers the hypothetical alternative 'abolition of the government-appointed monitoring committee', which was introduced in Chapter 2. Section 5.1 reviews the potential effects of abolishing the committee from the perspective of public welfare. Section 5.2 shows what research says about possible effects, and in Section 5.3, the findings are used to attempt to reach a conclusion on the social desirability of this alternative. Section 5.4 presents some additional findings relating to monitoring of compliance with and application of the code.

5.1 Survey of possible effects

This alternative would involve the dissolution of the government-appointed monitoring committee, which would mark the end of the tasks normally performed by the committee, particularly the investigation of compliance with and application of the code and the annual report on the findings to the government.[220]

In Chapter 2 it was argued that a first question that has to be asked is whether private parties would establish a similar committee. If a private committee were to perform precisely the same tasks as those of the existing monitoring committee, it is unlikely that there would be any effects apart from a transfer of financing. Further effects are only to be expected if no genuinely comparable (private and public) initiative is put in place.

If none of the tasks of the monitoring committee are assumed by another body there would, first, be cost savings. The existing monitoring committee was set up by the government and has an official secretariat. The committee's costs comprise the expenses of the secretariat, the costs of the members' time, the costs of the research conducted for the committee and the other costs associated with the committee's reports, all of which are paid from public funds.[221]

There are three ways in which the benefits realised by the committee could be lost. First, through the absence of an annual public survey of the degree of compliance (apply, explain or neither) with the best practices aggregated over all Dutch listed companies. Second, the additional studies would be lost. Third, there would no longer be any reporting to the government.

The question is what impact this would have on the provision of information and on the conduct of management boards, supervisory boards and shareholders. The absence of the annual surveys might have consequences for the reporting on corporate governance in annual reports and might have some significance for the relationship between managers, shareholders and other parties. To the extent that their conduct is based on the aforementioned public information about general compliance with the code, shareholders might be influenced.

[220] The committee's stated objective is to promote the topicality and usefulness of the code. However, it is not the task of the committee to make amendments to the code.

[221] With the exception of the time of the members and chairman for which they are not paid.

Other effects are possible via the government and the content of the code (or changes to it), since the government will receive information less systematically about compliance and application and the current relevance of the code.

To sum up, the potential effects of this alternative include the following (depending on whether or not private initiatives are taken to assume the tasks of the existing monitoring committee):

- a shift in the financing of the costs of monitoring or saving of those costs;
- a possible impact on and via shareholders, to the extent that their conduct is guided by public information about general compliance with the code;
- possible influence on the reporting by companies on corporate governance and on the corporate governance itself;
- the possibility that the government will receive information about corporate governance less systematically.

5.2 Occurrence of effects

5.2.1 Private monitoring

Experience in other countries

The international comparison in Chapter 4 shows that all of the countries studied have a system of monitoring. In some countries, it is performed by the government; in others, by private parties; and in some countries, there is a mix of public and private monitoring. A situation where there is a code that is embedded in law, but no monitoring, seems to be the exception.

Ireland and Sweden have a system of private monitoring. These countries have a greater degree of self-regulation of corporate governance than the Netherlands. In Ireland, the governance code applies for companies listed on the Irish Stock Exchange, which is also responsible for monitoring compliance with the code. Sweden has a similar system. There, the code was written by parties involved in the equity and bond markets and is monitored by the Swedish Corporate Governance Board, which was established by those parties. The private initiative to adopt a code and the private monitoring complement one another. However, this does not mean that there is always a direct relationship between the type of regulation of corporate governance and its monitoring. France has a system of self-regulation and the private parties that drew up the code perform the monitoring, but so does the AMF.

Differences between public and private monitoring

In the interviews, the question arose whether organisations that represent a particular party could and would produce sufficiently independent monitoring reports.[222] Private parties could be influenced by those they represent. Another point made in the interviews was that a committee

[222] A practical question is which private party or parties in the Netherlands would perform the monitoring. The data on which the monitoring is based are publicly available and are already used by the VEB and Eumedion for their own monitoring, which is less systematic than that of the monitoring committee.

with a substantial public component might expect more cooperation from listed companies.[223] Even if monitoring by a private party is independent, there might be differences between monitoring with a public component, as in the current situation, and entirely private monitoring.

5.2.2 Effect on companies via signal and prioritising

Interviews: signal and prioritising

It emerged from the interviews that monitoring by the government is seen as part of the government's efforts to facilitate and legitimise the governance code. The withdrawal of the government from the monitoring committee might then send a signal that the principles in the code are regarded as less important. The annual cycle of collecting and checking data, carrying out additional research and publishing the monitoring report with appendices, a routine that places corporate governance on the political and corporate agenda, would then also disappear.

Survey

The question is whether this would produce a reaction in the conduct of listed companies. In the survey, listed companies were presented with the hypothetical situation of a system without monitoring (hypothetical alternative 1). Table 5.1 and Table 5.2 show that the majority of the respondents said that neither the reporting nor the application of best practice provisions would change. This should indicate the effect in terms of the signal that is sent and the position of corporate governance on the agenda, together with other possible effects via the management of companies.

Table 5.1 Question: Would this hypothetical change cause your company to change its reporting in the annual report?

	Number	Percentage
Yes	1	3%
No	27	84%
Don't know	4	13%
No reply	0	0%
Total	*32*	*100%*

Source: SEO Economic Research. n=32.

[223] This hypothesis was not presented to the companies in the survey. In fact, the opposite also applies: a committee without a private component might be suspected of not being politically independent.

Table 5.2 Question: Would this hypothetical change cause your company to change its application of the best practices in the governance code?

	Number	Percentage
Yes	2	6%
No	26	84%
Don't know	3	10%
No reply	0	0%
Total	*31*	*100%*

Source: SEO Economic Research. n=31.

One reason frequently mentioned by companies in the survey for not changing their reporting and policy is that the statutory obligation would still exist. This suggests that the legal embedding of the code plays a more important role with respect to compliance and application than the monitoring of the code. Indeed, more respondents said they would alter the reporting if the statutory duty were also to disappear (see also Chapter 6).

When a survey is used to poll the views of respondents, it is possible that 'socially desirable' answers will be given. In this case, the socially desirable response could be seen as being that the annual report and corporate governance will *not* change. This would imply that the percentage of companies that would not change anything is in reality lower, since companies would then be saying that they regard transparency and sound corporate governance as more important than they actually do. If that is the case, it would reinforce the potentially *negative* effects of this alternative. In this context, it should be noted that the reported percentages are different for each hypothesis, as will be seen in Chapters 6 and 7. This suggests that the replies were probably not, or at least not entirely, dictated by considerations of social desirability.

5.2.3 Effect via provision of information

Besides the effects of the government sending a signal and placing corporate governance on the agenda with the annual publication cycle, ending monitoring would also have an effect in terms of the *information provided* by the monitoring. This information can be valuable for stakeholders and the publication of the information could influence conduct beforehand as well as *ex post facto*.

As already mentioned, most *listed companies* said in the survey that they would not change either their reporting or their corporate governance in the absence of monitoring. This suggests that companies are not guided to a significant extent by their 'position' in relation to the general picture with respect to compliance and application. Apparently, companies also do not expect a significant reaction in the conduct of *shareholders* or other stakeholders whose views they have to respect.[224] Our study of the literature revealed no research that showed whether, or to what extent, decisions on voting and investment depend specifically on (aggregated) monitoring of corporate governance.[225]

---

224 Shareholders were not surveyed for this study. The reaction referred to here is a change of conduct by shareholders as a result of the absence of 'the general picture', as a result of which a company's 'position' in relation to that general picture is no longer known.

225 Nor any studies regarding the degree to which reporting and corporate governance depend specifically on monitoring, aggregated or otherwise.

Monitoring says something not only about the position of individual companies in relation to 'the entire population', but also about which principles and best practice provisions are complied with better or worse by *listed companies as a whole*, as well as trends in compliance with and application of the code over time (see Chapter 3). Although this information does not provide any certainty about the actual quality of corporate governance, it does provide 'hooks' on which *the government or parliament* can hang policies – on behalf of 'society'. The recent series of accounting, business, national and bank scandals show that this is probably not an unnecessary luxury. Although such scandals do not occur on a daily basis, when they do the social costs can be enormous. In addition, it was mentioned in several interviews that the activities of a monitoring committee provide information that can enhance the topicality and usefulness of the code. Although this was not mentioned in the replies to the survey of listed companies, some respondents did mention that the annual scrutiny of compliance would no longer have to take place if monitoring were ended.

5.3 Summary and interpretation

The only quantifiable effect in this alternative is the annual cost savings (if no monitoring at all takes place) or the shift in the annual financing from public to private (if a similar private initiative were to be established). Given the total annual budget for the monitoring committee and the costs of the work of the secretariat, the savings would come to around € 350,000 a year. If there were no longer any monitoring, there would also be cost savings for companies, since they would no longer be required to check their compliance for the reports of a monitoring committee. The savings would be modest, however. The amount mentioned above is more likely to be at the upper than the lower end of the estimated savings, because, even without monitoring, the government will still collect information, but in a more ad hoc manner.

The bottom line, therefore, is whether the *negative* effects that might ensue from ending monitoring by the government would exceed the annual savings of € 0.35 million a year. Let's say the consequence of ending monitoring by the government is that private parties assume responsibility for it. This would yield *no* savings for society: it would save the government € 0.35 million a year, but would cost the private sector approximately the same amount. There is also the risk that such a move would send a signal to companies that the corporate governance code had become less important. The interviews and the survey seem to suggest that market parties do not regard this risk as substantial, but further quantification was not possible in the context of this study. A further risk is that monitoring by private parties might be less independent and less authoritative, which would affect its quality. If that is likely, however, it is highly questionable whether market parties would take on the monitoring in the first place, apart from individual organisations with their own specific interests.

Assuming that the consequence of ending government monitoring is that there is no longer any monitoring at all, the savings for society would be € 0.35 million a year. Once again, the risk is that this would send a signal to companies that the importance of the corporate governance code has diminished. Moreover, the issue of corporate governance would probably receive less priority

on the business and political agenda. Finally, aggregated information regarding compliance with and application of the code would be produced less systematically.

To sum up, it is impossible to say in advance whether private parties would assume the public role in the monitoring. If they did, little would have to change, assuming that the monitoring will be carried out independently. The disappearance of public involvement would bring an end to systematic monitoring and yield modest public savings. It is open to question whether those savings would cause social costs that exceed the savings. Accordingly, the question of whether the alternative outlined here, with no government monitoring, is socially desirable comes down to an estimate and valuation of the potential increase in risks. The principal risk seems to be related to the absence of robust information to keep corporate governance on the political agenda and to facilitate a timely response to relevant developments. This could ultimately lead to social costs. In their most extreme and most visible form, these would be flagrant violations of sound corporate governance ('scandals'), with widespread social consequences.

5.4 A variant and further insights

The government as principal

By promoting independent monitoring, a principal would mitigate the possible risks of non-independent, private monitoring. A variant that would reflect that is for the government to finance the monitoring and delegate it to an entirely private committee. In that case, an essential condition would be that the monitoring is performed independently and without prejudice, and that would naturally have to be assessed. This might also increase the authoritativeness of private monitoring.

This option fits in with the idea that the government no longer wants to be directly involved in monitoring, but does want to continue actively supporting it. It would not yield any direct savings for the government or for society. The differences between this option and the alternative that was investigated are:

- uncertainty about the continuation of monitoring would be removed; information (e.g., for the government) would be preserved;
- no savings or shift in financing;
- reduced risk of sending the wrong signal and of a deterioration in the quality of monitoring.

To sum up, this variant would not yield any savings or cause a shift in financing and there would still be a minor risk from the signal it sends and for the quality of monitoring.

Provision of information through monitoring

In the course of the research, it emerged that there are some uncertainties with respect to monitoring and the provision of information. These are discussed below. In fact, the impression is that the quality of monitoring in the Netherlands is high by international standards.

Confusion over terminology

The first uncertainty to arise in the course of this study concerns the terms 'compliance' and 'application'. The monitoring committee uses these terms differently from the statutory provision – more specifically in the reverse sense.[226] In the reports produced by the University of Groningen for the monitoring committee up to and including the 2010 financial year, the terms are used in the same way as in the statute; in other words, the reverse of how they are used by its client, the monitoring committee. Confusion is the predictable consequence.

Explanation and implicit compliance

The code and the statutory provision are based on the principle of apply or explain. The monitoring is therefore also based on that principle. If a provision in the code is not applied, it is still complied with provided an explanation is given. Consequently, the finding of whether or not an explanation has been given largely determines whether there has been compliance. It has already been shown in Chapter 3 that this finding is subject to different interpretations. On the one hand, this grey area is inherent to a code that is intended to promote sound corporate governance without prescribing everything in detail. On the other hand, this method does create uncertainty about the extent to which measures that depart from best practice provisions still comply with the requirements of sound corporate governance and when the reasons for departing from those provision have been adequately explained. This point was raised in various interviews, sometimes with the suggestion that the monitoring committee could give examples of valid or invalid explanations and, more generally, that the power to assess the validity of an explanation could lie with the committee.[227] See also Chapter 7.

If a company states in its annual report that it applies all best practice provisions in the code, according to the code and the monitoring committee there is complete application and compliance. Two reservations need to be made to this conclusion, however. First, there can still be differences between companies that apply all best practice provisions in the code in terms of the quality of their corporate governance (see section 3.7). This is perhaps even more evident if companies do *not* apply or comply with provisions: the degree of non-compliance is not established or monitored. In that sense, the monitoring is fairly 'black or white'. The informative nature of monitoring increases with the degree to which the extent of the non-compliance is also established.

The second point is that the code and monitoring serve two purposes: promoting sound corporate governance, and promoting transparency about corporate governance. The first is concerned with promoting behaviour, particularly by the management board; the second involves enhancing the provision of information, particularly for shareholders. Because of the possibility of implicit compliance (again, see section 3.7), there seems to be a greater emphasis on the first objective than the second. The question is whether this is the right balance. See also Chapter 7.

---

226 Monitoring committee: compliance is apply or explain. Statutory provision: application is comply or explain.

227 See also Abma and Olaerts (2011). Abma and Olaerts seem to favour a form of naming or shaming (see Chapter 7). Abma and Olaerts place the emphasis on an assessment of the soundness of the reasons for derogation rather than the soundness of the derogation itself. The question, however, is whether the two aspects can be so easily distinguished.

Measurement

The clearer the method of measurement, the easier the interpretation. There seems to be room for improvement in this respect. For example, it is not always clear which provisions are disregarded because they cannot be explicitly verified or are described as being 'applied' precisely by virtue of implicit application (are not explicitly verified) (see section 3.7).

6 Legal embedding of the code

This chapter focuses on the hypothetical alternative in which the legal embedding of the code would disappear. As explained in Chapter 2, by virtue of EU directives the minimum requirement for companies to include a statement on corporate governance in their annual report will remain. The principal change would therefore be that listed companies would no longer be obliged to refer to the government-designated governance code. This would be similar to the regulation of corporate governance in France and Italy (see Chapter 4). Another element of this alternative is the abolition of the monitoring committee established by the government, as in the alternative discussed in Chapter 5. Furthermore, in this alternative it is assumed that the government would adopt a passive attitude towards the corporate governance code, in line with the repeal of its statutory anchoring. The question is to what extent private parties would assume the task of keeping the code up to date. As regards the continuing obligation to publish a statement on corporate governance in the annual report, it is assumed that companies would meet the minimum requirements laid down in the EU directives.

Section 6.1 explores the possible effects of this alternative from the perspective of social welfare. Section 6.2 discusses what the various research methods used reveal about the occurrence of effects. In Section 6.3, we attempt to draw a conclusion about the public desirability of this alternative on the basis of the findings.

6.1 Survey of possible effects

Like the alternative in Chapter 5, this alternative seems to involve only a single change (the disappearance of the statutory basis for the code), but, as described above, it goes further, and the first question is what *system change* would occur if the statutory basis of the code were to disappear. For example, would the existing code, if it were no longer framed in law, remain relevant? In other words, would it be preserved by private parties. A related question is whether other codes might emerge, also on the initiative of private parties. There is also the question of whether private monitoring initiatives would be established. The effects of *these* changes would then depend on the choice made by companies between applying a code with comply or explain or providing information about corporate governance without reference to a code. The influence of *that* choice on the provision of information about corporate governance, on corporate governance and on the costs for the companies raises the question of what the importance is of that information and of the specific system of corporate governance, particularly for shareholders. The potential effects of amending or abolishing the system of monitoring were discussed in Chapter 5.

First, this chapter tries to give a sense of the possible system changes and their consequences. The central question is to what extent the disappearance of a corporate governance code that is supported by the government and embedded in law would influence the provision of information and the behaviour of companies.

The possible effects in this alternative would depend on the following:

- whether the existing code (no longer with a statutory basis) remains relevant;
- the emergence of other codes;
- the establishment of private monitoring initiatives;
- the choice companies have between applying a code with comply or explain or providing information about corporate governance without reference to a code;
- the influence it has on the information provided about corporate governance, corporate governance itself and the costs for companies;
- the importance of the information and of the specific corporate governance structure, particularly for shareholders;
- whether private monitoring initiatives arise and the consequences of changes to or the disappearance of monitoring.

6.2 Occurrence of effects

6.2.1 Implementation of EU obligations in different countries

The EU obligation for companies to include a statement on corporate governance in their annual reports (discussed above and in Chapters 2 and 4) is implemented in different ways in the countries that were studied (see Chapter 4). In some European countries, the governance code is embedded in law, as is currently the case in the Netherlands, Germany and the UK. In Ireland and Sweden, the obligation is imposed via the stock market and by means of a code. France and Italy have adopted different systems. In France, companies can choose whether to adopt a code. If they do, comply or explain applies; if they do not adopt a code, information about corporate governance must be published in the annual report. Italy has a similar system, with two differences: fines can be imposed (they cannot in France) and there is a single code (there is more than one code in France). In the hypothetical alternative explored in this chapter, no fines would be issued and, in principle, there would be just a single code based on the existing code.

6.2.2 Comparison with Italy and France

In *France,* there are a number of codes (which are private): that of AFEP/MEDEF and those of various trade associations. Furthermore, a listed company is not obliged to refer to a code. In 2009, three-quarters of companies referred explicitly to the AFEP/MEDEF code, according to the AMF.[228]. AFEP/MEDEF only analyses the AFEP/MEDEF code, which seems to form the basis for the codes of other business sectors in the French system, since every company in the sample said it used this code as a blueprint for its corporate governance policy. Unfortunately, there is no information available about the proportion of companies that do not refer to any code.

In *Italy,* there is currently a single corporate governance code (which is public-private), although the law does allow for other private codes and gives companies the option of not referring to any code. According to Assonime in its Compliance Report for 2010, 95% of companies said they adhered to the code; 5% explicitly did not.

228 AMF (2010a).

The experience from France and Italy illustrates the possibility that there would still be just one code and that no other codes would emerge alongside it. Experience in those countries also shows the possibility of a code remaining in place and forming the basis for other codes drafted by trade associations and other organisations. There is no evidence that a 'central' code will disappear as soon as the option is created of drafting other codes or of providing information without reference to a code. The French system does suggest greater variation - in codes and in monitoring - and the Italian system suggests that some companies (5% in that country) will opt not to refer to any code. Practical experience in France suggests that the monitoring is more complex and less complete if there is more than one code, since different organisations then produce their own reports.

6.2.3 What companies say

With respect to hypothetical situation 2, the survey indicated that the number of companies that would change their reporting if there were no longer a statutory requirement to publish a statement on compliance with the corporate governance code is roughly the same as the number that would not. The scenario presented to them did not correspond entirely with the alternative presented here,[229] but it does seem clear that less extensive information about corporate governance would be published in annual reports if companies were given the option of including information without explicit reference to a code. This would represent a modest reduction of costs for companies. Few companies say they would change their corporate governance. See Table 6.1 and Table 6.2.

Table 6.1 Question: Would this hypothetical change cause your company to change its reporting in the annual report?

	Number	Percentage
Yes	12	39%
No	11	35%
Don't know	8	26%
No reply	0	0%
Total	*31*	*100%*

Source: SEO Economic Research. n=31.

229 The hypothetical situation presented to companies was based on a continuation of the existing code (although an effect could be that the existing code would ultimately disappear) and the disappearance of the statutory obligation to publish a statement in the annual report (without mentioning the EU directive, which includes a less extensive reporting obligation).

Table 6.2 Question: Would this hypothetical change cause your company to change the application of the best practices in the governance code?

	Number	Percentage
Yes	4	13%
No	18	58%
Don't know	9	29%
No reply	0	0%
Total	*31*	*100%*

Source: SEO Economic Research. n=31.

The survey also presented another hypothetical prospect (hypothetical situation 3), in which the code is abandoned entirely. A majority of companies said they would then produce shorter reports, or not report at all. This would also yield modest cost savings. Companies said that this could be expected to lead to more discussions between the management board, shareholders and the supervisory board.

This suggests that both the code and its legal embedding have an impact, especially on reporting. The survey also showed that most companies regard the code and the statutory obligation as efficient and effective. The question is how these two findings can be reconciled. If the system is efficient and effective and companies could only expect to make limited cost savings, why would they report less if the statutory obligation were to disappear? Perhaps the signal effect is a factor here: a hands-off government that allows greater discretion is sending a signal that the provisions in the specific code have become less important. Another possible explanation is that the responses to the question of whether the code and obligation are efficient and effective were too optimistic and some companies perhaps actually regard the code as a whole as too onerous.

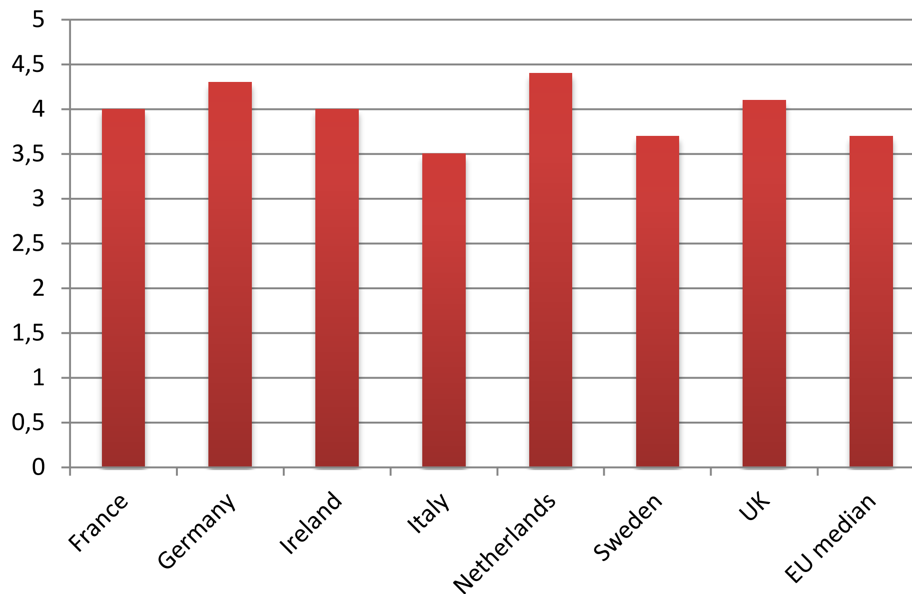
6.2.4 Interviews

Most of those who were interviewed considered the legal embedding of the code to be a fundamental element of the Dutch system. As discussed above, abandoning the code's statutory basis might send a signal that the principles in the code are regarded as less important. As already mentioned in Chapter 5, the surveys suggest that abandoning the legal embedding would have a greater effect than ending monitoring by the government. The fact is that the Dutch corporate governance code contains more than the minimum requirements prescribed by the EU.

6.2.5 Literature

In 2009, RiskMetrics published a comparative international survey of corporate governance in the countries of the EU. The report included a survey of management boards and business associations concerning the effectiveness of different corporate governance codes (Figure 6.1).

Figure 6.1 Rating of effectiveness of codes in EU countries



Source: SEO Economic Research, based on RiskMetrics (2009).

As the figure shows, the Netherlands scored well in the survey, while France, and particularly Italy, scored less well. Although it cannot be said that a transition to the hypothetical alternative would reduce the effectiveness of the Dutch system to those levels, in view of these figures there is also no reason to assume that it would have a positive effect.[230,231]

As far as the literature on the Dutch system is concerned, De Bos and Quadackers (2007) conclude that most listed companies feel that the benefits of the code outweigh the costs. To the extent that their analysis does suggest the need for changes, they are limited in scope and relate more to better explanation than to changes in the code, which does not imply the desirability of abandoning the legal embedding. Abma and Olaerts (2011) argue that the engagement of shareholders has increased substantially since the code was introduced, but that explanations are often not tailored to the specific situation or are entirely absent. They explore stronger roles for the accountant, the public regulator, the shareholder and the monitoring committee, which does not suggest the desirability of abandoning the statutory basis, but rather supports its retention. Hooghiemstra and Van Ees (2011) express reservations about the effectiveness of the code as a form of 'soft law'. Given the content of the code, they see more rather than less regulation as the solution. All in all, existing studies of the Dutch system provide no indication that abandoning legal embedding of the code would be an improvement. If anything, they indicate the opposite.

[230] Ideally, a comparison would be made of the application of and compliance with codes between the Netherlands, France and Italy. Unfortunately, such a comparison cannot be made on the basis of the data from the survey and the monitoring reports.

[231] A difference between the Netherlands, on the one hand, and France and Italy, on the other, is that in the latter countries the principle of apply or explain was introduced later (in 2009, compared with 2004 in the Netherlands). See Chapter 3.

6.3 Overview and interpretation

Abandoning the legal embedding of the corporate governance code would introduce a new system of regulation of corporate governance in the Netherlands. The Dutch corporate governance code predates its legal embedding, and the statutory basis predates the EU obligation to report on corporate governance in annual reports. The alternative studied in this chapter is based on minimal implementation of the EU obligation and would, therefore, represent a downgrading of the system that has been created in the Netherlands. Whether, and if so how, codes are produced and updated would then depend on private parties. It seems obvious that the information about corporate governance provided in annual reports would be less extensive. Monitoring would probably become more complex.

Such a system would only be an improvement if the existing system, which has been constructed since 2003, contains *defects* that will no longer arise if companies are no longer required to furnish information about corporate governance in accordance with the current code. Such defects might be related to a lack of customisation for companies, which could lead to a 'box-ticking approach' (which was sometimes referred to in the survey) and with the possibility that providing explanations for the non-application of provisions could be perceived as a negative signal (sometimes mentioned in the interviews).

To arrive at a positive final judgment on this alternative, the potential *benefits* of greater freedom (a more customised approach, reducing the risk that explaining non-application will send a negative signal) would have to be accompanied by *smaller* disadvantages arising from the changes in the system. Possible disadvantages include the following: the disappearance of the legal embedding could send the signal that the government attaches less importance to transparency and sound corporate governance. This could have consequences for the amount of information provided in annual reports, and possibly also for corporate governance itself. If, as a result of the disappearance of the statutory basis, there were no longer any code, shareholders might be deprived of the structure that such a code provides for assessing and drawing attention to the corporate governance policies of companies, which could have an impact on the relations in the 'triangle' and, again, on the provision of information and on corporate governance. Without a code, or with multiple codes, or with the possibility of not referring to a code, monitoring would also be less complete and/or less structured.

In conclusion, the disappearance of the statutory basis *might* mitigate *possible* defects in the current system by allowing greater freedom in the reporting on corporate governance. At the same time, it would lead to less extensive and/or less structured information about corporate governance in the annual reports of companies and in the aggregate monitoring of all listed companies, which could have negative consequences. It was not possible to produce a quantitative evaluation of these advantages and disadvantages on the basis of existing information. No evidence was found for the social desirability of this alternative. Any imperfections in the current system could probably be addressed better in other ways than by abandoning the legal embedding of the code.

Variant

Abandoning the legal embedding of the code embraces the idea that it is important to allow companies to decide for themselves how they will include information about corporate governance in their annual report. In the alternative discussed above, the government would end its monitoring and would not actively support the code. In the Italian system, companies have the option of not referring to the code, but only 5% avail of that option. A possible variant might therefore be for the government to continue actively supporting the existing code, but leave open the legal possibility of adopting other codes and of reporting on corporate governance without reference to a code. This would mitigate the risk of the code falling into disuse, but would also be accompanied by the effects associated with having more than one code and the reporting of information without reference to a code.

7 Incentives and sanctions: naming

Whereas the two preceding alternatives implied a more limited role for the government in relation to the code, with this hypothetical alternative its role would be expanded. Section 7.1 briefly discusses the theoretically possible incentive and sanction mechanisms in relation to the current system of regulation of corporate governance in the Netherlands. Section 7.2 specifically addresses 'naming'. Section 7.3 presents some conclusions.

7.1 Incentives and sanctions in the Netherlands

Chapter 2 described the current Dutch system as a system without sanctions. This was perhaps an exaggeration: there are laws that do not refer directly to the code but do affect corporate governance, and the corporate governance code can serve as a basis for bringing proceedings before the Enterprise Chamber. The fact is, however, that compliance with the code is required by law, but without any explicit definition of a mechanism for imposing sanctions. This is also illustrated by the fact that there are companies that do not fully comply with the code (see Chapter 2). The code has to be 'policed' by the shareholders themselves, with the statutory provision in hand.

What possibilities are there to introduce sanctions or stronger incentives for compliance in the Dutch system? This section briefly discusses the role of the external accountant; the role of public regulatory bodies; the role of other private bodies; fines; and the replacement of the code with legislation. Section 7.2 discusses the specific issue of naming (and shaming and faming).

The role of the auditor

The auditor approves the annual accounts, and includes the annual report in his evaluation. The auditor therefore has a role in checking the statement on corporate governance. Briefly,[232] the auditor's report must indicate, among other things, whether any shortcomings have been found

[232] Article 393 in Book 2 of the Dutch Civil Code states (section 5): "*The auditor reports the outcome of his audit by means of an opinion whether the annual accounts present a true and fair view. [...] The accountant's opinion shall include in any event [...] a statement about deficiencies found in connection with the audit referred to in paragraph 3, whether the annual report has been made in accordacne with the present Title [and] a statement about the compatibility of the annual report with the annual accounts.*" Paragraph 3 reads: "*The auditor examines whether the annual accounts provide the insight required by Article 362, paragraph 1. He will also verify whether the annual accounts meet the requirements set by or pursuant to law, whether the annual report, to the extent that he is able to assess so, is made in accordance with the present Title, whether it is compatible with the annual accounts [...]*". Part of 'the present Title' (Title 9 relating to the annual accounts and annual report) is Article 391, paragraph 4: "*Additional requirements may be set by Order in Council regarding the content of the annual report. These additional requirements may relate particularly to the compliance with a Code of Codnuct which is designated for this purpose in that Order in Council, and to the content, disclosure and the audit of an opinion on corporate governance.*" In the Order in Council of 23 December 2004, the Dutch corporate governance code was designated as a code of conduct (paragraphs 3 and 4): "*The Dutch corporate governance code as published in the Government Gazette no. 250 of 27 December 2004 is hereby designated as a code of conduct within the meaning of Article 391, paragraph 4 of Book 2 of the Dutch Civil Code. A public company shall include in the annual report a statement on compliance with the principles and best practice provisions of the code of conduct designated in Article 2 that are directed at the management board or the supervisory board of the company. If the company has not complied with the principles or best practice provisions or does not intend to comply with them in the current and succeeding financial year, it shall report this in the annual report, with a statement of the reasons.*"

in the compability of the annual report and the annual accounts and whether the annual report contains a statement on the application of the principles and best practice provisions in the corporate governance code, with an explanation of the reasons if they have not been applied. The explanatory memorandum to the relevant Order in Council says: "*The accountant shall enquire whether the annual report contains a passage as prescribed on the grounds of Article 2:391 (4). He does not have to form an opinion on the way in which the management deals with issues of corporate governance or the explanation given by the board. He must, however, establish whether that explanation corresponds with the information in the annual accounts.*"

In the interviews, it emerged that there is some debate about the desired role of the auditor with respect to the statement on corporate governance and the reasons given for non-compliance in the annual report. The key question is whether the auditor should be the one to verify whether a company has actually applied what it says it is applying, and whether it has given an explanation if it has not applied. This goes back to the recommendations of the Peters Committee in 1997, number 35 of which states that the *supervisory board* decides whether the auditor will investigate whether the recommendations have been carried out. At the moment, the Dutch Civil Code provides that the auditor is appointed by the general meeting of shareholders. The corporate governance code provides that the supervisory board will make a nomination and that the audit committee and the management board may advise the supervisory board. In fact, as far as is known, verifying whether a company is actually applying the code and whether it has given an explanation if it has not done so is not a specific task of the auditor in any country.

The role of the regulator

The AFM regulates the financial markets. It focuses on the annual accounts. The AFM does not perform a substantive assessment of a company's statement on its corporate governance policy or its explanations of non-compliance. Were a regulator like the AFM to do so, the shareholder's responsibility to evaluate corporate governance policy and the reporting on it would shift to the regulator. The essential question in any issue concerning supervision and sanctions in relation to corporate governance is whether the aim is to assist or encourage shareholders in the performance of their supervisory role, or to partially remove that supervisory role from the shareholder.

The role of the stock exchange[233]

In one of the countries surveyed in Chapter 4, Ireland, the stock exchange has the authority to suspend or cancel a listing if the code is not complied with. In Ireland, the stock exchange (the ISE) played an important role in writing the code. In the Netherlands, the stock exchange (Euronext Amsterdam) was involved in drafting and amending the code (see Chapter 2). The essential question here is the same as for the regulator: whether the purpose is to assist or encourage shareholders in the performance of their supervisory role, or to partially remove the supervisory role from the shareholder and assign it to the stock exchange.

233 Trade associations are another example of private organisations that could be allowed to impose sanctions.

Fines

The introduction of a system of fines would require various choices to be made. The main ones are which body would be allowed to impose fines, in which cases would fines be imposed and how high should the fines be. Logically, fines would be linked to non-compliance: in other words, non-application without an explanation. This would require decisions about when an explanation is or is not acceptable. Since this cannot be fully determined in advance, it would have to be assessed in each individual case. Once again, a fundamental question is whether the aim is to assist or encourage shareholders in the performance of their supervisory role, or to partially remove this supervisory role from the shareholder and delegate it to an agency that issues fines.

Of the countries with a code that were investigated in Chapter 4, fines specifically relating to corporate governance can be imposed in the UK and Italy. In both cases, the fines are connected with the requirement to include a statement on corporate governance in the annual report.

Laws

The Dutch code has a statutory basis. A more far-reaching legislative alternative would be to lay down the principles and best practice provisions from the code in laws. This would transform the system to pure government regulation. There was generally little enthusiasm for this option among the interviewees, particularly because laws are less flexible than a code with the possibility of explaining non-application. That alternative would mean abandoning the principle of apply or explain, because that type of flexibility is difficult to provide for in legislation. A more far-reaching legislative alternative, therefore, would call for a fundamental discussion of this pillar of the current corporate governance code, a discussion that is not within the ambit of this study.

7.2 Naming, shaming and faming

7.2.1 Elaboration

The monitoring committee currently reports at aggregate level, not at the level of individual companies. In the monitoring report for 2011 ('Third report on compliance with the Dutch Corporate Governance Code'), the committee referred a small number of individual companies to the need to improve compliance. We define *naming* as the publication of details about compliance with and application of principles and best practice provisions in the code at the level of individual companies. *Shaming* involves drawing attention to specific companies that perform poorly, while *faming* involves highlighting companies that perform well.

The terms compliance, application and explanation are closely connected with naming, faming and shaming. With apply or explain, the focus is on *compliance*, implying that shaming and faming can only be linked to compliance. Since non-application of provisions in the code is permitted with an explanation of the reasons, the interpretation of what constitutes a 'valid' explanation is crucial for naming, and especially for shaming and faming. Compliance, application, non-application with an explanation, and non-application without an explanation could, in principle, all be mentioned with neutral naming.

A system of naming that corresponds most closely with the existing system would be based on existing measurements of compliance and application by the monitoring committee. It is, in fact, already established for each listed company which provisions are applied or not applied - with or without an explanation. However, this information is not published for each individual company. If this information were disclosed for each individual company, establishing non-compliance, in particular, would become more important, quite simply because there would be more at stake. In that case, it would have to be clear which provisions should or should not be assessed and when an explanation has or has not been supported by adequate reasons.

A step beyond assessing an *explanation* would be establishing whether the assertion that the code has been *applied* is actually true. Naming could also address that issue.

An initial classification of companies that say they do not apply a provision can be made between those that provide an explanation and those that do not. If an explanation is given, a company can explain what its policy is without giving any further reasons. It could also give reasons for non-application without explaining what its policy is. Both the policy and the reasons could be explained in greater or lesser detail. The question is what will be *named,* and with shaming and faming, where the emphasis will lie. From the perspective of the shareholder, it is perhaps more important to know what the policy is than to know whether adequate reasons were given for that policy in the annual report. If the most important thing is that companies adhere to the spirit of the code, a good *explanation* is not the only requirement; a departure from a best practice provision that is properly explained but does not reflect the spirit of the code should also be mentioned.

A distinction between naming, on the one hand, and faming/shaming, on the other, is that the former is aimed more at providing information and the latter more at sending a signal. It seems logical to include all listed companies in a system of naming. With faming and shaming, the 'best' and 'worst' companies could be specifically mentioned, and every year a specific topic could be addressed.

7.2.2 Possible effects

Companies might take account of naming, faming and shaming for a variety of reasons. Or rather, because of the influence of a variety of groups. Shareholders might desert them, which would have a negative effect on the share price, or they might adopt a more critical attitude towards the management board, and potential shareholders might be deterred, making it more difficult to raise additional equity capital. Consumers might also react, perhaps through the intervention of a lobby group, which could cost the company sales and profits.

The effects on the company occur via the information provided by naming or faming/shaming, which is particularly relevant for the shareholder, and their deterrent and corrective effect. The former depends on the value the additional information has for the shareholder; the latter on the extent to which naming, faming or shaming have a corrective effect, how it is manifested (provision of information, corporate governance) and what its value is.

Naming increases the information available to (potential) shareholders. In principle, there will be modest additional costs for publishing information that is already available in connection with the

monitoring.[234] The greater the detail of the information and/or assessment, the higher the additional costs. Should only the existence of an explanation be checked, or also the quality of the reasons given? Should the departures from provisions be explicitly mentioned in a monitoring or naming report? Should actual application be checked?

Shaming and *faming* also increase the information available to (potential) shareholders. Since all the details would not have to be published every year, the costs of publication could be even lower than with naming. However, the amount of information provided would also decline. The costs for companies might increase, particularly with shaming, since companies that are on the list to be *shamed* would be inclined to check the information more closely and/or challenge the interpretation.

7.2.3 Occurrence of effects

Interviews

It emerged from the interviews that opinions are divided on naming. It was felt that naming could be particularly useful for small investors, since an individual shareholder will be less inclined to invest in searching for information than a major shareholder. A possible advantage of faming could be that the emphasis would not be so much on companies that meet the minimum requirements, but rather on examples of companies that go beyond what the code prescribes. It might also be advisable to focus faming on principles rather than on the entire code, since otherwise there might be a risk, for example, of a company being praised one year but 'slipping up' the following year, thus undermining the credibility of faming. Naming and shaming can only take place if a company has the right to communicate with the committee in order to defend itself. There could also be different categories, in addition to application and non-compliance, such as a 'good explanation' or an 'inadequate explanation'.

Country comparison

None of the countries surveyed in Chapter 4 publishes systematic information about compliance by individual companies. Consequently, these countries do not provide a model for a system of naming. In Italy, however, companies can be fined if the statement on corporate governance is deficient, in which case the information is published in two national newspapers. This could be regarded as shaming.

Portugal

In Portugal – a country that was not included in the country comparison – the CMVM (*Comissão do Mercado de Valores Mobiliários*) publishes details about individual companies in the *Annual Report on the Corporate Governance of Listed Companies in Portugal.*[235] Chapter I of the report in 2011, which covered the 2009 financial year, contains frequent references to individual companies. Chapter II, contains an analysis of average compliance and of compliance with each section of the *CMVM Recommendations on Corporate Governance,* in the form of tables in which each company is mentioned

---

[234] The costs for companies could also rise because of the checking of the naming, although the survey suggested there would be no major change.

[235] www.cmvm.pt/EN/Estudos/Documents/Final.Corporate.Governance.Report.2011.pdf.

individually. The figures for average compliance per company are broken down into *All recommendations*, *Essential recommendations* and *Other recommendations*. For each block of recommendations, there are tables showing the compliance rates with recommendations (which are similar to the best practice provisions in the Dutch code) by individual companies. *Compliance* in this case means application of the recommendations. The application of *comply or explain* is measured in a separate section, in which explanations are divided into *acceptable explanation*, *no explanation*, *non-effective explanation* and cases in which the company asserts that it does comply (i.e. applies), but the CMVM feels differently. There is automatically an investigation into the causes of differences of opinion between the CMVM and companies.

This system could be seen as naming, with a relatively mild form of shaming and faming. In the table on average compliance, for example, the companies are listed in alphabetical order, but there is an additional column with scores and different colours indicating how the companies have performed.

The authors of this report are not aware of any study that provides an estimate of the effects of this form of naming and shaming/faming.

Survey

In the survey, listed companies were presented with the hypothetical situation of naming (hypothetical alternative 4). See Table 7.1 and Table 7.2.

Table 7.1 Question: Would this hypothetical change cause your company to change its reporting in the annual report?

	Number	Percentage
Yes	4	15%
No	21	78%
Don't know	1	4%
No reply	1	4%
Total	*27*	*100%*

Source: SEO Economic Research. n=27.

Table 7.2 Question: Would this hypothetical change cause your company to change the application of the best practices of the governance code?

	Number	Percentage
Yes	0	0%
No	24	89%
Don't know	2	7%
No reply	1	4%
Total	*27*	*100%*

Source: SEO Economic Research. n=27.

The majority of the respondents said they would not change their reporting or corporate governance as a result of naming. If that is true, the question is whether naming is ineffective in itself or whether the code is already so effective that naming would not have any additional effect. Another possibility is that the reality is different, possibly because the respondents gave a socially desirable response. Some companies said they would report in more detail and expected to be subject to extra controls. The companies were not asked separately about faming and shaming.

Literature: Naming

In the literature review, no specific information was found about the value of additional information for shareholders or about potential changes in reporting and corporate governance by companies. The literature focuses more on shaming in relation to irregularities. In fact, the distinction between naming, on the one hand, and shaming/faming, on the other, is not very strict: naming can contain information that could be used for the purposes of shaming or faming in another medium.[236] The general literature suggests that naming could play a role in making available information that market parties could benefit from knowing.[237] The literature on corporate governance and market failures adds the problem of free-riding by shareholders to this (Chapter 2, section 2.3.1). An individual shareholder will not be inclined to invest a lot of time in disclosing information about corporate policy, in the knowledge that the information will benefit all shareholders, while he or she alone incurs the costs.[238] Information about application, explanation and non-compliance by individual companies should, in principle, be available from public sources, but finding it takes time and effort.[239] In practice, therefore, shareholders face obstacles in assessing the corporate governance policy of the companies in which they invest or are thinking of investing.

Literature: Shaming

In the literature, shaming is regarded as a possible solution for information-related problems,[240] specifically on matters that are not immediately 'visible'. Information about a company's corporate governance policy stands out in this category. A positive 'side effect' of shaming might be that it makes individuals, consumers and shareholders more aware of their own preferences ('sense of values'). There could also be disadvantages, however. Companies might be wrongly shamed, although the negative effects of that are constrained by existing rules (suing for defamation). And the *shamer* also has a reputation to protect. In addition, the effects of shaming might be too great, for example if shareholders were to abandon the company *en masse* for a minor 'violation'.

---

236 Skeel, Jr. (2001).

237 Keuzenkamp, Theeuwes and De Nooij (2003).

238 Strictly speaking, it is more correct to refer to (potential) shareholders, who have a choice between investing in different companies or investing their money in other assets.

239 A shareholder (a holder of depositary receipts in this case) would, for example, have to request the trust conditions from the trust office in order to verify compliance with provision IV.2.1 of the code. This provision reads: "The management of the trust office shall enjoy the confidence of the depositary receipt holders and operate independently of the company which has issued the depositary receipts. The trust conditions shall specify in what cases and subject to what conditions holders of depositary receipts may request the trust office to call a meeting of holders of depositary receipts." The code does not give any guidelines on disclosure of the conditions.

240 Keuzenkamp, Theeuwes and De Nooij (2003).

In the case of shaming, in any case, it has to be remembered that not all elements of – in this case – corporate governance are determined solely by the company (the management board), but also by the shareholders, for example. Shaming generally works best if it is supported by sound legal arguments, which, in the case of corporate governance, once again raises the issue of the value to be assigned to an explanation, and if reputation is important (to shareholders and consumers, in this case). In shaping and implementing a system, it is important to avoid arbitrariness and legal inequality.

Some writers specifically discuss the role of shaming in relation to offences. Formally speaking, non-compliance with provisions of the code is illegal, but there is a distinction in legal practice between failing to explain why a company does not adhere to the maximum term of office for members of the supervisory board (a provision of the code) and falsifying financial information (which is regulated in laws separate from the code), for example. Dyck, Volchkova & Zingales (2008) identify a relationship with shaming in lobbying by hedge funds that creates greater media attention for corporate governance violations, which media attention in turn leads to improvements in corporate governance. These effects occur because of the reputation of companies and because regulators take action. The latter would not apply in the Dutch situation if no laws are broken other than non-compliance with the code, and it is questionable whether the analysis – which related to Russia in the period from 1999 to 2002 – also applies to the Netherlands. With respect to the falsification of financial information, Karpoff et al. (2006) show that the effect of a fine on a company's reputation can be far greater than the fine itself. Miller (2006) shows that the media serve as a watchdog (again with respect to falsification of financial information) by conducting their own research and publishing the research of others, although the latter only on a selective basis. Van Erp (2008) distinguishes four circumstances under which reputational effects occur: where there is information asymmetry and transaction costs, where reputation is relevant for future performance, if information is disseminated to stakeholders and when there is a moral dimension. The – empirical - question is to what extent these aspects cover corporate governance issues. The analysis by Van Erp (2011) of the financial markets in the Netherlands also considers the moral dimension, which naturally plays a role in the normative framework of the code.

This shows that shaming can have effects on the reputation of companies and that those effects could also occur in relation to provisions of the Dutch corporate governance code. However, no specific information on that point was found in the literature review, so it is not possible to say with certainty what the net effects of shaming would be.

Faming: the Transparency Benchmark[241]

The Transparency Benchmark is published by the Ministry of Economic Affairs in association with the Netherlands Institute of Chartered Accountants (NBA). The 2011 edition rated the 469 largest companies in the Netherlands on the degree of transparency in their reporting on corporate social responsibility in the 2010 financial year.[242] *Faming* ensues from the award of a prize for the best report. Because all the participating companies are rated and presented in order

[241] There seems to have been little research into faming in the academic literature.
[242] www.transparantiebenchmark.nl/. The benchmark has existed (in various forms) since 2004.

of their rating, the report also includes elements of *naming* and *shaming*.[243] The emphasis on transparency (information about the policies that were pursued rather than the policies themselves) makes it somewhat similar to compliance with the corporate governance code, under which companies can depart from best practice provisions with an explanation of the reasons. In this case, naming, faming and shaming relate to the provision of information on corporate social responsibility, which means that there could be effects on the provision of information and, indirectly, on corporate social responsibility itself. The Transparency Benchmark differs from the monitoring of compliance with and application of the corporate governance code in that companies first rate their own reporting, and their opinion is then checked by a team of researchers. In the current Dutch monitoring of corporate governance, researchers immediately determine the degree of compliance and application.

In the literature review, no studies were found that had established the effects of the Transparency Benchmark or similar initiatives. The literature is more concerned with the effect of *obligations* to report on corporate social responsibility on the provision of information about the subject.

7.3 Interpretation

The social desirability of introducing naming depends to a large extent on the value that shareholders attach to information concerning compliance with and application of the provisions of the corporate governance code. In that context, it is relevant that shareholders face practical obstacles in assessing companies' policies on corporate governance.

The costs of introducing naming would not necessarily be high, but the system would require a clear interpretation of 'explain' and the right of companies to defend themselves. A potential risk of naming is that it could also unintentionally introduce shaming (through publication by other media, for example). Shaming has more of an effect on reputation. The greater the reputational effect, the greater the effectiveness of shaming, but shaming also involves risks: the effects could be greater than are appropriate for the 'offence', and the management board is not the only party that influences a company's corporate governance policy. Even more than with naming, shaming calls for an unambiguous and shared interpretation of 'explain'.[244] Faming is also intended to have an effect on reputation, and there seems to be less risk attached it than to shaming. A possible issue could be that faming on the basis of an overall score for compliance with the corporate governance code would probably not tell the entire story about a company's transparency and the quality of its corporate governance.

Naming offers *opportunities* in terms of access to information (direct), as well as possible effects on the reporting of information on corporate governance in annual reports and on corporate governance itself (indirect). It would require more effort, and therefore cost more, than the

[243] Shaming also occurs by naming companies in an appendix to the report that is not publicly accessible (in Dutch). A list of companies with 'zero scores' in 2010 was also sent to Parliament www.rijksoverheid.nl/documenten-en-publicaties/formulieren/2012/09/20/lijst-uitgesplitste-nulscores.html).

[244] It emerged from the interviews that companies are sometimes afraid that an explanation sometimes induces a negative reaction.

current situation (interpretation of explanations, right to challenge findings). There is also a risk of incorrect shaming. In themselves, *shaming* and *faming* would yield less additional information than naming, but would have a more direct effect on reputation. The risk of disproportionate effects is greatest with shaming. A further quantification of these conclusions was not possible within the scope of this study.

To make a more specific estimate of the value of these instruments – naming, shaming and faming specifically in relation to compliance with and application of the corporate governance code – further research could be conducted among the target group: existing and potential shareholders and other stakeholders. If these instruments are found to have significant value, a further study could be conducted to determine how the instruments could be designed to minimise the risks of incorrect shaming or faming, while retaining the positive effects for the provision of information and on corporate governance.

8 A balanced system?

The subtitle of this report is "A balanced system?" Chapter 3 showed that the level of compliance with and application of the Dutch corporate governance code is generally high. Chapter 4 showed that there are various systems of regulation, monitoring and sanctions in relation to corporate governance. Chapters 5, 6 and 7 investigated the possible effects of hypothetical changes in the Dutch system. In addition, surveys were conducted and individuals were interviewed for the purposes of this study. What are the main conclusions? And on what issues is there less certainty?

Monitoring: retain

On the basis of this study, there is no reason to conclude that abolishing the system of government-financed and supervised monitoring of compliance with and application of the corporate governance code is socially desirable. The current high level of compliance and application provides no guarantees for the future. Moreover, even now there are some provisions that are complied with or applied less well. Monitoring provides information that helps the government and parliament to formulate policies, as well as information for the general public. It keeps corporate governance on the agenda of policy makers and listed companies and helps avoid the need to formulate ad hoc policies. The modest savings that would arise from ending monitoring would not be sufficient to justify ending the system.

Legal embedding: retain

Abolishing the statutory basis of the Dutch corporate governance code would open the way for alternative codes and for the reporting of information on corporate governance policy by listed companies without reference to a code. This would give companies greater freedom in their reporting and might have advantages in the sense that companies could make their own choices about what information on corporate governance appears in the annual report. This *might* increase the motivation of companies to report relevant information on corporate governance. But there would probably also be disadvantages. Where a single code provides a structure, more than one code, or the absence of the structure provided by the existing code, would not make the assessment of information and policies relating to corporate governance any easier. Monitoring of corporate governance at an aggregated level would probably also be more difficult and less complete. Opposed to greater freedom in reporting is the risk that the information provided about corporate governance and the application of the best practice provisions, which are seen as elements of sound corporate governance, would suffer.

Abolishing the legal embedding of the code seems a fairly arbitrary solution for *possible* defects in the existing code and would risk sending a signal that corporate governance does not need to be taken so seriously. A better option, therefore, would seem to be to conduct research specifically into the demand among companies for a customised system and the degree to which the 'apply or explain' regime does not adequately meet their needs, as well as looking at ways of improving the provision of information to shareholders and of preventing a 'box-ticking approach', including the reasons for it and the remedies for it.

Naming, shaming and faming: worth investigating further

The publication of information at individual company level – as is already done in the *Transparency Benchmark* in relation to corporate social responsibility and in Portugal with respect to the application of corporate governance recommendations – would generate more information about corporate governance, particularly for existing and potential shareholders. Providing this information would require a greater effort by the monitoring committee and by companies themselves. Greater weight would be assigned to determining the validity of an explanation and decisions would be challenged more often, but companies might be encouraged to comply even better with the provisions of the code. *Shaming* – the explicit publication of the names of companies with a poorer record of compliance – provides less additional information than *naming* and, through the risk of damage to the company's reputation, both provides a greater incentive to improve compliance and creates a risk of disproportionate effects for companies in relation to the 'offence'. *Faming* also provides less additional information than *naming*, involves a smaller risk of causing disproportionate damage to a company's reputation than *shaming*, but also provides less incentive to increase compliance.

To assess whether naming, shaming or faming would be preferable to the current situation and, if so, in what form, more research is needed into the impact on the provision of information, the value of the information and ways of managing the risk of causing disproportionate damage to a company's reputation.

Code and monitoring: transparency and standardisation

The Dutch corporate governance code and its monitoring serve two purposes: to promote *transparency* about the policies on corporate governance pursued by listed companies and to establish *standards* of sound corporate governance. The principle of applying provisions of the code or explaining why provisions are not applied – *apply or explain* – makes the same distinction. *Applying* the provisions of the code means that the standards of the code have been complied with. An *explanation* provides information about derogations from the provisions of the code.

The latter aspect represents a grey area in the system: the possibility of giving an explanation. Although the possibility of departing from provisions of the code almost automatically creates a desirable flexibility in corporate governance, it is unclear what the precise function of an explanation is. It could be a way of showing that although a provision has not been applied, the underlying *standard* – the 'spirit' of the code – has been met. An explanation might also be purely a way of providing *information* about what corporate governance policies are being followed, and why, instead of the provisions of the code.

This distinction plays a role in different ways. Establishing whether an explanation is 'valid' determines whether or not the code has been complied with. Naturally, this is reflected in the aggregated figures in the monitoring. The interpretation of what constitutes a valid explanation influences the information provided, and perhaps even the corporate governance of listed companies. The choice between – or perhaps we should say the balance between – explanation as *normative* or as *informative* touches on an essential question: whether the code is intended to give shareholders an instrument in their dealings with the company, or whether it is intended to exert influence on the company via the government – in the form of the monitoring committee –

separately from the shareholders. If naming, shaming or faming were to be introduced, this issue would necessarily come to the forefront.

Making the two objectives, normative and informative, more explicit could provide a clearer view of the arguments and possible consequences in the discussion of the corporate governance code, the monitoring and possible alternatives to the exsiting system.

Literature

A Guide To Sarbanes-Oxley (2006), The Sarbanes-Oxley Act.Via www.soxlaw.com on 26 July 2012.

Abma and Olaerts (2011), *De effectiviteit van de comply or explain-regel in Nederland*, TvO 2011-5.

Arcot, S. R., & Brunoy, V. G. (2006), *In Letter but not in Spirit: An Analysis of Corporate Governance in the UK.*

Association Française des Entreprises Privées, & Mouvement des entreprises de France (2003), *The Corporate Governance of Listed Corporations.*

Association Française des Entreprises Privées, & Mouvement des entreprises de France (2010), *Corporate governance code of listed corporations.*

Associazione fra le società Italiane per azioni (2004), *Handbook on Corporate Governance Reports.*

Associazione fra le società Italiane per azioni (2012a), *Comply or explain: Preserving Governance Flexibility with Quality Explanations,* Brussels.

Associazione fra le società Italiane per azioni (2012b), *Corporate Governance in Italy: Compliance with the CG Code and Related Party Transactions (Year 2011).*

Autorité des marchés financiers (2010a), *AMF 2010 report on corporate governance and executive compensation.*

Autorité des marchés financiers (2010b), Press release: *AMF publishes its 2010 report on corporate governance and executive compensation,* Paris.

Autorité des marchés financiers (2012, 6 August 2012), *What we do.* Via www.amf-france.org/affiche_page.asp?urldoc=lesmissionsamf.htm&lang=and&Id_Tab=0 on 6 August 2012.

Bainbridge, S. M., & W. D. Warren (2012), *Corporate Lawyers as Gatekeepers,* Oxford University Press.

Bebchuk, L. A., A. Cohen, C.C.Y. Wang, *Learning and the Disappearing Association between Governance and Returns*, Harvard Discussion Paper No. 667, Forthcoming in Journal of Financial Economics.

Berlin Center of Corporate Governance (2012a), *Aktuelles.* Via www.bccg.tu-berlin.the/main/aktuelles.htm on 2 August 2012.

Berlin Center of Corporate Governance. (2012b), *Corporate Governance Report 2012: Kodexregime und Kodexinhalt im Urteil der Praxis,* Berlin.

Bianchi, M., Ciavarella, A., Novembre, V., & R. Signoretti. (2010), *Comply or explain? Investor protection through Corporate Governance Codes.*

Bohinc, R. (2011). One or two-tier corporate governance systems in some EU and non-EU countries. *Megatrend Review, 8 (1) 2011: pp. 57-76.*

Bos, de & Quadackers (2007), *Kosten en Baten van de Nederlandse Corporate Governance Code*, MCA: June 2007, number 4.

Camfferman, K. (2008), *The AFM and the interpretation of IFRS*, O&F.

Claessens, S., B. Yurtoglu, 2012, *Corporate Governance and development – an update*, Global corporate governance forum, Focus 10.

CMVM (Comissão do Mercado the Valores Mobiliários) (2011), *Annual Report on the Corporate Governance of Listed Companies in Portugal.*

Coates, J.C. (2007), The goals and promise of the Sarbanes-Oxley Act. *The journal of economic perspective*, vol 21, no. 1.

Coffee J. C. Jr. (2004), What caused Enron? A capsule social and economic history of the 1990s. *Cornell Law Review.*

Comitato per la Corporate Governance (2011), *Corporate governance code* .

Commission of the German corporate governance code (2012), *German corporate governance code.* Via www.corporate-governance-code.the/index-e.html on 1 August 2012.

Commission of the German Corporate Governance Code (2012a), *2012 Corporate Governance Report*, Berlin.

Commission of the German Corporate Governance Code (2012b). *German Corporate Governance Code.*

Commissione Nazionale per le Società e la Borsa (Consob) (2012), *Consob - What it is and what it does*. Via www.consob.itoainen/consob/what/what.html?symblink=/mainen/consob/what/index.html on 25 July 2012.

Commissione Nazionale per le Società e la Borsa (Consob), (after 2007), *Supervisory authority for the investors' protection*.

Consolidated Law on Finance (2012), No.58 of 24 February 1998 Cong. Rec.

Corporate Governance Code Monitoring Committee (1999), *Kabinetsreactie op eenmalige monitoring. 2012*, via www.commissiecorporategovernance.nl/Kabinetsreactie.

Corporate Governance Code Monitoring Committee (2004), *Taakopdracht*. Via www.commissiecorporategovernance.nl/Taakopdracht on 1 August 2012.

Corporate Governance Code Monitoring Committee (2006), *Second Report on compliance with the Dutch corporate governance code*, December 2006, The Hague.

Corporate Governance Code Monitoring Committee (2008a), *De Nederlandse corporate governance code. Beginselen van deugdelijk ondernemingsbestuur en best practice bepalingen*.

Corporate Governance Code Monitoring Committee (2008b), *Fourth report on compliance with the Dutch corporate governance code*, December 2008, The Hague.

Corporate Governance Code Monitoring Committee (2010), *Second report on compliance with the Dutch corporate governance code*, December 2010, The Hague.

Corporate Governance Code Monitoring Committee (2011), *Third report on compliance with the Dutch corporate governance code*, December 2011, The Hague.

Corporate Governance Code Monitoring Committee (2012a), *The Dutch Corporate Governance Code.* Via www.commissiecorporategovernance.nl/corporate-governance-code on 22 July 2012.http://commissiecorporategovernance.nl/Corporate_Governance_Code

Corporate Governance Code Monitoring Committee (2012b), *The Monitor Commissie.* Via www.commissiecorporategovernance.nl/the-monitoring-Committee on 26 July 2012.

Corporate Governance Code Monitoring Committee (2012c), *First Corporate Governance Committee: Peters Committee.* Via www.commissiecorporategovernance.nl/Committee-peters on 26 July 2012.

Demsetz, H. (1983), T*he structure of ownership and the theory of the firm*, Journal of Law and Economics, vol. 26, no. 2, pp. 375-390.

Department for Business Innovation & Skills (BIS) (2012), *Consultation on revised remuneration reporting regulations*.

Duhamel, Fasterling and Refait-Alexandre (2012), *Seeking legitimacy through complying with corporate governance codes. An analysis of 'comply or explain' disclosures by companies in the French SBF 120*.

Dyck, Volchkova and Zingales (2008), *The Corporate Role of the Media: Evidence from Russia*, The Journal of Finance, Vol. LXII, No. 3, June 2008.

Elst, van der, De Jong et al. (2007), *Een overzicht van juridische en economische dimensies van de kwetsbaarheid van Nederlandse beursvennootschappen*.

Enriques, L., P. Volpin (2007), *Corporate governance reforms in continental Europe*, Journal of Economic Perspectives, volume 21, no. 1, pp. 117-140.

Erp, van (2008), *Reputational sanctions in private and public regulation*, Erasmus Law Review Volume 01 Issue 05.

Erp, van (2011), *Naming without shaming: The publication of sanctions in the Dutch financial market*, Regulation & Governance (2011) 5, 287–308.

European Parliament and the Council (2006), Directive 2006/46/EC. 14 June 2006.

European Corporate Governance Forum (2009), *Statement of the European Corporate Governance Forum on Cross-border issues of Corporate Governance Codes* [Electronic Version]. *EUCGF Statement.* Via http://ec.europa.eu/internal_market/company/docs/ecgforum/ecgf-crossborder_and.pdf.

European Corporate Governance Institute (2002, 12 June 2002), *The German Corporate Governance Code (The Cromme Code).* Via www.ecgi.org/codes/code.php?code_id=44 on 25 July 2012.

European Corporate Governance Institute (2010, 16 September 2010), *German Corporate Governance Code as amended on 26 May 2010*. Via www.ecgi.org/codes/code.php?code_id=308 on 25 July 2012.

European Corporate Governance Institute (2011), *Corporate Governance Codes and Principles - Italy.* Via www.ecgi.org/codes/code.php?code_id=351 on 23 July 2012.

Financial Reporting Council (2005), *Annual report 2004/2005.*

Financial Reporting Council (2010a), *The UK Corporate Governance Code*.

Financial Reporting Council (2010b), *The UK Stewardship Code*.

Financial Reporting Council (2012a), *UK Corporate Governance Code 2012*. Via www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx.

Financial Reporting Council (2012b), *UK Stewardship Code 2012*.Via www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Stewardship-Code.aspx.

Financial Service Authority (2012), *Who are we?* Via www.fsa.gov.uk/about/who on 6 August 2012.

Furubotn, E.G., Pejovich, S. (1972), *Property rights and economic theory: a survey of recent literature*, Journal of Economic Literature, vol. 10, no. 4, pp. 1137-1162.

Galle, J. G. C. M. (2012), *Consensus on the comply or explain principle within the EU corporate governance framework: Legal and empirical research,* Kluwer.

Grant Thornton (2011), *Corporate governance review 2011*.

Hansmann, H. (1988), *Ownership of the firm,* Journal of Law, Economics, and Organization, vol. 4, no. 2, pp. 267-304.

Hart (1995), *Corporate governance: some theory and implications*, The economic journal, vol. 105, nr 430, pp. 678-689.

Hooghiemstra and Van Ees (2011), *Uniformity as response to soft law: Evidence from compliance and non-compliance with the Dutch corporate governance code*, Regulation & Governance (2011) 5, 480–498.

I. X. Zhang (2007), Economic consequences of the Sarbanes–Oxley Act of 2002. *Journal of Accounting and Economics 2007*(44), 74–115.

Irish Stock Exchange (2010), *The Irish corporate governance annex*.

Irish Stock Exchange (2012), *Irish Corporate Governance Requirements*. Via www.ise.ie/ISE_Regulation/Consultation-Papers/Historic_Consultation_Papers/Corporate_Governance_Annex/ on 6 August 2012.

IT Governance (2012), *Corporate governance in the US*. Via www.itgovernanceusa.com/corporate-governance.aspx on 24 July 2012.

Jackson, G. (2010), *Understanding corporate governance in the United States*.

Jensen, M.C., Meckling, W.H. (1976), *Theory of the firm: managerial behavior, agency costs and ownership structure*, Journal of Financial Economics 3, pp. 305-360.

Jones, I. W., & M. G. Pollitt (2001), *Who influences debates in business ethics? An investigation into the development of corporate governance in the UK since 1990,* University of Cambridge Working Paper No. 221.

Jong, A. D., De Jong, D. V., Mertens, G., and Wasley, C. E (2005), The role of self-regulation in corporate governance: evidence and implications from The Netherlands, *Journal of corporate finance 2005* (11), 473-503.

Karpoff, J.M., D. Scott Lee and Gerald S. Martin (2006), The Cost to Firms of Cooking the Books.

Keuzenkamp, Theeuwes and De Nooij (2003), *Aan the schandpaal: the economische betekenis of 'naming and shaming'*, SEO Report 717.

Klein, B., Crawford, R., Alchian, A. (1978), *Vertical integration, appropriable rents, and the competitive contracting process*, Journal of Law and Economics 21, pp. 297-326.

Larcker, D.F., G. Ormazabal, D.J. Taylor (2010), *The Regulation of Corporate Governance*.

Lekvall, P. (2009), The Swedish Corporate Governance Model, chapter 6.14. In *The Handbook of International Corporate Governance,* Institute of Directors.

Love, I. (2010), *Corporate Governance and Performance around the World: What We Know and What We Don't*, World Bank Research Observer, volume 26, issue 1, pp. 42-70.

Miller, G.M. (2006), *The Press as a Watchdog for Accounting Fraud*, Journal of Accounting Research Vol. 44 No. 5, December 2006.

Ministry of Economic Affairs in collaboration with NBA, *Transparency Benchmark 2011*.

Mitnick (2012), *Origin of the Theory of Agency: An Account by One of the Theory's Originators*.

Morck, R., D. Wolfenzon, B. Yeung (2005), *Corporate governance, economic entrenchment and growth*, Journal of Economic Literature, Vol. XLIII (September 2005), pp. 655–720.

Office of the director of corporate enforcement (2012), *Corporate governance*. Via www.odce.ie/and/company_law/company_pages.aspx?article=794a757a-62cd-4df5-98df-b5a416ac415e on 6 August 2012.

Public Company Accounting Oversight Board (2005), *Sarbanes-Oxley and the Post-Enron Environment: Auditor Oversight*. Via http://pcaobus.org/News/Speech/Pages/08022005_GoelzerSOXAuditorOversight.aspx on 26 July 2012.

Public Company Accounting Oversight Board (2011), *Annual report 2011*.

Putterman, L. (1993), *Ownership and the nature of the firm*, Journal of comparative economics 17, pp. 243-263.

RiskMetrics (2009), *Study on Monitoring and Enforcement Practices in Corporate Governance in the Member States*. 23 September 2009.

SEC (2012), *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*. Via www.sec.gov/about/whatwedo.shtml.

Skeel, Jr. (2001), *Shaming in Corporate Law*, University of Pennsylvania Law Review, Vol. 149, No. 6 (June, 2001), pp. 1811-1868.

Swedish Corporate Governance Board (2010), *The Swedish Corporate Governance Code*.

Swedish Corporate Governance Board (2011), *Annual report 2011*.

Swedish Corporate Governance Board (2012a), *A brief history of corporate governance*. Via www.corporategovernanceboard.se/corporate-governance/history

Swedish Corporate Governance Board (2012b), *Comply or explain*. Via www.corporategovernanceboard.se/the-code/comply-or-explain.

Swedish Corporate Governance Board (2012c), *The Swedish Corporate Governance Board*. Via www.corporategovernanceboard.se/about-the-board.

The Italian Companies and Stock Exchange Commission (Consob) (after 2007), *Supervisory authority for the investors' protection*.

University of Groningen (2005*), Corporate Governance in Nederland: Een onderzoek naar de stand van zaken in het boekjaar 2004, alsmede naar de verklaring van verschillen tussen beursgenoteerde vennootschappen*, November 2005.

University of Groningen (2006), *Corporate Governance in Nederland: Een onderzoek naar de stand van zaken in het boekjaar 2005 en de ontwikkelingen ten opzichte van het boekjaar 2004*, December 2006.

University of Groningen (2007), *Corporate Governance in Nederland: Een onderzoek naar de stand van zaken in het boekjaar 2006 en de ontwikkelingen ten opzichte van het boekjaar 2005*, December 2007.

University of Groningen (2008), *Corporate Governance in Nederland: Een onderzoek naar de stand van zaken in het boekjaar 2007 en de ontwikkelingen ten opzichte van het boekjaar 2006 en voorgaande jaren*, September 2008.

University of Groningen (2009), *Een analyse van de uitleg voor afwijkingen van best practice bepalingen van de Nederlandse corporate governance code over boekjaar 2008,* November 2009.

University of Groningen (2010), *Corporate Governance in Nederland: Een onderzoek naar de wijze van naleving en toepassing van de principes en best practice bepalingen van de code 2008 door Nederlandse beursgenoteerde vennootschappen in het boekjaar 2009 evenals de redengeving voor eventuele afwijkingen*, December 2010.

University of Groningen (2011a), *Corporate Governance in Nederland: Een onderzoek naar de wijze van naleving en toepassing van de principes en best practice bepalingen van de code 2008 door Nederlandse beursgenoteerde vennootschappen in het boekjaar 2010 evenals de redengeving voor eventuele afwijkingen*, November 2011.

University of Groningen (2011b), *Corporate governance in Nederland: De wijze en mate van naleving en toepassing van de principes en best practices van de Nederlandse corporate governance code door de Nederlandse beursgenoteerde vennootschappen in het boekjaar 2010, alsmede de redengeving van eventuele afwijkingen*, 4 November 2011.

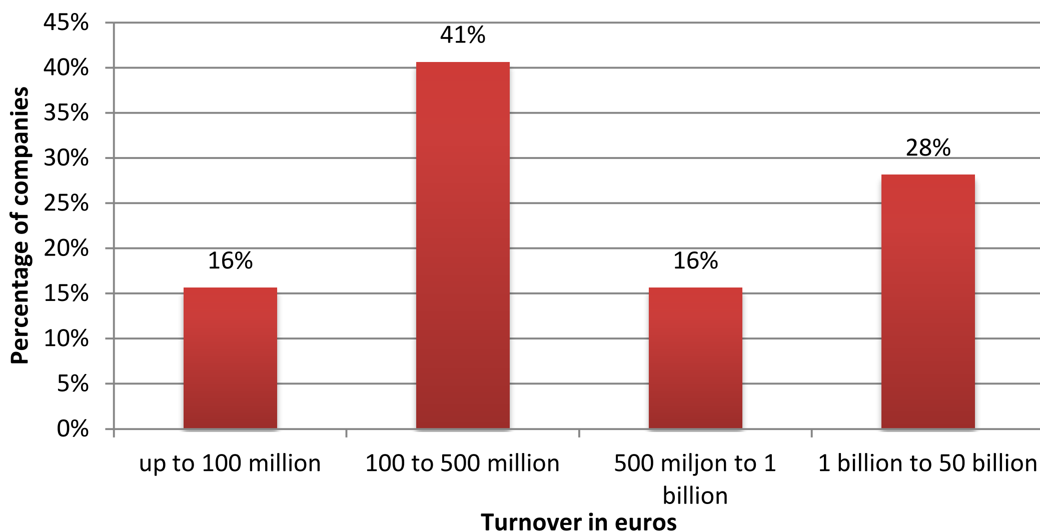
VEB (2009), *Kredietcrisis helpt naleving code-Tabaksblat*, Effect 26, 26 December 2009.

Appendix A Online survey of listed companies

Response and general features

We asked 103 listed companies to take part in the survey. Five companies informed us that they were no longer listed or were no longer obliged to comply with the Dutch corporate governance code. The panel therefore included 98 companies, of whom 36 started to complete the online questionnaire. Twenty-five companies completed it. The net response rate is 26%. Figure 8.1 gives a breakdown of the respondents by annual turnover.

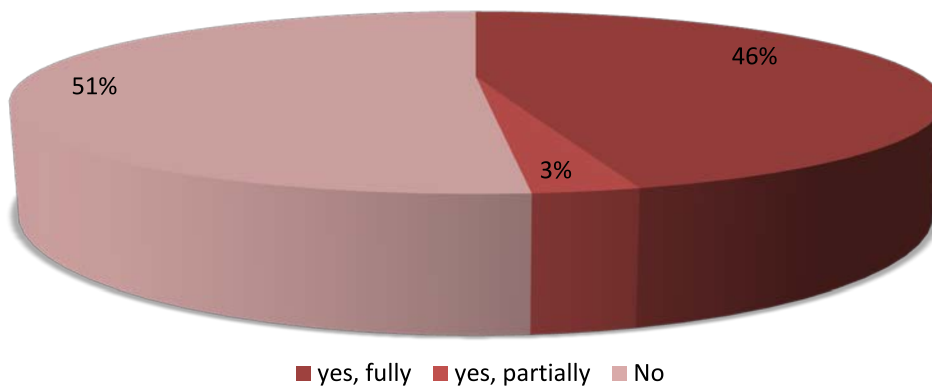
Figure 8.1 Almost half of the companies that responded had a turnover of between € 100 million and € 500 million in the Netherlands in 2010



Source: SEO Economic Research. Question: What was the Dutch *annual turnover* of your company in the 2010 financial year in millions of euro? (n=32)

Figure 8.2 shows that the respondents were almost equally divided between companies that did and did not have a two-tier structure.

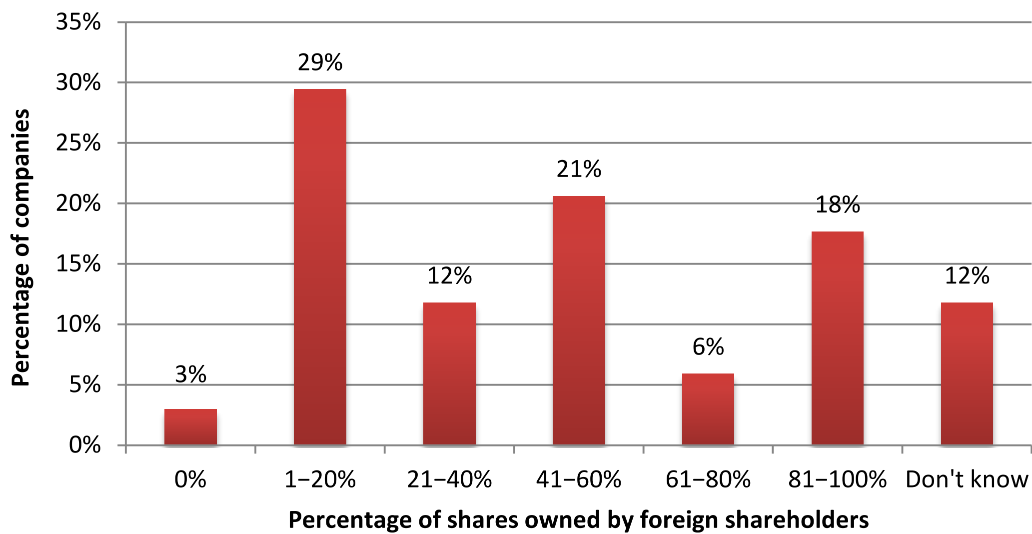
Figure 8.2 Roughly half of the respondents had a two-tier structure in 2010



Source: SEO Economic Research. Question: Did your company fall under the rules for entities with a two-tier structure in the 2010 financial year? (n=35)

Figure 8.3 shows the breakdown of companies by the proportion of shares owned by foreign shareholders.

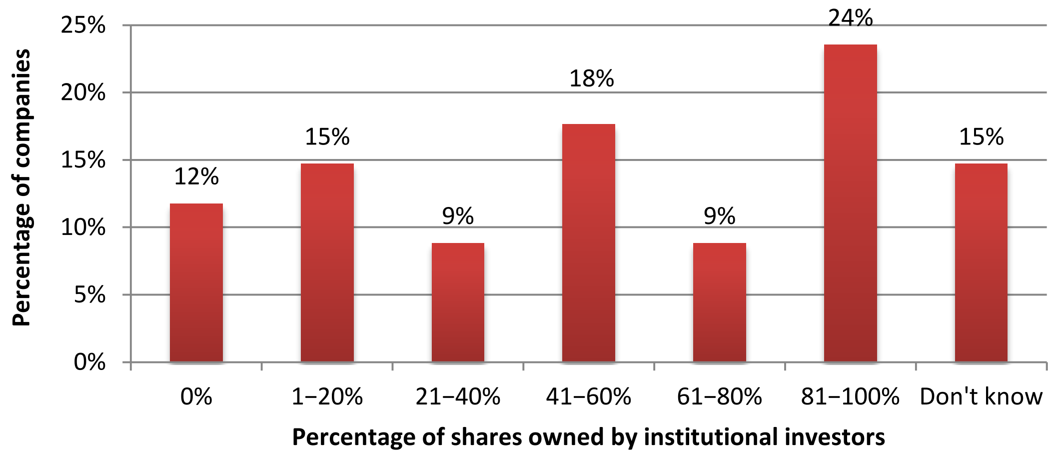
Figure 8.3 Percentage of shares owned by foreign shareholders among companies that responded



Source: SEO Economic Research. Question: Could you give an estimate of the percentage of shares owned by foreign shareholders on 31–12–2010? (n=34)

Figure 8.4 shows the breakdown of companies by the proportion of shares owned by institutional investors.

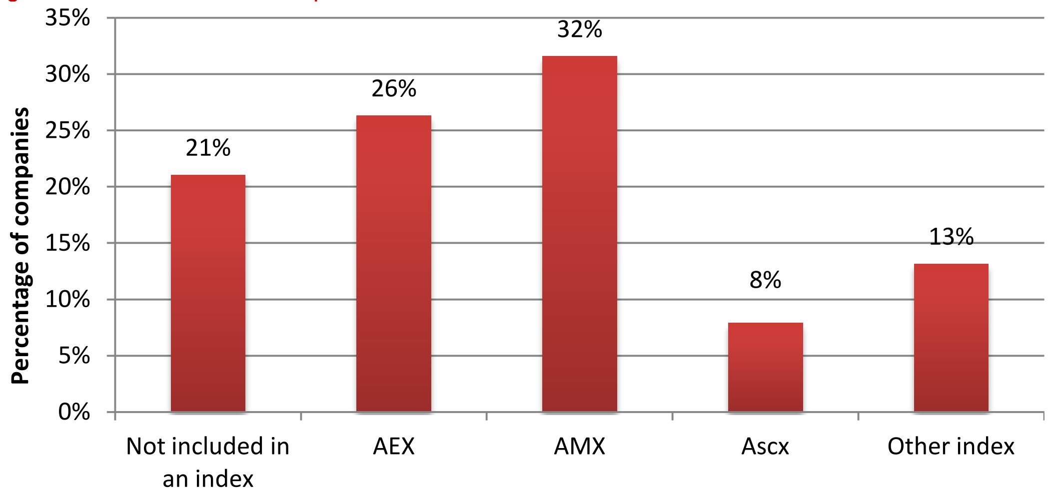
Figure 8.4 For almost a quarter of the respondents, 80-100% of the shares are owned by institutional investors



Source: SEO Economic Research. Question: Could you give an estimate of the percentage of shares owned by institutional investors on 31–12–2010? (n=34).

Figure 8.5 shows the breakdown of companies by share index.

Figure 8.5 A third of the respondents were listed in the AMX index in 2010



Source: SEO Economic Research. Question: Multiple-choice question (four companies gave two answers). Question: Was your company included in a share index in the 2010 financial year? (n=34)

Costs of statement in the annual report

The companies were asked to describe the recurring annual costs arising from the obligation to include a statement on corporate governance in the annual report as a total and in three mutually exclusive categories. These categories were not all filled in by every respondent, so the total was not always equal to the sum of the components. We have corrected for this as follows.

1) *Respondents entered the total and a figure for all three categories, and the total is equal to the sum of the components*. No correction is needed.

2) *Respondents entered the total, but no figure for some or all of the categories.* In that case, the total is used and the following corrections were made in the categories that were entered:
a. if one of the categories that was entered already exceeded the total: all observations of this respondent were scrapped for the three categories, but not for the total.
b. if the sum of the categories that were entered exceeded the total: all observations for this respondent were scrapped for these three categories, but not for the total.
c. if neither a nor b, no correction was necessary.

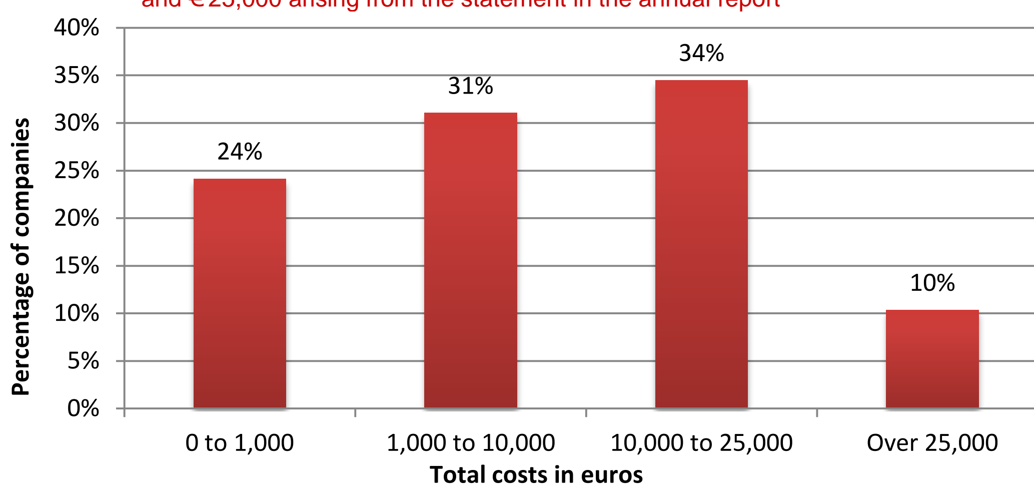
3) *Respondents did not enter a total, but did enter a figure for some or all of the categories.* In that case, the total was calculated as the sum of the categories for which figures were entered.

4) *Respondents entered both the total and figures for all three categories, but the total is smaller than the sum of the figures for the three categories.* In that case, the total was used and all observations of this respondent for the three categories were scrapped.

5) *Respondents entered both the total and figures for all three categories, but the total is larger than the sum of the figures for the three categories.* In that case, the three categories were used and the total was recalculated as the sum of the figures for the categories entered.

Figure 8.6 shows the total costs that companies said they incurred.

Figure 8.6 Almost 35% of the respondent companies have annual costs of between € 10,000 and € 25,000 arising from the statement in the annual report

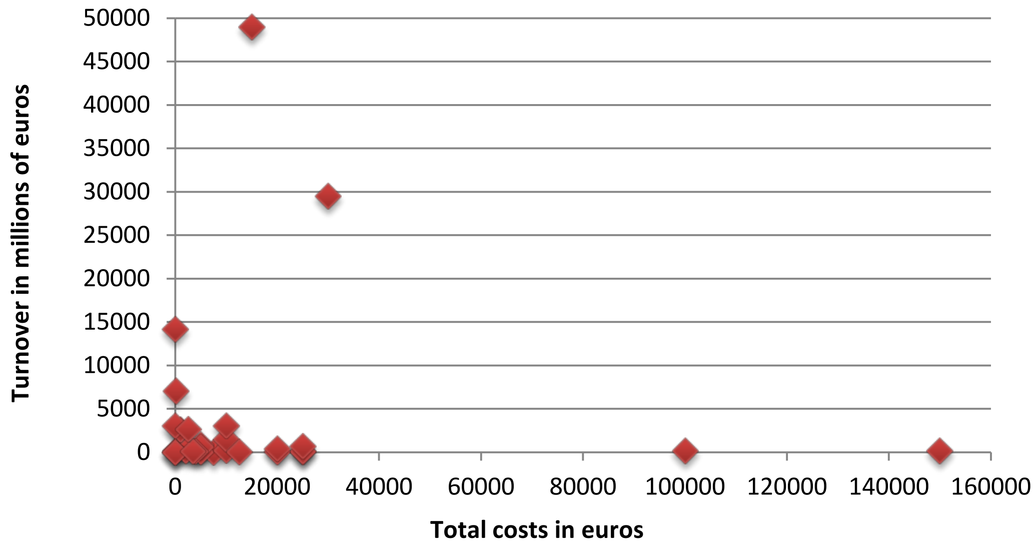


Source: SEO Economic Research Question: What is your estimate of the total annual recurring costs incurred by your company in the 2010 financial year, in euros, as a result of the obligation to publish a statement in the annual report on compliance with the principles and best practice provisions of the corporate governance code? Average = € 16,840, minimum = € 0, maximum = € 150,000. (n=29)

On average, the costs were equal to 0.0096% of the company's turnover, with a maximum of 0.08%.[245] The total costs for the statement in the annual report represent only a small portion of the turnover. We looked for a correlation between turnover and total costs (Figure 8.7 does so for all respondents; Figure 8.8 omits four respondents as 'outliers' and looks again at the relationship). No relationship was found.

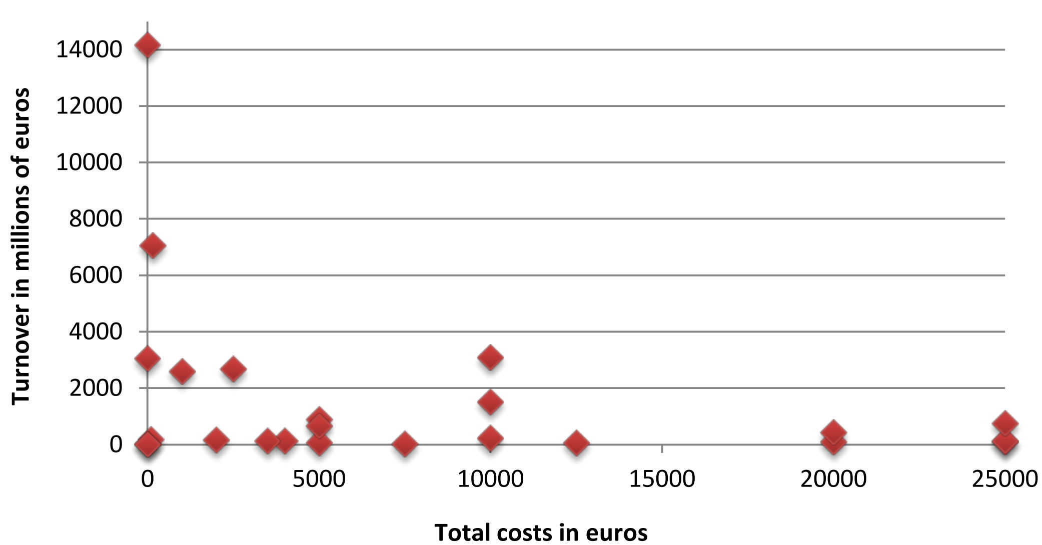
245 Based on 28 respondents.

Figure 8.7 There is no apparent relationship between company turnover and total costs incurred as a result of the statement in the annual report (all respondents)



Source: SEO Economic Research. Respondents that reported their turnover but not the total costs are not included. (n=29)

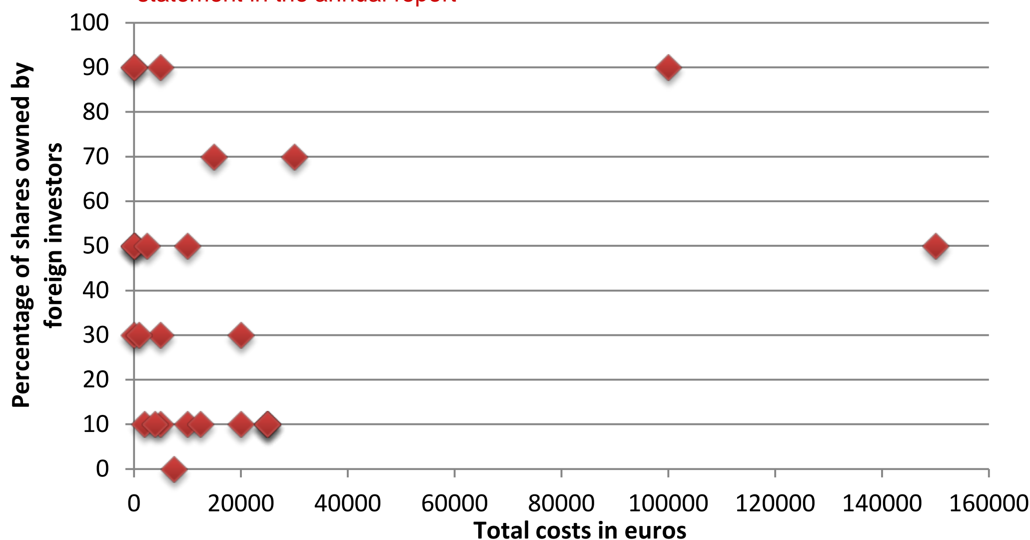
Figure 8.8 There is no apparent relationship between company turnover and the total costs incurred as a result of the statement in the annual report (all respondents minus four outliers)



Source: SEO Economic Research. The same as Figure 8.7, but without four 'outliers'. (n=25).

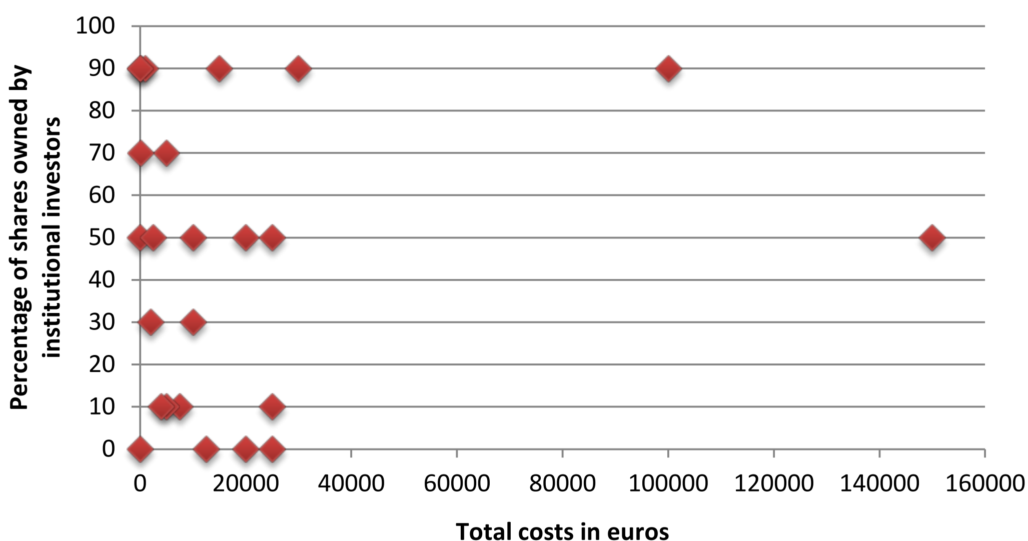
In Figure 8.9, Figure 8.10, Figure 8.11 and Figure 8.12 we analyse the relationship between the total costs incurred by a company as a result of the statement in the annual report and the ownership of share by foreign shareowners, the ownership of shares by institutional investors, the two-tier regime and the share index, respectively. There does not appear to be any convincing, strong correlation, particularly if the influence of 'outliers' is taken into account.

Figure 8.9 Percentage of shares owned by foreign investors and total costs related to the statement in the annual report



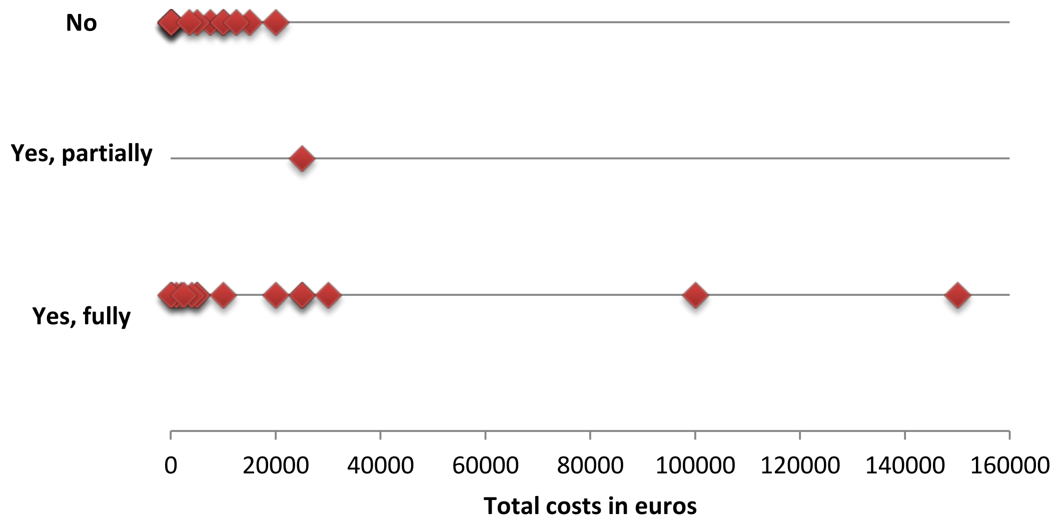
Source: SEO Economic Research. The median of the answers for the categories was taken for the percentage of shares owned. Respondents that reported the percentage of shares owned by foreign investors but not total costs are not included. Respondents who did not know the percentage are also not included. (n=26)

Figure 8.10 Percentage of shares owned by institutional investors and total costs related to the statement in the annual report



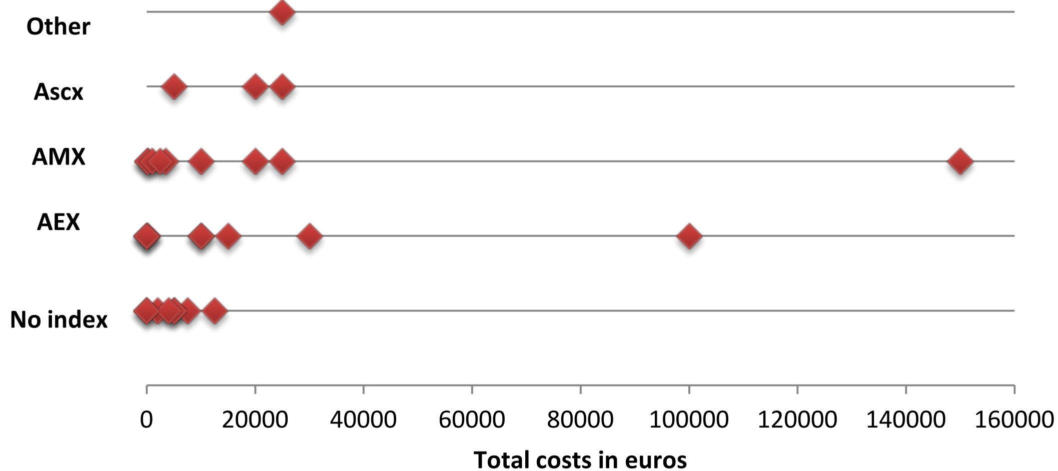
Source: SEO Economic Research. The median of the answers for the categories was taken for the percentage of shares owned. Respondents who reported the percentage of shares owned by institutional investors but not the total costs are not included. Respondents who did not know the percentage are also not included. (n = 24)

Figure 8.11 Two-tier regime and total costs related to the statement in the annual report



Source: SEO Economic Research. Respondents that reported that they fall under the two-tier regime but not the total costs are not included. (n=29).

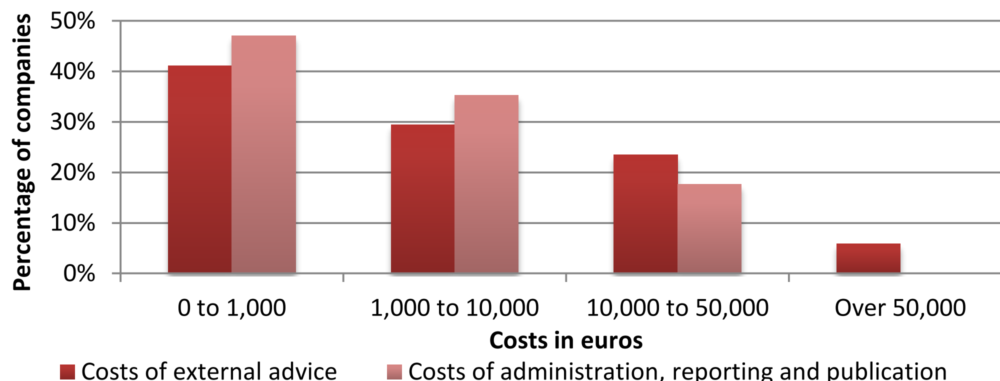
Figure 8.12 Share index and costs related to the statement in the annual report



Source: SEO Economic Research. Respondents who reported the index but not the total costs are not included. For respondents that replied Other, in addition to the AEX, AMX or Ascx, only one of the three latter indices is included. (n=29)

Figure 8.13 shows the costs incurred specifically for external advice and for administration, reporting and publication (the third category is other costs). Remarks made in this context were that maintaning the system costs less than setting it up (when the code is implemented) provided no major changes occur; that some of the costs might also be incurred even without mandatory reporting; and that the additional costs are difficult to estimate (based on the number of hours that employees spend on reporting, among other things).

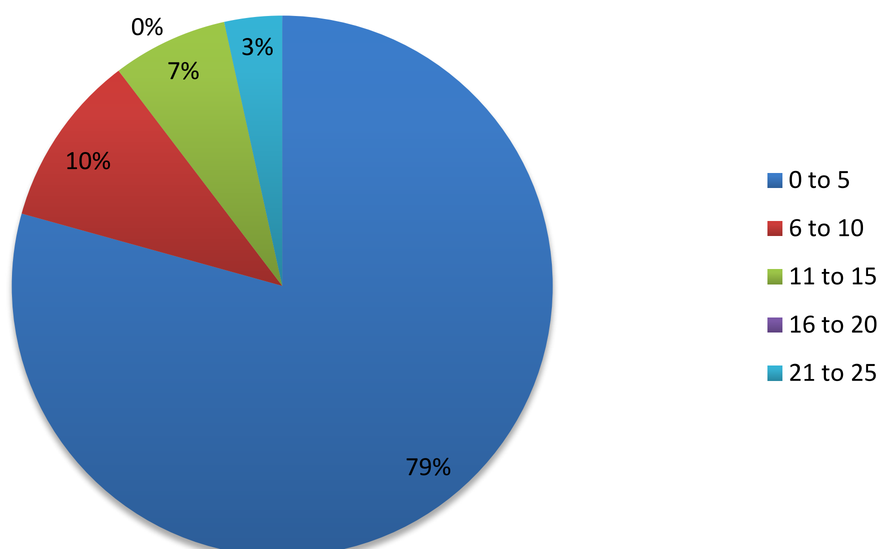
Figure 8.13 Roughly three-quarters of the companies that responded incurred a maximum of € 10,000 in costs for external advice related to the statement in the annual report and a maximum of € 10,000 for administration, reporting and publication in 2010



Source: SEO Economic Research. Question 1 (n=17): What is your estimate of the costs incurred by your company in the 2010 financial year, in euros, for *external advice* related to the obligation to include a statement in the annual report on compliance with the principles and best practice provisions of the corporate governance code? Average costs = € 8,707; minimum = € 0; maximum = € 60,000. Question 2 (n=17): What is your estimate of the costs incurred by your company in the 2010 financial year, in euros,for *administration, reporting and publication,* related to the obligation to include a statement in the annual report on compliance with the principles and best practice provisions of the corporate governance code? Average costs = € 3,150; minimum = € 0; maximum = € 10,000.

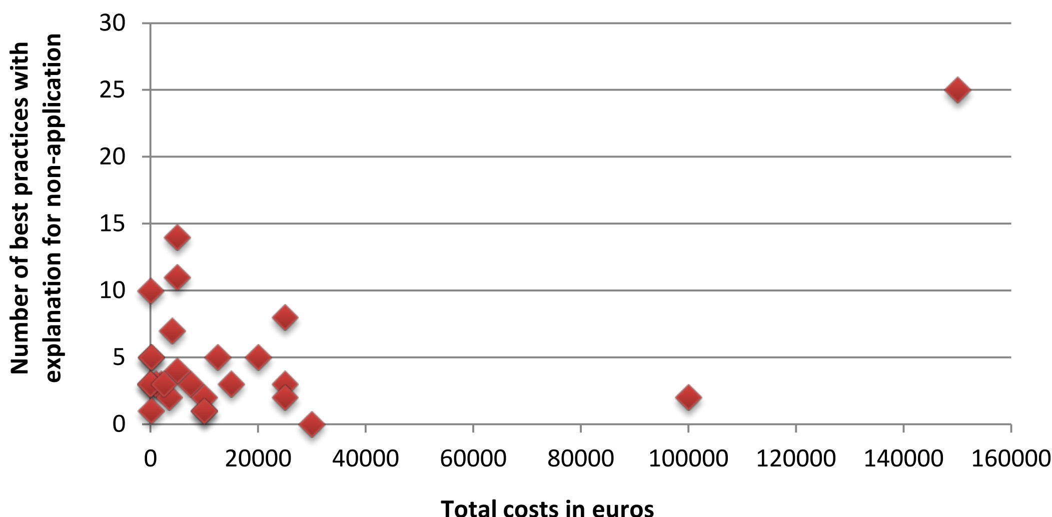
Finally, the costs arising from the mandatory statement were analysed according to the number of best practice provisions in which a reasoned explanation for non-application was given. Figure 8.14 shows that the majority of the companies said they made such a statement for a small number of provisions. No relationship was found between providing an explanation and the total costs as a result of the manadatory statement (Figure 8.15).

Figure 8.14 Almost 80% of the companies that responded had given a reasoned explanation for non-application of up to five best practices in 2010



Source: SEO Economic Research. Question: The corporate governance code contains 22 principles and 129 accompanying best practice provisions. For how many best practice provisions did your company given a reasoned explanation for non-application in the 2010 financial year? Average = 4.8; minimum = 0; maximum = 25. (n=29)

Figure 8.15 Reasoned explanation for non-application of best practices and total costs as a result of mandatory statement



Source: SEO Economic Research. Only respondents that answered both questions are included. (n=27)

Hypothetical changes in the regulation of corporate governance

In this module, some hypothetical changes were presented to the respondents. For each one they were asked about its effect on their statement in the annual report, on the application of best practice provisions, about other effects and about the effect on the relationship between the management board, the supervisory board, shareholders and other stakeholders. There were open and closed questions.

Hypothetical situation 1: monitoring committee

The following situation was presented: "*Suppose the current monitoring committee is abolished and is not replaced by an equivalent (private) alternative. Research into compliance with principles and the best practice provisions of the corporate governance code will no longer be carried out and, hence, no longer published either. The corporate governance code and the obligation to include a statement in the annual report will remain the same, however.*"

It was assumed that there would be no equivalent initiative in this situation in order to discover what effect the disappearance of monitoring would have, rather than if the monitoring were carried out by another party. This would probably have a greater effect and, in that sense, produce a 'maximum'.

Table 8.1 and Table 8.2 show that the majority of respondents said that neither the reporting nor the application of best practice provisions would change.[246]

---

[246] The replies to the question about the effect on the relationship between the management board, the supervisory board, shareholders and other stakeholders expand on this and are not presented/summarised here.

Table 8.1 Question: Would this hypothetical change cause your company to change its reporting in the annual report?

	Number	Percentage
Yes	1	3%
No	27	84%
Don't know	4	13%
No reply	0	0%
Total	*32*	*100%*

Source: SEO Economic Research. N=32.

Table 8.2 Question: Would this hypothetical change cause your company to change the application of the best practices in the governance code?

	Number	Percentage
Yes	2	6%
No	26	84%
Don't know	3	10%
No reply	0	0%
Total	*31*	*100%*

Source: SEO Economic Research. n=31.

Respondents that answered 'yes' or 'no' were then asked some open questions. Analysis of their replies shows that the reporting would not change because of the continued obligation to include a statement, as well as the importance of compliance and the ensuing transparency to the organisation itself. Factors less frequently mentioned were the interests of shareholders and investors, which overlaps in part with transparency. With respect to the absence of changes in the application of provisions, respondents referred to the same reasons as they gave for not changing their reporting: the statutory obligation still exists, companies take account of *stakeholders* and see no reason to amend their policy.

Table 8.3 shows that although a small majority said they expected no other effects, roughly one-fifth did anticipate other effects. Among the effects mentioned were that the annual verification of compliance would no longer have to take place (for the purposes of monitoring), that there would no longer be a benchmark and that other parties might perhaps focus more on compliance with the code.

Table 8.3 Question: Besides these channels, do you expect any other positive or negative effects, including additional costs or savings, for your company as a result of this hypothetical change?

	Number	Percentage
Yes	6	19%
No	18	58%
Don't know	6	19%
No reply	1	3%
Total	*31*	*100%*

Question : Questions 1 and 2 concerned the possible implications of abolishing the current monitoring committe for the reporting in annual reports and for the application of best practice provisions of the corporate governance code. Besides these channels, do you expect any other positive or negative effects, including additional costs or savings, for your company as a result of this hypothetical change? (n=31)

Source: SEO Economic Research

With this hypothetical alternative, respondents might have given socially desirable answers. For an estimate and interpretation of this effect, see Chapter 5 (section 5.2.2). The fact that different answers were given on the other hypothetical alternatives (see below) suggests that the influence of possible social desirable answers is not so great as to prevent any conclusions from being drawn.

Hypothetical situation 2: obligation to publish a statement

The respondents were presented with the following situation: "*Suppose that not only is the current monitoring committee abolished, but also the statutory obligation to include a statement in the annual report. Research into compliance with principles and the best practice provisions of the corporate governance code will no longer be carried out and, hence, no longer published either. Furthermore, Dutch listed companies will no longer be obliged to state in their annual reports whether they apply the principles and best practice provisions of the code, and if not, why not. In this hypotheitical situation, the corporate governance code itself will remain in place, for example on the initiative of market parties.*"

This hypothetical situation was presented in order to estimate the effect of the statutory obligation. The continued existence of the code was assumed precisely in order to isolate that effect. It should be noted, however, that because of the EU directives there will always be *an* obligation to report (see Chapters 2 and 4), but it would not necessarily be linked to the code. In that sense, this hypothetical change shows 'maximum effects'.

Table 8.4 and Table 8.5 show a different picture from that in the first hypothetical situation: the modal respondent believed that reporting would change and only a small majority were already able to say that the application of provisions in the code would not change.

Table 8.4 Question: Would this hypothetical change cause your company to change its reporting in the annual report?

	Number	Percentage
Yes	12	39%
No	11	35%
Don't know	8	26%
No reply	0	0%
Total	*31*	*100%*

Source: SEO Economic Research. n=31.

Table 8.5 Question: Would this hypothetical change cause your company to change its application of the best practices in the governance code?

	Number	Percentage
Yes	4	13%
No	18	58%
Don't know	9	29%
No reply	0	0%
Total	*31*	*100%*

Source: SEO Economic Research. n=31.

It is clear from the replies to the open questions that the major change would be *shorter* reports. Respondents also stated that reporting changes (on the website) is more useful than providing the same information every year. Various reasons were given for shorter reports, including saving costs and time, but also because the reporting would then more closely reflect the company's wishes ('customisation'). Several respondents mentioned that the company did not see transparency about every aspect as a benefit. Asked about the effect on the costs of reporting in the annual report (or a change in the method of reporting), most respondents said they expected a modest decline; a few said there would not be any difference and a few said the decline would be more substantial.

Regarding the application of best practice provisions, a majority said they still did not anticipate any change (Table 8.5). The reasons are the same as those given earlier: the importance of sound governance for the company itself, and the interests of shareholders/stakeholders.

As with the first hypothetical situation, more than half of the respondents said they did not expect any other effects (not shown). The same applies for the relationship between the management board and the supervisory board, shareholders and other stakeholders (not shown). It was stated, for example, that that relationship might be fostered by the code, but did not depend on it; also, that the attitude of shareholders might perhaps change without statutory embedding, or that the provision of information would improve.

The results for this hypothetical situation might also have been coloured by socially desirable replies. The fact that effects were mentioned in relation to the reporting means that if socially desirable replies were given, their effect would not be so great as to prevent any conclusions from being drawn.

Hypothetical situation 3: the code itself

The respondents were presented with the following situation: "*Suppose that not only is the current monitoring committee abolished and the obligation to include a statement in the annual report lapses, but the Dutch corporate governance code in its current form is abandoned. The code with principles and best practice provisions is no longer kept alive by the government or private parties, thus there are no longer any formal principles or best practice provisions to be reported on or that would be normative and, hence, no information about them will be published by a committee any longer.*"

This situation goes a step further than the previous one and is subject to the same proviso about EU directives on reporting on corporate governance in the annual report, an obligation that is not in fact necessarily bound to a code. The situation was presented in order to gain an impression of the effect of the code.

Table 8.6 shows a dramatic change in the replies compared with the replies to the same question in the two previous hypothetical situations: two-thirds of the respondents said they would change their reporting in the annual report, compared with less than 5% and roughly 40%, respectively, in the two earlier situations. Only 10% said they would not change their reporting.

Table 8.6 Question: Would this hypothetical change cause your company to change its reporting in the annual report?

	Number	Percentage
Yes	19	66%
No	3	10%
Don't know	5	17%
No reply	2	7%
Total	*29*	*100%*

Source: SEO Economic Research. n=29.

On the question of what would change in the reporting, the most common answer was that the report on corporate governance would be shorter. Some respondents also said that the reporting on corporate governance would be tailored to the spirit of the code, without reference to a specific code. Some respondents said they would not report any longer. Time and costs were a factor in the decision to produce shorter reports, although the majority did say that cost savings would be modest.

Table 8.7 and Table 8.8 show that policy changes and other effects are anticipated more frequently than with the first two hypothetical changes: now by around a quarter, while roughly half of the respondents said there would be no changes.

Table 8.7 Question: Would this hypothetical change cause your company to change its policy as currently embodied in the principles and best practice provisions?

	Number	Percentage
Yes	7	25%
No	14	50%
Don't know	6	21%
No reply	1	4%
Total	*28*	*100%*

Question: In this hypothetical situation the corporate governance code no longer exists and it is no longer formally possible to refer to the principles and best practice provisions of that code. With the current principles and best practice provisions of the code in mind, would this hypothetical change cause your company to change its policy as currently embodied in the the principles and best practice provisions? (n=27)

Source: SEO Economic Research

Table 8.8 Question: Besides these channels, do you anticipate other positive or negative effects, including additional costs or savings, for your company as a result of this hypothetical change?

	Number	Percentage
Yes	7	26%
No	13	48%
Don't know	6	22%
No reply	1	4%
Total	*27*	*100%*

Question: Questions 1 and 2 concerned the possible implications of the disappearance of the Dutch corporate governance code for the reporting in the annual report and for the application of the current best practice provisions. Besides these channels, do you anticipate any other positive or negative effects, including additional costs, or savings, for your company as a result of this hypothetical change? (n=27)

Source: SEO Economic Research.

The half of the respondents who see no reason to alter their governance policy most frequently gave as the reason that the policy suited the company.

The percentages for possible consequences for the relationship between the management board and the supervisory board, shareholders and other stakeholders correspond with those in the previous two tables. More discussion is mentioned as a possible consequence, and that is not meant in a positive sense.

Socially desirable responses could also be a factor with this alternative. Once again, it is assumed that because of the effects that are outlined, particularly for reporting, but also for policy, the influence of any socially desirable replies is not so great as to prevent any conclusions from being drawn.

Hypothetical situation 4: 'naming'

The respondent were presented with the following situation: "*Suppose that on the basis of the current situation, in other words with a corporate governance code, legal embedding and a monitoring committee, from now on, for every company,in other words for all Dutch listed companies, including yours, information will be published annually for each best practice on:*
• *whether this best practice is applied, according to the annual report; or that*
• *it is not applied, but that there is an explanation of why not; or that*
• *it is not applied without further explanation.*"

This situation could be classified as 'naming'. From the replies to all the questions, a majority of the respondents anticipated no change in response to this (see Table 8.9, Table 8.10, Table 8.11 and Table 8.12).

Table 8.9 Question: Would this hypothetical change cause your company to change its reporting in the annual report?

	Number	Percentage
Yes	4	15%
No	21	78%
Don't know	1	4%
No reply	1	4%
Total	*27*	*100%*

Source: SEO Economic Research. n=27.

Table 8.10 Question: Wouldthis hypothetical change cause your company to change its application of the best practices of the governance code?

	Number	Percentage
Yes	0	0%
No	24	89%
Don't know	2	7%
No reply	1	4%
Total	*27*	*100%*

Source: SEO Economic Research. n=27.

Table 8.11 Question: Besides these channels, do you expect any other positive or negative effects, including additional costs, or savings, for your company as a result of this hypothetical change?

	Number	Percentage
Yes	3	11%
No	17	63%
Don't know	6	22%
No reply	1	4%
Total	*27*	*100%*

Question: Questions 1 and 2 concerned the possible implications of the publication of information abut compliance at the level of individual companies for the reporting in the annual report and for the application of the best practice provisions of the corporate governance code. Besides these channels, do you expect other positive or negative effects, including additional costs, or savings, for your company as a result of this hypothetical change? (N=27)

Source: SEO Economic Research

Table 8.12 Question: In your view, would the hypothetical change have consequences for the relationship between the management board, the supervisory board and shareholders and other stakeholders?

	Number	Percentage
Yes	1	4%
No	19	70%
Don't know	6	22%
No reply	1	4%
Total	*27*	*100%*

Source: SEO Economic Research. N=27.

For the reporting, a reason given for no change was that the data on which the monitoring is based are publicly available and that publication in the annual report does not depend on 'extra' publication. However, the respondents that did expect a change said that it would be related to additional checks and publication of more detailed information by the company itself (which would increase costs and take more time).

We feel the influence of possible socially desirable replies is greatest with this alternative, although it is not possible to estimate how much it might have coloured the replies.

Efficiency and effectiveness of the current system

This part of the survey concerns the influence of the Dutch system on transparency and corporate governance, and the efficiency of its design. We discuss the code, the legal embedding and the monitoring.

The code

Table 8.13 shows that three-quarters of the respondents said that the code is effective and efficient.

Table 8.13 Question: Do you feel that the code is effective and efficient in promoting transparency and sound corporate governance?

	Number	Percentage
Yes	20	74%
No	3	11%
Don't know	4	15%
No reply	0	0%
Total	*27*	*100%*

Question: The current corporate governance code contains 22 principles and 129 best practice provisions. 1. Do you feel that the code is effective and efficient in promoting transparency and sound corporate governance? (n=27)

Source: SEO Economic Research

The legal embedding

Table 8.14 shows that most respondents said that the legal embedding promotes transparency and sound corporate governance, and saw no alternative that would be more efficient or effective.

Table 8.14

	Question 1		**Question 2**	
	Number	Percentage	Number	Percentage
Yes	22	81%	2	7%
No	4	15%	15	56%
Don't know	1	4%	10	37%
No reply	0	0%	0	0%
Total	*27*	*100%*	*27*	*100%*

Question 1: Do you feel that this obligation to report promotes transparency and sound corporate governance? Question 2: In your view, would another form of legal embedding or statement in the annual report be more efficient or effective in promoting transparency and sound corporate governance? (n=27)

Source: SEO Economic Research

Monitoring

Table 8.15 shows that almost half of the respondents regarded the current method of publication by the monitoring committee as effective and efficient and that roughly a quarter did not.

Table 8.15

	Question 1		Question 2	
	Number	Percentage	Number	Percentage
Yes	13	48%	13	48%
No	7	26%	7	26%
Don't know	7	26%	7	26%
No reply	0	0%	0	0%
Total	*27*	*100%*	*27*	*100%*

Question 1: Do you feel that the current method of publication about the best practice provisions is effective in promoting transparency and sound corporate governance? Question 2: Do you feel that the current method of publication about the best practice provisions is designed efficiently? Although the numbers and percentages are the same for the two questions, not all respondents gave the same answers to both questions. (n=27)

Source: SEO Economic Research

The quarter of the respondents that said they did not feel the current method of publication was effective gave various reasons: the reporting is too technical, there is too much emphasis on details, too much box-checking, too little added value, interpretation changes from year to year and absence of naming & shaming. The quarter of the respondents that said they did not feel the current method of publication was efficient mentioned a more concise publication as a possible improvement, but a few also said that the reports could contain more explanation.

It is suspected that there was some element of socially desirable replies in the answers to the questions on the effectiveness and efficiency of the code and its legal embedding. The percentage of respondents that said the code or legal embedding could be more effective or efficient was small, between 7% and 15%. With hypothetical alternative 2 (the repeal of the legal embedding), 39% said they would change the reporting. Although not impossible, and totally impossible to prove, it is still difficult to imagine that a large majority of the respondents could see no room for improvement, although they would change their reporting if they were given the scope to do so.

Conclusion

The closing, open, question read: "*All things considered, do you have anay suggestions for a more cost-efficient or more effective method of promoting transparency and sound corporate governance in the Netherlands, other than the current structure with a corporate governance code, legal embedding and a monitoring committee?*"

Roughly the same number of respondents replied 'no' as 'yes' to this. The suggestions varied: there could be a simple checklist; there should be no question of box-checking; naming & shaming could be introduced; the monitoring committee duplicates other parties (VEB, Eumedion, accountants); the monitoring committee could report less frequently; the code could be more general; duplication with legislation or other codes could be prevented by revising it; and more attention could be devoted to reporting by supervisory boards and to information regarding possible risks/scenarios.

The most frequent answer to the final question about the survey was that estimates of costs and savings are difficult to make.

Appendix B Interviewees

Interviewee	Works with
Francois Carstens	MESA and attached to the Nederlandse Vereniging van Commissarissen and Directeuren (NCD)
Harm-Jan the Kluiver	Dutch Association of Listed Companies (VEUO)
Professor Phillip Wallage	KPMG
Mr. drs. Niels Lemmers	Dutch Association of Shareholders (VEB)
David Tomic	Dutch Association of Shareholders (VEB)
Rients Abma	Eumedion
Wouter Kuijpers	Eumedion
Cees Vermaas	NYSE Euronext
Duco Wildeboer	NYSE Euronext
Erik Breen	Robeco
Carola van Lampoen	Robeco
Gerben Everts	AFM
Peter Veenis	AFM

seo economic research

Roetersstraat 29 . 1018 WB Amsterdam . T (+31) 20 525 16 30 . F (+31) 20 525 16 86 . www.seo.nl