

Collected Abstracts: Research Forum Sessions

GOV

**Governance
(and accounting)**

Code: **GOV R01**
Abstract ID: **0074**

Day: **Thursday**
Time: **16.00-17.30**
Room: **Q118**

Family business, agency costs and cost of equity: an empirical analysis on Italian listed companies

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Agency costs, deriving from the separation between ownership and control, affect whatever company model. In case of firms with dispersed ownership (the public companies), the classic agency conflict regards the relation between shareholders and managers. In case of family firms the classic agency conflicts are mitigated thanks to reduced separation between ownership and control, but there are other types of agency conflicts, moreover between family shareholders and minority ones. This paper focuses on the relation between agency costs and ownership structure, in the specific perspective of minority shareholders, providing a first empirical evidence of the proposition that family ownership reduces the agency costs of equity and has a negative effect on the equity risk perceived by the market. The analysis empirically compares family and non-family firms, sorted from Italian listed companies, in any sector with a significant presence of family business, in order to get evidence of family's ownership impact on equity cost of capital. The methodology of the analysis has the following steps:

- 1) classification of the companies by ownership structure and by sector and calculation of the relevant variables;
- 2) calculation of the mean values of each variable by sector and by ownership structure groups;

regression model processing in order to test the correlation between equity risk and familiarity, controlling for operating risk, financial risk and marketability one.

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Room: **Q118**

Corporate governance and discretionary accounting accruals

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The purpose of our study is to investigate the whether board size and insider ownership can act as constraints on earnings management, or whether, on the contrary, there exist a positive influence of insider ownership on discretionary accruals. We find that the informativeness of earnings does not always increase with managerial ownership, supporting a non-linear association. The decrease in the need for outside monitoring due to the alignment of interests between insiders and outside shareholders proves to be effective when the insiders stake is not above 50%, supporting the convergence of interest hypothesis. On the other hand, when this ownership stake is above 50%, our results show that insiders are less involved in the informativeness of earnings, supporting the entrenchment hypothesis. Our research contributes to the debate regarding managerial ownership by demonstrating that on average earnings are more likely to be manipulated when insider ownership is high. The positive relationship between high managerial ownership and accounting discretion can be justified by the lower information asymmetry and the management entrenchment and the resulting lack of market discipline. The existence of substantial inside block holders leads to lower monitoring or scrutiny of managers and this implies higher opportunity for accruals management. The size of the board doesn't seem inhibit managers from using discretionary accruals to achieve self-serving objectives.

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Earnings management when the CEO changes – results of a questionnaire

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I sent a questionnaire to 720 persons (whereof 315 answered, 43.8 %) to answer the following questions: (1) Do you think that the retiring (new) CEOs increase (decrease) earnings and – in your opinion - which balance sheet items are concerned? (2) Should the law prohibit that the CEO switches to the Supervisory Board? (3) In your opinion, which objectives are relevant for the change of the CEO to the Supervisory Board?

I asked following groups: CEOs and chairmen of the Supervisory Board of listed companies in Germany, associates of small business enterprises, journalists in the field of business, representatives of audit firms, representatives of associations protecting private investors, professors, and representatives of trade unions. Among other things I find: Representatives of companies do not support to prohibit the change of CEOs to the Supervisory Board. In contrast, other groups support prohibition. Support (no support) to prohibit the change of CEOs to the Supervisory Board is related to support (no support) that the retiring CEOs increase (decrease) earnings significantly. No support to prohibit the change of CEOs to the Supervisory Board is related to no support that the new CEOs decrease earnings significantly. Surprisingly, all groups deny that CEOs use research and development expenditures to manage earnings – contrary to existing empirical results.¹

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An examination of the relationship between performance and volunteerism in Northern Ireland credit unions

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This paper investigates the relationship between volunteer input and credit union performance. A survey instrument is used to gather data on the number of volunteers that are involved in the operational and governing duties of credit unions in Northern Ireland and the level of time contributed weekly. A multivariate statistical framework is utilised to examine the data. The results indicate that a strong correlation between volunteer input and credit union performance exists with respect to hours contributed to operational activities. This is expected due to the displacement of cost by volunteer input. However, what is of interest is the positive relationship that is reported between input to governing duties and efficiency. The analysis also considers the characteristics and qualifications of board members. Credit unions are normally located in more deprived locations (Ward and McKillop, 2005). It is suggested that location may restrict the pool of relevant qualified persons who are suitable to join the board, affecting performance (Clutton-brock, 1996). As volunteer input is found to have a positive impact on performance, secondary regressions are used to determine whether key credit union characteristics, such as age, common bond type, affiliation to a particular trade association and deprivation of location have an influence on levels of assistance received.

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Insider Ownership, Blockholders and Performance of Swiss Companies

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The problematic arising from the different roles that managers (agents) and owners (principals) play in the corporations is the base of the Agency Theory. Traditionally, Corporate Governance literature prescribes, in order to mitigate the agency problem, the increase of executive equity holdings and the incorporation of large blockholders to increase the monitoring as the solution recipe. This paper considers how the structure of shareholdings can influence company performance in publicly listed companies. In Switzerland, shareholder configuration differs greatly from the traditionally disperse ownership of Anglo-Saxon countries. Similar to the German model, founding families, banks and private equity investors are often present in the shareholding configuration of many companies. Typically, they almost control 40% of the capital and over 40% of the voting rights. Contrary, insider ownership shows more disperse figures and less clear results. We study the relationship between large blockholders, insider ownership and firm performance in a sample of a 116 publicly listed companies in the Swiss Stock Exchange (SWX). We compare their performance with European Industry Indices obtaining better performance in those companies with large shareholders and inconclusive results for insider ownership, leaving room for further research.

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Benchmarking Greek Corporate Governance Structures and Disclosures

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This study develops a comprehensive governance index for Greek listed companies by benchmarking governance quality against three levels: a) compliance with the minimum governance requirements of the Greek regulation (i.e. lower level), b) compliance with the incremental recommendations of the Greek voluntary corporate governance code (i.e. middle level) and c) compliance with additional international best practices, prescribed mainly by the UK Combined Code (i.e. higher level). Using a sample of 175 Greek listed companies in 2003 and based on information collected from annual reports we find that corporate governance quality deteriorates as we move from the lower/compulsory level of compliance to the middle and higher voluntary levels, necessitating the “comply or explain” approach. The overall average corporate governance rating is 46%, lower than that reported by prior research based on questionnaire-constructed indices. This result suggests that companies have a tendency to overstate their own governance quality. Moreover, the level of governance compliance increases with firm size. Finally, we document a relatively high degree of non-disclosure relating to governance compliance. This in turn is a sign of “bad governance”.

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Cooperation between Management Board and Supervisory Board - Empirical Evidence from a German Study

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The German Corporate Governance Code (DCGK) presents essential statutory regulations for the management and supervision of listed companies. German stock corporations have a dual-board system as opposed to a one-board system with a Board of Directors. The DCGK specifies the role of the Supervisory Board that “appoints, supervises and advises the members of the Management Board and is directly involved in decisions of fundamental importance to the enterprise.” The Supervisory Board not only has a supervising function but also an advising one. The latter function especially requires certain abilities and motivation. Yet, little empirical evidence is provided on how senior managers view the supervising and advising functions of the Supervisory Board. This paper examines the competence and motivation of German Board Members from the Chief Executive Officer’s (CEO) point of view. CEOs are asked because they play an extremely important role in the German Corporate Governance System. On the one hand the CEO cooperates intensively with the members of the Board of Supervisors, especially with the Head of Supervisory Board. On the other hand he is monitored and advised by the Board Members. Therefore, the CEO has a deep insight into the competences and motivation of Board members. We formulate hypotheses on the basis of the relevant economic literature. We tested the hypotheses in an empirical study asking 291 CEO of big and medium-sized German companies. 86 CEO answered. Our empirical results show for example that in general CEOs are satisfied with the contribution of Supervisory Boards. Yet, there are deficits, especially concerning the advisory function.

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Governance reform and the changes in legislation on corporate control in China

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Since China entered the World Trade Organisation in November 2001, worldwide attention has been paid to the current Chinese legal system, political policies, and development of economic reform. Corporate governance reform is now the centre of enterprise reform. This paper evaluates the development of corporate governance reform in China and identifies changes in legislation on corporate control. This paper provides evidence to show that China has been making significant progress in developing corporate governance reform. It concludes that China has established a fundamental legal framework for corporate governance. The changes in regulations on corporate control indicate that the development of a more sophisticated corporate governance system is under way. The paper argues that in Chinese context as far as the rights of selecting management remain in state’s hand, the independent board of directors will have less power to achieve the goals in corporate control. This paper also argues that it is very dangerous for individual investors to invest in the Chinese market and they have to bear higher risks. This paper suggests that increasing the Sophistication of the corporate governance system of both internal and external control is the key for the Chinese market This paper also suggests that in the long-term, building up a cultural background for applying corporate governance system is very important in Chinese society.

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Corporate Governance Frameworks: Parameters for International Harmonization

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Published corporate governance frameworks are becoming increasingly important as governments, regulators, exchanges and others respond to the widespread and devastating failures that plague the global investment environment. This paper begins with several brief analytical vignettes on failures in corporate governance, extending into an analysis of a wide range of authoritative corporate governance frameworks of Europe, Australasia and the Americas. The analysis identifies and classifies common elements, and more particularly highlights significant deviations. These differences are explained in terms of historical, cultural, and institutional factors, and further labelled as items that are justifiable at the national level or items where deficiencies should be rectified. The paper concludes with specific recommendations for parameters for the international harmonization of corporate governance frameworks.

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Corporate governance vis a vis Corporate performance: Some evidence from Italian Companies

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The relationship between corporate governance and firm performance is a topic which has evinced interest of researchers from different areas of the world, each one trying to explain it, by using different theoretical perspectives; agency theory, stewardship theory, stakeholder theory and the like. It is particularly interesting to notice that a strong majority of these studies were conducted considering an Anglo-Saxon corporate governance system with samples of British or US firms.

Only very recently researchers have focussed their attention specifically on different business and corporate governance contexts like the Asian or the Continental European one.

Using a sample of companies listed on the Italian Stock Exchange we have tried to verify the presence and intensity (extent) of the relationship between corporate governance (both board structure and ownership variables have been considered) and corporate performance (by using both accounting and non accounting performance measures). The choice of Italian businesses depends on the peculiarities of its corporate governance system (ownership concentration, family control and pyramidal groups) as highlighted in previous studies (Bianco-Casavola, 1999).

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Determinants of Executive Remuneration: Australian Evidence

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Corporate governance and the role of executive pay have increased in importance in the business arena in recent years. Prior research, most of which relies on agency theory to establish the determinants of executive remuneration packages, has produced weak or mixed results. In addition, most prior studies examine only cash compensation, thus potentially biasing any results. Australian research has been limited due to the lack of available data, but new reporting guidelines means it is now timely to reassess our understanding of both the components of executive pay, and factors which influence this important corporate governance mechanism. This study uses both agency theory and the theory of managerial power to develop a comprehensive model of influences on executive pay. It examines both cash and incentive components of CEO compensation disclosed by a sample of top 500 Australian companies from 2003 to 2005. The model incorporates economic constructs (financial and share performance, growth opportunities, firm risk) hypothesised to reducing agency costs; in addition to variables argued to reflect managerial power or influence over the compensation setting process (including measures of ownership structure, board monitoring effectiveness and managerial human capital). Results indicate a mix of both agency and managerial power constructs influence the compensation setting process, with those affecting cash compensation differing from those influencing incentive components.

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A Comparison of the Compensation Structures of Australian CEOs and other Senior Managers

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The relative compensation of CEOs and non-CEO executives has only received scant attention in finance and accounting literature to date. The emphasis of prior research examining the structure and determinants of compensation has been on the CEO. Analysis has generally been limited to the US (e.g. Ryan and Wiggins, 2000). Finkelstein (1992) notes however, that it is a 'dominant coalition' of senior managers within a firm that is responsible for setting the policy and strategic direction of the organisation, not merely the CEO. In fact while the CEO is generally considered the most powerful member of the group, this is not always the case - managers with large shareholdings may be more influential than the CEO (Finkelstein, 1992). This study analyses the difference in compensation structures of the top five executives within a sample of top 500 Australian companies over 2003 to 2005. Variations in structures and levels of compensation, together with determinants of compensation are examined. Results indicate that the compensation structure of CEOs aligns with those of lower tier managers. While the level of pay for CEOs is significantly greater than other managers in the firm, the level of compensation of other successive levels of managers shows no significant variation. Factors found to influence CEO compensation are also found to explain pay of lower level managers within Australian firms.

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CEO Compensation Structure and Firm Performance

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The relation between CEO compensation structure and firm performance has been documented in the literature. However, these studies concentrate on a data set where equity-based compensation is routinely used. This study provides the first detailed evidence on firm performance and CEO compensation structure in a market where equity-based compensation is not always offered to the CEO. There are two objectives of this study. First, the study provides evidence on the relation between firm performance and CEO compensation structure [cash versus equity], a question that has not been addressed in the literature to date. While some theorists state that firm performance could improve where CEO compensation contains equity-based components, others argue that compensation contracts should be set dependent on the underlying economic characteristics of the firm, and that if this is done, there should be no cross-sectional differences in firm performance. The second objective of this study is to build a model that describes an 'efficient' compensation structure, and to test the performance consequences of deviations from this contract. The prediction is that performance would be lower in firms using sub-efficient CEO compensation structures. This study is the first to build a model that recognises that it may be efficient not to use equity-based compensation in CEO contracts. Overall, this study provides important evidence on the use of equity-based compensation in CEO compensation contract.

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Corporate leverage and CEO cash compensation

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This study finds that firms increase the sensitivity of CEO cash pay to earnings as their leverage rises. It is argued that this result obtains because firms want to provide CEOs with incentives to avoid costly debt covenant violation. Existing research suggests that the likelihood of debt covenant violation increases with the firm's leverage. Furthermore, debt covenant violation has been found to result in economically significant increases in the interest rate charged on the firm's debt. Such rises in interest rates result in lower after-interest earnings, and cause CEO cash pay to fall, especially when the pay-performance sensitivity of CEO cash pay to earnings is high. CEO wealth thus is relatively more exposed to the negative impact of debt covenant violation on interest rates as the pay-performance sensitivity of CEO cash pay to earnings rises. Consequently, CEOs have stronger incentives to engage in activities that prevent the debt covenant violation, and hence the ensuing increase in interest rates, from occurring when firms increase the weight on earnings in CEO cash pay.

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Equity Compensation Deferrals by Corporate Outside Directors

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Despite the central importance to governance researchers, there is no empirical and theoretical consensus on what determines the compensation paid to corporate outside directors. To date, the few empirical studies on these issues have relied on actual remuneration to draw inferences on the incentive structure of director pay. In this paper, we use an alternative approach to investigate aspects of board compensation contracting on which previous research is silent. We shift the focus from actual to perspective compensation and address under which circumstances corporate directors might be willing to alter the risk profile of their compensation packages. We identify a particularly interesting and unexplored setting to address this question (director deferred compensation plans), and investigate a set of contractual and economic factors that might affect the decision for corporate directors to take such actions.

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Spiritual scriptures impact on six ethical models

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Moral issues greet the business community constantly, confronting us with problems on handling accounting rules that can determine a company's future. We are bombarded with news regarding fraudulent activities in companies that mishandled accounting rules leading to undermining the confidence of customers, employees, suppliers, shareholders and the community. Dealing with ethical issues is often perplexing and without the benefits of a decision making model underlined by ethical positions we may be apt to repeat our old ways. Further, value and belief systems are often times absent and not connected to a decision making model in a useful manner. We argue for a modification of decision-making models that has been accepted in companies with stronger links with ethics and morality. With this aim we propose a return to the base values of Buddhism, Christianity, Hinduism, Judaism, and Islam by scriptures, underlying six dominant ethical approaches that drive practices in organizations.

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The Association between Audit Fee Pricing and the Extent of Voluntary Disclosures: Evidence from Malaysia

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This paper uses 445 observations from Malaysian listed companies for the year 2001 to test the relationship between the extent of voluntary corporate disclosures and audit pricing. This study uses 2-stage least squares regression analysis to control for various factors that are considered likely to affect the extent of voluntary corporate disclosures. Results indicate that the extent of voluntary corporate disclosure is positive and significantly associated with audit fee pricing. This result suggests that in this emerging economy, greater voluntary disclosure by a firm result in more audit effort that in turn results in a higher audit fee being charged.

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Banks' reports on value management

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Information disclosure is the key aspect of corporate governance, allowing for the company's appraisal and the performance conditions and conscious decision making. The scope and quality of information presented by a company therefore indicates the firm's accountability to the stakeholders. The issue of company value creation is now a predominant topic in the theory and practice of management. Creating value is not just an internal process - a company has to inform and convince the stakeholders about the value created and its potential. The report should allow for the assessment of the company's goals achievement and the future perspectives, allow for the analysis of value drivers, value creation strategy, and the main risks and their management. The paper concentrates on banks; it discusses bank's goals and presents value drivers and value management processes: performance management, risk management and resources (capital, assets and intellectual assets) management. As the paper emphasizes the necessity of value creation processes presentation, it proposes the optimal content of bank informative annual report. The paper presents the outcomes of the study of annual reports of Polish public banks. The evaluation concerned the usefulness of the reports in the analysis of value drivers and value potential of the banks was performed. Six categories of information were evaluated: Strategy, Corporate Governance, Financial Performance, Risk and risk management, Resources, Shares.

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The Internal Audit Function in the IBEX-35 Spanish Companies from a Corporate Governance Perspective

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The recent corporate failures such as Enron and WorldCom, etc were highly catastrophic and had a terrible effect on immediate stakeholders. The pressures of globalisation, intense competition, increased social awareness and increased shareholder have lead to organisations encouraging good Corporate Governance. Corporate Governance is now seen as extending to the overall management of the organisation - the way in which it conducts its business. As a consequence of that expressed previously, a reaction took place on the part of the government of different countries that drove the emission of different rules or recommendations for the Board of Directors and its committees. This paper focuses on one of this committee: The Audit Committee and its relationship with Internal Audit. Corporate Governance reports in countries, such as the United Kingdom and the United States have recommended an Internal Audit Function in companies and institutions as a mechanism for good internal control. The objective of this paper is to know the Internal Audit function in the IBEX-35 Spanish companies from Corporate Governance perspectives. The main conclusion is that Spanish companies that quoted on the IBEX-35 follow the recommendations drove by Anglo-Saxon reports

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Cross Listing, Bonding and Corporate Governance

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This paper examines the relationship between cross listing and corporate governance for Canadian firms cross-listed on U.S. stock exchanges during the period 1997-2003. We provide evidence for corporate governance improvements during the listing for firms listed in NASDAQ and AMEX. These governance improvements affect positively firms' valuation. However, similar improvements are observed for matched non cross-listed firms, which leaves the question whether governance improvements is the effect of a cross listing in U.S. open. We further examine the association of corporate governance and the decision to cross list. We find no relation between the decision to cross list in NASDAQ and AMEX and corporate governance. But we find that the probability for a decision to cross list in NYSE increases with the independence of board and audit committee. Given the stricter listing and governance requirements of NYSE relative to NASDAQ and AMEX we suggest that these requirements serve as a screening mechanism, attracting firms with better governance quality. Moreover, we examine the association of corporate governance and the existence of a cross listing. We provide evidence that the existence of a cross listing relates to less insider owners for firms listed in NASDAQ and AMEX and more outside blockholders for firms listed in NYSE.

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**Do Directors' Trades Convey Information
About Industry Trends?**

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In this study we examine whether directors' trades provide information to other investors in firms in the same industry. Specifically, we address the question that if directors trade on industry-specific information, whether information transfer occurs such that investors in the other firms can profit by mimicking these trades. Directors and executives are most informed about the risks and opportunities facing their firm and also about its operations. However due to insider trading regulations that disallow trading on non-public information, Ayres and Bankman (2001), Tookes (2004) and Huang (2004) provide theoretical and empirical evidence of substitute trading in competitor firms. Our sample consisted of Australian firms with director share trading between 1996 and 2003. We provide evidence of positive information transfer relating to directors' trades where the reaction in the competitor firms was stronger when the trades occurred in larger firms, when directors traded in groups and when executive directors traded (information hierarchy hypothesis). The reaction was also stronger when there firms were interlocked.

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**Did Sarbanes Oxley Foster a Global Shift in Corporate
Governance? Evidence of change in European Union
Countries**

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With passage of the Sarbanes-Oxley act in July, 2002, a revolution in corporate governance procedures took place. Certainly, given the accounting, internal control, and governance problems in U.S. companies in the early 2000s, change was necessary. But what happened in other countries with developed economies and sophisticated financial markets? Accounting scandals of the same magnitude certainly were not evident. Did the countries of the European Union follow in the US's footsteps to try to prevent their own version of WorldCom and Enron or were similar internal control and corporate governance procedures already in place? What this paper accomplishes is a comparison of the criteria from Sarbanes-Oxley to existing procedures and subsequent changes made in the EU and EU countries