

What Drives Corporate Governance Reform? Firm-Level Evidence from Eastern Europe

Leora F. Klapper

Development Research Group
The World Bank
1818 H Street, NW
Washington, DC 20433
(202) 473-8738
lklapper@worldbank.org

Luc Laeven

Financial Sector Department
The World Bank
1818 H Street, NW
Washington, DC 20433
(202) 458-2939
llaeven@worldbank.org

Inessa Love

Development Research Group
The World Bank
1818 H Street, NW
Washington, DC 20433
(202) 458-0590
ilove@worldbank.org

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What Drives Corporate Governance Reform? Firm-Level Evidence from Eastern Europe

Abstract: We study differences in the use of two corporate governance provisions – cumulative voting and proxy by mail voting – in a sample of 224 firms located in four Eastern European countries. We find a significant relationship between ownership structure and the use of corporate governance provisions. Firms with a controlling owner (owning more than 50% of shares) are less likely to adopt either of the two provisions. However, firms that have large, minority shareholders are more likely to adopt these provisions. We do not find any significant relationship between the use of these provisions and foreign ownership. Our results suggest that the decision to adopt these corporate governance provisions is influenced by large, minority shareholders in their battle for representation on the board and in managerial decisions.

JEL: G34 (Corporate Governance), P2 (Transition Economies)

1. Introduction

On the country level, the laws that establish shareholder rights and the degree to which these laws protect investors differ significantly around the world, in part because of differences in legal origins and judicial efficiency (La Porta, Lopez-de-Silanes, Shleifer, and Vishny, 1998). Furthermore, shareholder protection may vary across firms within countries. For example, in some countries, provisions in country-level investor protection laws may not be binding because firms have the flexibility in their corporate charters and bylaws to choose to “opt-out” and decline specific provisions (Easterbrook and Fischel, 1991, and Black and Gilson, 1998). In addition, firms could improve upon the investor protection rights listed in their legal code by voluntarily choosing to increase disclosure, select independent boards, and impose disciplinary mechanisms to prevent management and controlling shareholders from engaging in expropriation of minority shareholders. It is likely, therefore, that firms within the same country will offer varying degrees of protection to their investors.

Recent literature has offered a number of explanations for why firms may find it beneficial to adopt better corporate governance mechanisms. Greater investor protection may increase investors’ willingness to provide financing and therefore improve firms’ access to external finance (La Porta, et al., 1998). Certain firms, such as those with greater sales growth and a lower percentage of fixed assets, may find it easier to expropriate from minority shareholders and therefore may find it optimal to impose ex-ante stricter governance mechanisms to prevent ex-post expropriation (Himmelberg, Hubbard, and Palia, 1999). However, since stricter corporate governance mechanisms

may come at a cost to the controlling shareholder, it is not clear a priori in what cases a firm may decide to adopt better corporate governance standards.

A number of recent papers have studied differences in firm-level corporate governance mechanisms (see Shleifer and Vishny, 1997, and Maher and Andersson, 2000, for comprehensive surveys). A study of U.S. firms uses differences in takeover defense provisions to create a corporate governance index and finds that firms with stronger shareholder rights have better operating performance, higher market valuation, and are more likely to make acquisitions (Gompers, Ishi, and Metrick, 2003). Other studies find that the governance practices of Russian corporations are strongly related to implied value ratios and that governance of Korean firms is strongly related to firm performance (Black, 2000 and Black, Jang and Kim, 2002, respectively). A cross-country study using firm-level corporate governance rankings across 14 emerging markets and find that this corporate governance index is related to firm's performance and valuation (Klapper and Love, 2003). Most of these papers have focused on the relationship between corporate governance, firm performance and corporate valuation. However, they do not analyze what type of firms is more likely to adopt specific corporate governance provisions, which is the focus of this paper.

Our paper uses a unique dataset of firm-level corporate governance provisions in four Eastern European countries – the Czech Republic, Hungary, Poland and the Slovak Republic. We study the determinants of differences in firms' corporate governance mechanisms aimed at the protection of minority shareholders. The protection of minority shareholders is becoming an increasingly important issue in Eastern European countries, since as these countries transition to market economies, firm-level ownership and control

remain very concentrated. As a result, the main agency conflicts arise between controlling shareholders and minority shareholders rather than between shareholders and managers, as is the case in most western countries (Berglof and Pajuste, 2003).

An additional advantage of focusing on firms in transition countries is that the privatization process of these firms may have offered a natural process for choosing an incentive-compatible corporate governance framework. In other words, privatization has enabled and spurred these firms to search for a governance framework that is in the interest of the main shareholders of the firm. Our sample of firms, therefore, provides for a natural experiment to investigate the differences between the types of corporate governance provisions that firms decided to enact.

Most previous studies of corporate governance have constructed various corporate governance indices, which aim to comprehensively measure specific aspects of corporate governance. However, such studies often present a “black-box” index, which aggregates and obscures the understanding of specific governance provisions. For example, Klapper and Love (2003) shows that corporate governance is related to performance and valuation, but they are unable to disentangle the value of specific governance provisions. This makes it more difficult to identify which provisions matter most and develop detailed policy recommendation.

In this paper we take a different approach and focus on two specific corporate governance provisions that are widely believed to be important mechanisms to improve the protection of minority shareholder rights: (1) proxy by mail voting and (2) cumulative voting. “Proxy by mail” provisions allow shareholder to submit their votes by postal or electronic mail. “Cumulative voting” is defined by La Porta, et al. (1998) as: “.. if the

company law or commercial code allows shareholders to cast all their votes for one candidate standing for election to the board of directors...”

These provisions are two of the six provisions included in the anti-director rights index constructed by La Porta, et al. (1998).¹ The reason for focusing on these two provisions is that they are the only two of the six provisions considered by LLSV (1998) that are not mandatory in the Company Law or Commercial Code of any of the four countries that we study at a time of our survey (see Pistor, 2000). Therefore, if we find that a particular company allows for any of these two provisions, we can assume that the choice was driven by firm-level considerations and not because it was prescribed by a country-level law.

Another advantage of our data is that in addition to information on governance provisions, it also contains detailed ownership data, which includes the country of origin of the five largest shareholders (in addition to their ownership stake). This allows us to study whether the corporate governance provisions stipulated by law in the “home country” of large shareholders affect the governance provisions adopted by foreign-owned firms in the “host country”. This addresses a very important policy-relevant question of whether foreigners export better corporate governance standards to their host countries. We are not aware of any other studies of this phenomenon.

We also use ownership information to identify firms with a shareholder that owns 50% or more of the firm’s equity, which we refer to as a “controlling” shareholder. Previous literature suggests reasons that investors may choose to become a controlling

¹ The other four provisions are: whether ordinary shares are required to carry one vote per share; whether firms are required to deposit their shares prior to Shareholder Meetings, therefore preventing the sale of these shares for a number of days; whether minority shareholders have the right to challenge management decisions in court or require management to purchase shares in the case of ownership changes; and whether shareholders have the preemptive right to buy new issues of shares.

shareholder, rather than a smaller “portfolio” investor. One explanation is that a controlling shareholder maximizes shareholder value because a large ownership stake provides managers with incentives to increase cash flow and valuations (e.g. Morck, Shleifer and Vishny, 1988, McConnell and Servaes 1990.) However, another view suggests a “bad country” bias, meaning that investors choose to become controlling investors in countries in weak investor protection in order to maximize their “private” benefits of control. In other words, investors in weak legal environments may become controlling shareholders not only to protect themselves from expropriation, but also because they are better able to expropriate from the firm themselves (Giannetti and Koskinen, 2004). For instance, evidence suggests that multinational firms direct FDI more often to countries with weaker investor protection (Kelley and Woidtke 2004).

We find that the use of the cumulative voting provision is related to the firm’s ownership structure. Specifically, we find that firms with a controlling shareholder are less likely to adopt cumulative voting. One explanation for our finding may be that the controlling shareholder would object to adopting cumulative voting. With cumulative voting, minority shareholders are still able to elect members to the board, even when there is a controlling shareholder. For example, if the board has 10 seats and the controlling shareholder holds 55% of shares, outside (non-controlling) shareholders may be able to elect up to four seats on the board. Without cumulative voting, however, the controlling shareholder is able to elect all board members.

We also find that the presence of other large shareholders (beyond the largest shareholder) leads to more likely adoption of cumulative voting. We suggest that large minority shareholders benefit most from stronger voting rights, since their larger

shareholdings make it more likely that they can elect board representation. For example, in a firm in which no single shareholder has a majority stake, other large shareholders may wish to adopt cumulative voting in order to acquire increased power in electing directors. Even in the case that the largest shareholder holds more than 50% of the vote, other large shareholders may want to introduce cumulative voting in order to increase their presence on the board. By participating in board meetings, minority shareholders may be able to reduce diversion by the main shareholder. This oversight role becomes even more important in the case of a controlling shareholder, who may have greater incentive to divert company value to personal use. We find this effect to be strongest for the second largest block holder.

To summarize, we find that firms with a controlling shareholder are less likely to adopt cumulative voting, while firms with other large block holders are more likely to adopt this provision. We find similar results for the proxy by mail provision, although they are not statistically significant at conventional levels. Our results suggest that the choice of cumulative voting provision can be explained by the incentives of large block holders to influence the control of the company.

We also find that foreign owners do not behave differently from domestic owners with a controlling stake. We do not find any significant effect of foreign ownership on the adoption of these provisions, regardless of whether the foreign owners come from countries with or without these provisions in their “home country” legal codes. This suggests that foreigners are not likely to export better corporate governance standards to their host countries.

The paper proceeds as follows. Section 2 presents our methodology. Section 3 presents the data. Section 4 presents the empirical results. Section 5 concludes.

2. Methodology

Our empirical test is straightforward. Controlling for country-specific effects, we investigate what firm-specific characteristics are associated with two provisions – proxy by mail voting and cumulative voting – being included in the company’s charter or not. Our regression model takes the following form:

$$\text{Provision}_{ij} = C_j + \beta F_{ij} + \varepsilon_{ij} , \quad (1)$$

where Provision is either a dummy variable indicating whether or not the firm allows proxy by mail voting or a dummy variable indicating whether or not the firm has enacted cumulative voting in the company’s charter; i indicates firm i and j indicates country j ; C_j is a country dummy variable; F is a vector of firm-specific variables; and ε is an error term. We focus on two categories of firm-specific variables: the first set contains ownership structure and privatization variables and the second set contains financial variables.

As presented in the following data section, the firms in our sample have very high ownership concentrations (which is consistent with previous evidence in Berglof and Pajuste, 2003). Our empirical analysis tests whether the adoption of governance provisions depends on the ownership structure of the company. Our first variable is a dummy variable for whether or not the largest shareholder has over a 50% ownership stake, which we refer to as the “controlling” shareholder. In the presence of a controlling

owner, the provision of cumulative voting may increase the board representation of minority shareholders, although the largest shareholder can win a majority of the votes on any director seat with or without cumulative voting. Since cumulative voting gives greater oversight to minority shareholders (and may reduce the ability of controlling shareholders to expropriate from the firm), we expect to find that firms with a controlling shareholder will be less likely to adopt cumulative voting provisions.

However, the bargaining power of the largest shareholder will depend on whether there are other large shareholders as opposed to the case where the remainder of the shares are widely held. Clearly, in a firm without a controlling shareholder, the other large shareholders (i.e. excluding the largest owner) would prefer to have cumulative voting, which may give them power to elect some of the directors. Even in the case that the largest shareholder currently owns more than 50%, the ability to participate on the board – even as a minority voice – would create incentive for the other large shareholders to adopt cumulative voting. We therefore expect that firms with several large shareholders would be more likely to adopt cumulative voting.

To test this hypothesis we include either (1) the cumulative ownership stake for first five major shareholders, or (2) the ownership stake of the largest shareholder, the second shareholder, and the cumulative ownership stake of the third through fifth largest shareholders.² Even in the case that other large shareholders hold much smaller stakes relative to the largest shareholder, these smaller shareholders might act in agreement and combine their shares during votes to counterbalance the largest shareholder.

² We aggregate the third through fifth shareholders because of the large number of firms with less than five block holders (i.e. the fourth and fifth shareholders are missing).

We also test whether the identity of the owners (i.e. bank, government, or management) has any effect on the governance provisions, with special attention to the role of foreign shareholders. We create a dummy for whether the controlling shareholder is a foreigner and include it in addition to our dummy indicating a controlling shareholder to test if foreign controlling shareholders behave differently than domestic shareholders. We also create similar dummies for the presence of bank and government ownership.³ We also control for the period in which the firm was privatized, by creating several dummy variables splitting the privatization into 3 general “waves”: wave 1 contains companies privatized in 1989-1991, wave 2 is 1992-1994 and wave 3 includes the rest.

Our second focus is on the set of financial characteristics that could explain variations in the degree to which firms enact certain corporate governance provisions. La Porta, et al. (1998) argue that greater investor protection increases investors’ willingness to provide financing and will therefore enhance firms’ access to external finance. This may suggest that firms that are in need of external finance are more likely to enact governance provisions to improve shareholder rights in order to attract external financing.⁴

To test this premise we use several firm characteristics measuring access to different sources of finance and the need for funds. We use size (measured by size in USD) to control for a potential size effect. We also use the ratio of equity to total assets to see if there is a correlation between financial leverage and the adoption of governance

³ Results with government and bank ownership were insignificant and therefore are not reported in the tables.

⁴ In a recent paper, Klapper and Love (2003) study firm-level determinants of an aggregate corporate governance index and find that firms that are faster growing and are less capital intensive are more likely to adopt stricter governance provisions, as well as firms that issue ADRs. However, they only focus on the aggregate governance index and are not able to differentiate between specific governance provisions as our data permits in this paper.

provision. We have also explored other financial ratios, such as fixed assets to total assets, return on assets, and sales growth, but do not find any of these variables to enter significantly (not shown).

Our final set of tests considers the effect of the home country of the foreign owners. It has been argued that in countries with weak governance standards, foreign owners from countries with higher corporate governance standards are likely to export their higher standards and apply them to firms they take over in the host country (see, for example, Dyck 2000). One reason may be that foreign owners face reputational or legal risks if they do not apply the same governance standards in the host country as they apply in their home country. They would also be more familiar with the implementation of these provisions and have the experience and legal expertise to address issues arising as a result of such provisions. Therefore, we also investigate whether firms in our sample are more likely to allow proxy by mail voting and/or cumulative voting if they are owned by a foreign firm from a country where either proxy voting or cumulative voting is prescribed by the law of the country of origin.⁵

Most of the foreign-owned firms in the four countries we investigate are owned by firms incorporated in either Western European countries, the U.S. or Canada. In Western Europe, the laws typically do not prescribe proxy voting and cumulative voting, whereas they do in Canada and the U.S. Exceptions are France and Norway, where the law prescribes proxy voting by mail and Spain, where the law prescribes cumulative voting (La Porta, et al. 1998).

⁵ Since our data only represents a cross-section of firm-level characteristics, we cannot distinguish between several alternative hypotheses. For example, foreigners could induce changes in governance provisions after they invest in these firms, or, foreigners may be more likely to invest in the firms that already have desirable governance provisions (although firms may voluntarily improve their governance in order to attract foreign investors). This distinction is an important topic for future research.

We run the following regression to test whether or not foreign owners from countries that prescribe proxy voting and cumulative voting by law tend to “export” these stronger corporate governance rules to their host countries:

$$\text{Provision}_{ij} = C_i + \beta F_{ij} + \gamma G_{ij} + \varepsilon_{ij} , \quad (2)$$

where F is a vector of firm-specific variables, including a dummy variable for a controlling owner and G is a set of two “home-rule” variables: first, a dummy equals to one if the law of the home country of any of the foreign owners prescribes proxy voting or cumulative voting (we construct separate variables for proxy voting and cumulative voting) and second, a dummy equals to one if none of the foreign owners come from a country with “home-rules”.

Since our dependent variables are binomial (0,1) variables, we estimate all of the above models with a Probit procedure, allowing for heteroskedastic (White) errors. The numbers reported in the tables are marginal effects. Hence, in the case of dummy variables, the reported coefficients indicate the probability of changing the outcome if the dummy variable changes from 0 to 1.

3. Data

Our unique set of data on corporate governance provisions enacted by firms comes from Aspekt, a private Czech data provider recognized by the Czech public authorities to offer company data to the public. Aspekt consultants collected this information on a company-by-company basis via interviews and company public filings. We follow the same definition of proxy voting and cumulative voting as in La Porta, et

al. (1998) and construct variables identical to the ones used in their study, although we construct these variables at the firm level and they at the country-level. Cumulative voting equals one if the charters allow shareholders to cast all of their votes for one candidate standing for election to the board of directors, and zero otherwise. Proxy by mail equals one if the corporate charters or bylaws allow shareholders to submit their proxy vote to the firm by postal or electronic mail, and zero otherwise.

We supplement our corporate governance data with firm-level financial (balance sheet and income statement) and ownership data from Aspekt, Worldscope and Amadeus.⁶ Our final sample of firms includes 224 publicly traded firms for which data is available. The data are well distributed among the four Eastern European countries in our sample: 74 firms from the Czech Republic, 56 firms from Hungary, 56 firms from Poland, and 38 firms from the Slovak Republic.

Table 1, Panel A, columns 2-3 show that there is large variation within and across countries in the use of both governance provisions. Only 12% of companies have enacted proxy voting in their company's charter, but over 39% of firms have enacted cumulative voting provision. Among the four countries studied, cumulative voting is most prominent in Poland and the Slovak Republic, while proxy voting is found most frequently in Hungary and Poland, while being virtually absent in the Czech Republic and totally absent in the Slovak Republic.

Panel A, columns 4-6 show the distribution of firms over the "waves" of privatization, beginning in 1989. The first wave is defined as firms privatized between

⁶ In the case that firm-level data was missing in the Aspekt database, we first tried to collect additional data from Worldscope, a database that includes financial statements of listed firms around the world. In the case that the firm was not included in WorldScope, we used Amadeus, a database published by Bureau Van Dyke that includes financial statements for all registered listed and private firms in 35 European countries.

1989 and 1991, the second wave between 1992 and 1994 and the third wave anytime after 1995. Column 7 shows the number of years since privatization. We find that the majority of firms in all countries were privatized during the second wave and that on average it has been about 8 years since privatization. One notable difference is that firms in Hungary and Poland were privatized throughout the 1990s, whereas firms in the Czech Republic and Slovakia were privatized primarily during the second wave (74% and 70%, respectively).

Panel B presents the ownership structure of firms in our sample. Columns 1 and 4 show that almost half of our sample have significant foreign ownership (defined as greater than 20% of total shareholding). Foreign ownership is most prominent in Hungary (where about 70% of all listed firms have significant foreign ownership) and is least prevalent in the Slovak republic (where only about 26% of firms have foreign ownership). Column 2 shows that the Czech republic has the highest remaining government ownership (27% of our sample firms have over 20% government ownership stakes), while Hungary and Poland have very few government-controlled firms among listed firms. Banks have large ownership stakes in over 10% of firms in all countries, except Poland, plus smaller stakes in many more firms (column 3).

Next we consider ownership concentration. Consistent with Berglof and Pajuste (2003), we find that ownership in our sample is very highly concentrated. On average, the largest shareholder owns over 50% of shares in all countries except Poland (in which they have about a 40% stake, as shown in column 6), while the five largest shareholders represent over an 80% stake (again in all countries except Poland, as shown in column 5). We also find that in over 50% of the firms the largest shareholder has over a 50% stake

(column 8), which holds in all countries except Poland. However, in quite a few firms there are other large shareholders and their combined shares are nontrivial. For example, the four largest shareholders (excluding the first one) own on average about 30% of the shares with the highest concentration in Hungary (which is about 40%).

Panel C shows summary statistics for the key financial ratios of firms in our sample, by country. Surprisingly, the firms are quite similar in all four countries – the average and standard deviation of leverage ratios, profitability and growth ratios are very much in line. Interestingly, the sample average Tobin's Q is around one, i.e. firm's market value equals to the book value of equity, which suggests relatively inefficient equity markets.

4. Empirical Results

Tables 2 and 3 present our regression results. Our dependent variables are dummies indicating the adoption of firm-level corporate governance provisions: cumulative voting in Table 2 and proxy by mail voting in Table 3. Our explanatory variables are firm characteristics, including country effects to control for differences across countries.

In Table 2 we find that the adoption of cumulative voting is significantly negative related to having a controlling owner. Column 2 includes a dummy for majority foreign ownership and finds it to be insignificant. This suggests that owners with controlling stakes behave similarly whether they are domestic or foreign. In addition, government and bank controlling ownership is also insignificant (not shown). Interestingly, in

column 3 the combined stake of the five largest owners is positive and significant (controlling for the controlling dummy).

In Table 2, columns 4 and 5 we split the total ownership of the five largest shareholders into the stake of the first shareholder, the stake of the second shareholder, and the combined shareholding of the third through fifth shareholders. We continue to include the controlling ownership dummy, because the largest shareholder may act differently depending on whether he has a majority stake or not. In this case we find that the effect of controlling ownership is insignificant. Rather, most of the explanatory power now comes from the second block shareholder, i.e., firms where the second largest shareholder holds a relatively large stake are significantly more likely to have cumulative voting.

In Table 2, columns 6-8 we show that our results are robust to controlling for firm size and leverage. In addition, we do not find that asset tangibility, profitability or sales growth are related to these two governance provisions (not shown). We also do not find that a significant foreign ownership presence (of at least 20% or more of the total stake) has a statistically significant effect (not shown). Finally, we do not find a significant effect of the privatization wave on the adoption of governance provisions.

In Table 3 we find similar patterns for the proxy voting provision, however the results are generally not significant at conventional levels. We find that a controlling shareholder is weekly significantly less likely (at 10% significance) to have proxy provisions, but we find no effect of the second or other block holders. The weaker results for proxy voting may suggest that cumulative voting is a more important provision for minority shareholders than proxy voting. For example, proxy voting may not be effective

without cumulative voting, especially if the firm's largest shareholder holds a controlling stake. The weaker results for proxy voting are also reflected in the number of firms in our sample that has adopted the provision: only 12% for proxy voting, versus 39% for cumulative voting.

In both Tables 2 and 3 we also find significant country effects, which are in line with proportions presented in the Table 1. In particular, we find that the firms operating in the Czech Republic are much less likely to allow cumulative voting and proxy voting than firms in the other three Eastern European countries. However, country effects explain only about 10% of the variation in the adoption of these provisions.

The results presented so far are consistent with our hypothesis discussed in Section 2. We argue that large shareholders are able to influence the adoption of governance provisions in order to give themselves the most bargaining power in the voting process. Those who find it unfavorable (i.e. controlling shareholders with more than 50% of the votes) are unlikely to adopt these provisions, while those who find it most beneficial (i.e. a group of large shareholders next in line after the first largest owner) are more likely to adopt them.

Next, we study whether the home country of the foreign owners affects the likelihood of the adoption of these provisions. Firms in Eastern Europe, and in particular the Central European countries that we study, have large foreign ownership stakes. As shown in the second column of Table 4, Panel A, about 62% of our firms have at least some foreign ownership; the highest number of foreign-owned firms is in Hungary (80%) and the lowest is in Slovak Republic (42%). The remaining columns show the percentage of firms with foreign owners from countries with and without legislated

cumulative and proxy voting. For example, 9% of firms in our sample have foreign owners from countries with mandatory cumulative voting and 13% of firms in our sample have foreign owners from countries with mandatory proxy voting.

These foreign-owned companies may be required to adhere to higher standards of corporate governance and therefore be more likely to adopt stricter governance provisions. The reputational concerns of foreign firms are expected to be particularly prominent for foreign firms from countries where the law prescribes a greater set of corporate governance provisions than the host country. We therefore test whether firms that are foreign owned by a firm incorporated in a country where the law prescribes cumulative voting and/or proxy by mail voting are more likely to enact cumulative voting and/or proxy voting. We use the data from La Porta, et al. (1998) and Gelfer et al. (2000) to assess whether the laws of the home country of the foreign owners prescribe proxy and/or cumulative voting.

The regression results of these so-called home-rule tests are reported in Table 4, Panel B. We do not find that foreign companies for which the law of the country of origin prescribes cumulative voting or proxy voting are more likely to allow for these provisions in the host country. Therefore, our results do not support the hypothesis that foreign owners export better governance practices to the firms they hold in host countries.

5. Conclusions

We study differences in the use of two corporate governance provisions in four Eastern European countries: proxy by mail voting and cumulative voting. Although these provisions are not prescribed by the law in any of these countries, we find that many

firms in these countries choose to voluntarily allow for such type of voting by enacting these provisions in their corporate charters. Some of the within country variation in the use of these provisions can be explained by differences across firms in the concentration of ownership and the occurrence of controlling shareholders. We also find that firms where the second largest shareholder controls a major stake are more likely to adopt cumulative voting. However, a significant part of the variation in corporate governance is due to cross-country variation. We do not find that firms are more likely to have these provisions if the firm's controlling owner is foreign or if the law of the country of origin of the controlling owner prescribes these provisions, suggesting that corporate governance standards are not systematically exported by foreign owners from countries with high corporate governance standards to countries with weaker corporate governance standards.

To summarize, our results suggest that main shareholders tend to adopt corporate governance provisions to protect their own interests. We find that controlling shareholders are less likely to improve the voting rights of minority shareholders, whereas other large shareholders, in particular the second largest shareholder, may fight for the adoption of corporate governance provisions to gain control and board representation. Our results highlight the importance of country-level laws and mandatory investor protection provisions to support large scale firm-level corporate governance reform.

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Table 1: Summary statistics of shareholder rights and ownership structure

Panel A reports the summary statistics on the shareholder rights and privatization variables. Columns (2)-(3) report the percentage of firms with shareholder rights provisions; columns (4)-(6) report the percentage of firms privatized in Privatization Wave I (1989-1991), Wave II (1992-1994) or Wave III (1995 and after); column (7) reports sample average of number of years since privatization. Panel B reports the summary statistics on the ownership variables. Ownership indicators in columns (1)-(3) in Panel B are defined for firms with 20% or more of each type of ownership. Panel C reports the summary statistics on the financial firm characteristics. *Equity* is the ratio of equity to total assets; *Sales* is Log of sales in USD; *Tangibility* is the ratio of fixed assets to sales and *ROA* is the ratio of net income to total assets.

Panel A. Shareholder rights and Privatization

	Number of Firms	% of Firms with		Privatization: % of Firms in			
		Cumulative Voting	Proxy Voting	Wave 1	Wave 2	Wave 3	Average Years
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Czech Republic	74	26%	4%	12%	74%	14%	7.87
Hungary	56	20%	18%	24%	36%	23%	7.67
Poland	56	66%	25%	38%	41%	21%	8.39
Slovak Republic	38	55%	0%	10%	70%	16%	7.73
All Sample	224	39%	12%	21%	57%	18%	7.97

Panel B. Ownership Structure

	% of firms with ownership by			Average % of firm shares held by			% of firms with largest shareholder owning over 50%
	Foreigners	Government	Bank	Foreigners	Largest shareholder	Five largest shareholders	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Czech Republic	47%	27%	11%	38%	69%	89%	70%
Hungary	70%	7%	18%	43%	52%	96%	52%
Poland	32%	11%	4%	19%	39%	64%	25%
Slovak Republic	26%	18%	11%	17%	62%	82%	68%
All Sample	46%	17%	11%	31%	56%	83%	54%

Panel C. Financial Ratios

		Equity	Sales	Tangibility	ROA
		(1)	(2)	(3)	(4)
Czech Republic	Mean:	0.53	18.18	0.77	0.03
	Std:	0.21	1.64	0.55	0.10
Hungary	Mean:	0.60	17.85	0.62	0.04
	Std:	0.21	1.79	0.42	0.08
Poland	Mean:	0.51	18.01	0.54	0.02
	Std:	0.21	1.54	0.49	0.10
Slovak Republic	Mean:	0.47	17.45	0.67	0.00
	Std:	0.24	2.05	0.38	0.07
All Sample	Mean:	0.54	17.95	0.66	0.03
	Std:	0.22	1.72	0.49	0.09

Table 2: Determinants of cumulative voting

Dependent variable is Proxy voting by mail. *Controlling* is a dummy equal to 1 if the largest shareholder holds more than 50% of total shares; *Controlling Foreign* is a dummy equal to 1 if there is a foreign shareholder who holds more than 50% of total shares; *Share_1-5* is equal to the sum of all block ownership (shareholdings greater than 5%) by the 5 largest shareholders (normalized by 100); *Share_1*, *Share_2*, and *Share_3* is the percentage of shares held by the first, second, and the sum of the third, fourth and fifth largest shareholders, respectively (normalized by 100); *Privatization-1* is a dummy indicating the first privatization wave, 1989-1991; *Privatization-2* is a dummy indicating the second privatization wave, 1992-1994; and *Privatization-3* is a dummy indicating the third privatization wave, 1995 and after (the omitted category); *Sales* is the log of total sales in US\$; *Equity* is the ratio of the book value of total equity to total assets; *Czech Rep*, *Hungary*, and *Poland* are country dummies. Regressions are estimated using a Probit model and the reported numbers are marginal effects. Robust standard error values are in brackets. *, **, and *** indicate significant at 10%, 5%, and 1%, respectively.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Controlling	-0.127 [0.073]*	-0.155 [0.084]*	-0.222 [0.080]***	-0.179 [0.123]	-0.203 [0.124]	-0.151 [0.127]	-0.203 [0.140]	-0.131 [0.075]*
Controlling Foreign		0.115 [0.092]						
Share_1-5			0.710 [0.315]**					
Share_1				0.329 [0.291]	0.482 [0.327]	0.268 [0.301]	0.413 [0.330]	
Share_2				0.748 [0.354]**	1.078 [0.438]**	0.818 [0.371]**	0.952 [0.431]**	
Share_3-5					-0.218 [0.134]			
Privatization-1							-0.031 [0.134]	
Privatization-2							0.072 [0.117]	
Sales						0.033 [0.023]	0.033 [0.026]	0.037 [0.022]
Equity						0.523 [0.186]***	0.551 [0.207]***	0.570 [0.188]***
Czech Rep	-0.213 [0.103]**	-0.241 [0.104]**	-0.260 [0.104]**	-0.247 [0.102]**	-0.233 [0.105]**	-0.264 [0.103]**	-0.232 [0.120]*	-0.245 [0.102]**
Hungary	-0.297 [0.088]***	-0.341 [0.085]***	-0.378 [0.084]***	-0.318 [0.085]***	-0.327 [0.084]***	-0.381 [0.076]***	-0.322 [0.091]***	-0.373 [0.077]***
Poland	0.131 [0.122]	0.099 [0.123]	0.221 [0.126]*	0.206 [0.125]*	0.163 [0.127]	0.201 [0.127]	0.314 [0.137]**	0.116 [0.123]
Observations	205	205	205	205	205	198	170	198
Pseudo-R2	0.18	0.19	0.20	0.20	0.21	0.24	0.24	0.22

Table 3: Determinants of proxy by mail

Dependent variable is Proxy voting by mail. *Controlling* is a dummy equal to 1 if the largest shareholder holds more than 50% of total shares; *Controlling Foreign* is a dummy equal to 1 if there is a foreign shareholder who holds more than 50% of total shares; *Share_1-5* is equal to the sum of all block ownership (shareholdings greater than 5%) by the 5 largest shareholders (normalized by 100); *Share_1*, *Share_2*, and *Share_3* is the percentage of shares held by the first, second, and the sum of the third, fourth and fifth largest shareholders, respectively (normalized by 100); *Privatization-1* is a dummy indicating the first privatization wave, 1989-1991; *Privatization-2* is a dummy indicating the second privatization wave, 1992-1994; and *Privatization-3* is a dummy indicating the third privatization wave, 1995 and after (the omitted category); *Sales* is the log of total sales in US\$; *Equity* is the ratio of the book value of total equity to total assets; *Czech Rep*, *Hungary*, and *Poland* are country dummies. All regressions include dummies indicating 1-digit SIC industry codes. All regressions exclude Slovakia as there are no cases in our sample in which Proxy by mail is stipulated in the charter. Regressions are estimated using a Probit model and the reported numbers are marginal effects. Robust standard error values are in brackets. *, **, and *** indicate significant at 10%, 5%, and 1%, respectively.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Controlling	-0.073 [0.037]*	-0.073 [0.041]*	-0.074 [0.043]*	0.003 [0.053]	0.002 [0.053]	0.003 [0.057]	0.014 [0.058]	-0.068 [0.038]*
Controlling Foreign		0.033 [0.052]						
Share_1-5			0.005 [0.127]					
Share_1				0.197 [0.131]	0.194 [0.140]	0.173 [0.144]	0.150 [0.139]	
Share_2				0.020 [0.145]	0.007 [0.189]	0.001 [0.147]	0.097 [0.148]	
Share_3-5					0.006 [0.064]			
Privatization-1							0.015 [0.054]	
Privatization-2							-0.042 [0.052]	
Sales						-0.006 [0.011]	-0.009 [0.010]	0.003 [0.011]
Equity						-0.039 [0.087]	-0.035 [0.082]	-0.035 [0.089]
Czech Rep	-0.073 [0.036]***	-0.108 [0.037]***	-0.097 [0.037]***	-0.077 [0.038]**	-0.076 [0.038]**	-0.074 [0.044]*	-0.071 [0.045]	-0.091 [0.038]**
Hungary	0.097 [0.044]	0.004 [0.046]	0.010 [0.051]	0.017 [0.047]	0.017 [0.047]	0.028 [0.053]	0.023 [0.056]	0.023 [0.049]
Observations	205	191	205	205	205	198	170	198
Pseudo-R2	0.12	0.12	0.12	0.14	0.14	0.13	0.17	0.12

Table 4: Foreign ownership and the home rule

Panel A shows summary statistics of foreign ownership. Panel B shows regression results. The dependent variable is either a dummy for cumulative voting (columns (1)-(2)) or a dummy for proxy voting (columns (3)-(4)). *Controlling* is a dummy equal to 1 if the largest shareholder holds more than 50% of total shares;. The remaining independent variables are dummies indicating foreign shareholders from countries with or without cumulative voting (columns (1)-(2))and proxy by mail (columns (3)-(4)). Columns (3)-(4) exclude Slovakia as there are no cases in our sample in which Proxy by mail is stipulated in the charter. Regressions are estimated using a Probit model and the reported numbers are marginal effects. Robust standard error values are in brackets. *, **, and *** indicate significant at 10%, 5%, and 1%, respectively.

Panel A. Proportion of foreign owners with and without home rule

Country	% of firms with				
	Any foreign ownership	Foreign owners from country			
		With cum. voting	Without cum. voting	With proxy voting	Without proxy voting
Czech Republic	61%	5%	55%	14%	47%
Hungary	80%	11%	70%	16%	64%
Poland	57%	13%	45%	11%	46%
Slovak Republic	42%	11%	32%	11%	32%
All Sample	62%	9%	52%	13%	49%

Panel B. Regression results

	Cumulative Voting		Proxy by mail voting	
	(1)	(2)	(3)	(4)
Controlling		-0.141 [0.058]*		-0.064 [0.211]
Foreign from country with cum. voting	-0.088 [0.433]	-0.086 [0.442]		
Foreign from country without cum. voting	0.091 [0.223]	0.102 [0.179]		
Foreign from country with proxy by mail			0.093 [0.259]	0.103 [0.221]
Foreign from country without proxy by mail			-0.042 [0.426]	-0.035 [0.508]
Czech Republic	-0.302 [0.001]***	-0.305 [0.001]***	-0.195 [0.000]***	-0.170 [0.003]***
Hungary	-0.358 [0.000]***	-0.379 [0.000]***	-0.045 [0.372]	-0.032 [0.543]
Poland	0.100 [0.341]	0.036 [0.741]		
Observations	224	224	186	186
Pseudo-R2	0.13	0.142	0.11	0.12

