

## THE ROLE OF THE COUNTRY PECULIARITIES OF CORPORATE GOVERNANCE SYSTEMS DEVELOPMENT IN THE ASSESSMENT OF THEIR EFFECTIVENESS

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**Summary**

**G**ood corporate governance is very important for sustainable development, not only for the individual bank, but also for the economy as a whole. The quality of governance should be continuously improved and good governance should be promoted. However, what is not measured cannot be improved. Hence, there is a need for a measure of the corporate governance performance. New specific measure of the corporate governance in Ukrainian and Italian banks will help take into account the features of corporate governance in different countries, including different levels of their development. This is one important field, while the analysis of common principles of corporate governance systems in different parts of Europe is another. Therefore, comparative research has explored the different foundations of corporate governance systems in Italy and Ukraine.

Describing the quality of corporate governance exceptionally in terms of formal (fixed by law) or informal (recommended by various codes and «best practices» requirements to the structure and composition of the board of directors, degree of disclosure, etc.) might be useful to describe the

nature of the process, but not sufficient for picture of the quality of corporate governance process. Therefore, should be changed the method of measure's construction itself, in particular, the measuring should be moved from a mechanical approach based on formal components (as structural and others), to organic, primarily based on the use of qualitative criteria along with the quantitative. Moreover, measures / indicators of corporate governance can be quite limited application in relation to determination of performance (primarily financial: revenue growth and shareholder value), because in many cases significant criteria / indicators of quality are not taken into account. Each bank looks for the performance in order to guarantee the survival. In fact, the manner whose bank measure performance is crucial for their progress because the performance plays important role in the development of strategic plan, the assessment of bank objective and managers' remuneration.

We can distinguish two broad approaches to measure the corporate governance performance, each with strengths and limitations. One approach relies on «broad but shallow» multi-country cross-sectional studies across many countries (for example, Aggarwal, Erel, Stulz and Williamson, 2006; Klapper and Love, 2004; Durnev and Kim, 2005; Doidge, Karolyi and Stulz, 2007). These studies potentially offer greater generalizability. At the same time, what matters in governance may well differ between developed and emerg-

ing markets and most studies either mix the two or examine only developed markets. Moreover, for emerging markets, the available governance measures are limited, purely cross-sectional, cover only the largest firms in each country, and dated (2001 for the Credit Lyonnais Securities Asia survey; 2002 for the Standard and Poor's disclosure survey). In most cases, commercial corporate governance performance measures (such as S&P index) are limited to disclosure, and rely partly on analyst views, which could be affected by bank performance. Control variables, essential to address omitted variable bias, are limited, due to data availability.

The second approach, and the one we pursue, involves narrow-and-deep studies of particular, important countries. These studies sacrifice generalizability in exchange for ability to develop governance measures that are tailored to a particular country's laws, ability to focus on particular types of countries, broader coverage of firms within a country, stronger control variables, and, in some studies, access to panel data or to legal shocks that can provide identification. Generalizability can be addressed by examining results from a number of countries and looking for patterns – or the lack thereof. Published studies exist for Brazil (Carvalho-da-Silva and Leal, 2005; Leal and Carvalho-da-Silva, 2007); Hong Kong (Cheung, Connelly, Limpaphayom and Zhou, 2007); Korea (Black, Jang and Kim, 2006a); and Russia (Black, 2001; Black, Love and Rachinsky, 2006).

The aim of this paper is to underline the differences between two different systems of corporate governance (in Italy and Ukraine), to explain the reasons that may determine the choice of one or another of the measures of corporate governance performance in bank and to construct a composite measure of corporate governance performance that determine the level of corporate governance development.

We suggest that the benefits of corporate governance practices vary based on bank and country characteristics, neither of which is well understood. Governance is not one-size fits all. Our paper shows that governance ratings can mostly be explained by country characteristics because it is costly for firms to adopt governance provisions. We extend previous investigations by using data on actual governance provisions, financial statement rather than governance ratings based on qualitative assessments.

An evaluation is made of various ways in which corporate governance can be operationalized as part of a panel data econometric analysis. Corporate governance is not a concept that can be directly observed. Consequently, it is necessary to identify suitable proxy variables. Many indicators have been developed at international level to evaluate the quality of corporate governance. The paper emphasizes the difficulty of using indexes to reflect the type of governance that characterizes banks operating in continental European countries (as Italy) and Post Soviet Area (as Ukraine). In order to evaluate the quality of governance of banks a specific model is formulated taking into account the main variables useful in understanding the asymmetry existing between minority and majority shareholders.

The structures of corporate governance presented in banks operating in different national, legal and cultural contexts, active at global level, pose some problems concerning

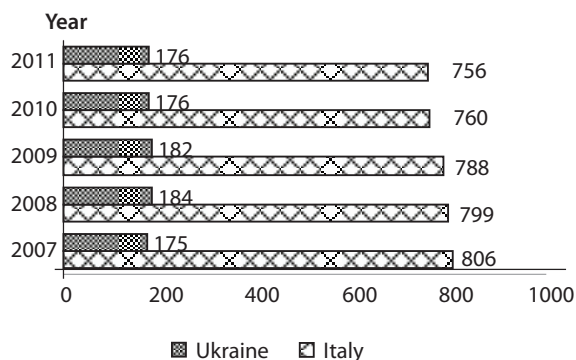
measuring of effectiveness of models of corporate governance. The most effective governance system's measurement depends on context and on banks' specific circumstances and systems' of corporate governance as a whole. It would therefore be difficult for an index, or any one variable, to capture nuances critical for making informed decisions. Thus, we decided to analyze differences of two systems of corporate governance adopted in Italy and Ukraine with intent take into account their peculiarities in measuring of corporate governance in banks. The Italian corporate governance system belongs to the Latin sub-group, although it has its own individual features, and does not fit completely into the international standard models. There we can see resemblance with Ukrainian corporate governance model because it also has its own peculiarities. But, neither system is perfect.

In recent years, comparative corporate governance has focused on the systems of Germany, Japan and the United States. This has given the impression that the only alternative among rival corporate governance systems exists between the system of bank governance in Japan and Germany and the protections provided by the legal system and the market for corporate control in the United States. If nothing else, a study of the Italian and Ukrainian corporate governance system shows that there are alternative systems. The Italian system appears to be a failure in the sense that it provides only extremely modest legal protection for minority shareholders, and does not provide a mechanism for constraining managerial excess, either through institutional investor monitoring, a market for corporate control, or strong legal rules. The Italian model of corporate governance is characterized by a high degree of ownership concentration. In the absence of an institutional framework facilitating more dispersed ownership, as in the Anglo-Saxon countries, or mechanisms for financial supervision, as in some Continental European countries, a limited degree of separation between ownership and control is achieved mainly by using pyramidal groups.

Investigated unique practice of corporate governance in Italy and Ukraine, we remark that both, Italian and Ukrainian model of corporate governance is characterized by a high degree of ownership concentration. In the absence of an institutional framework facilitating more dispersed ownership, as in the Anglo-Saxon countries, or mechanisms for financial supervision, as in some Continental European countries, a limited degree of separation between ownership and control is achieved mainly by using pyramidal groups. Almost all banks are controlled by a small group of majority shareholders, often just one individual private owner. For Italy it's a usual practice when smaller banks are separated between larger banking groups. As for Ukraine there are big financial-industrial groups which directly or indirectly (via Cyprus companies or other ways) are the shareholders in banks. At the end of 2010, there were 760 banks operating in Italy, for Ukraine that number was – 176 (figure 1).

In Italy the number of banking groups is 76 (including 2 largest – UniCredit and Intesa Sanpaolo, which also presented in Ukrainian banking system). One of the main differences between Ukrainian and Italian banking system is a rate of foreign capital in banks equity. For Ukraine this number is 40,6% (at the end of 2010), at the same time in

Italy foreign shareholders held equity interest of more than 5%. Moreover, foreign investors do not play a significant role in management process in Italian system of corporate governance. And we can remark about existing barriers for foreign investors.



**Figure 1. Number of banks operated in Italy and Ukraine during 2007 – 2011**

Investigation the characteristics of different systems of corporate governance we have chosen on the basis of two banks: Mediobanca, a representative of the Italian corporate governance system, and First Ukrainian International Bank (FUIB), as a representative of the Ukrainian system of corporate governance. Mediobanca's core businesses are lending and investment banking, helping its clients, which include leading Italian corporates as well as numerous medium-sized businesses and international groups, to grow by providing them with professional advisory services in addition to traditional medium-term bank credit.

First Ukrainian International Bank which represents Ukrainian corporate governance system based on two-tier Board of directors and consists of Supervisory board and Management board. The Supervisory board model is continental. According to these characteristics corporate governance in Ukraine is similar for corporate governance in Germany, but without delegation of representatives from Labor group to Supervisory Board. These significantly reduce the

level of protection of labor group rights and the level of corporate social responsibility of the bank institution.

### SUMMARY

Therefore, the aim of this paper is to underline the differences between these different systems of corporate governance and to explain the reasons that may determine the choice of the corporate governance performance measure by a bank or other users of this information. Independent estimation of corporate governance practice gain now a bigger importance than ever, especially on developing markets. It's difficult to form an integrated tool to monitor corporate governance in different countries with their own traditions and culture. But still they should be based on integrity, transparency, accountability and responsibility principals. ■

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