

Board Of Directors In Europe: A Comparative Law Analysis

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In this article we make a comparative analysis of corporate governance laws with respect to boards of directors and directors' duties in ten European countries (Spain, Italy, France, Germany, Austria, Portugal, Greece, Ireland, The Netherland and the United Kingdom). The analysis focuses on corporate governance and directors' duties for companies limited by shares. The article focuses on three major objectives: 1) to compare different laws that could improve the board's strategic role, 2) to measure with an index the extent to which legislation intervenes in the composition of boards of directors for each country, 3) to point out some divergences and convergences among the European countries analyzed. The results show that some divergences among these ten European countries still exist, Germany and Austria have the highest legal rules indices, Portugal has the lowest. Nonetheless, the marked similarity of some countries that belong to different legal families support our idea that a new culture among companies is being developed.

Field of Research: *Corporate Governance, Board of Directors*

1. Introduction

Corporate governance in the European Union countries is characterized by a process of integration fostered by the free circulation of capital, the introduction of the Euro as a common currency and the constitution of a unique European market. The aim to harmonize fiscal policy and corporate laws meets both general convergence forces and some persisting diversities. The perception is that a new culture that goes above specific national features is being developed. Nonetheless several cultural, institutional, historical and economic factors still affect corporate governance.

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Even if this paper is the result of the shared research of the authors, the Introduction paragraph can be attributed to Lal Chugh –Project Coordinator – the literature review, the description of the sample, the methodology and results paragraphs can be attributed to Cristina Bettinelli.

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In the existent literature only a few have engaged in European comparative company law. This article analyses company law provisions in ten European countries: Spain, Germany, France, Italy, Austria, Portugal, Greece, Ireland, The Netherlands and United Kingdom. Eight of the countries selected belong to the Romanistic-German legal system, two other countries belong to the Common Law system. This article will consider the law requirements for boards of directors in companies limited by shares. By companies limited by shares, we mean those in which each shareholder pays debts up to the amount of the shares they have bought if it fails; legally speaking, such companies have a legal personality, limited liability and transferable shares. The aim is to compare the legal requirements for boards of directors in all these countries, to assess the level of legal intervention (legal rules index) and to verify whether in the EU the convergence among different legal families is being strengthened.

2. Literature Review

The link between corporate governance and culture is determinant (Salacuse, 2003), moreover some scholars asserted that, considering the increasing internationalization of capital markets and commerce, harmonization of corporate governance standards across national boundaries is inevitable and invaluable (Hansmann and Kraakman, 2001). On this regard some authors anticipated that harmonization of national corporate governance standards will be slackened by path-dependent factors such as local cultural values and the political and legal economies of each country (Bebcuck & Roe 1999, Gilson 1996, 2001). A debated question regards whether corporate governance convergence should be desirable or not. So far a leading idea on this issue has not been found. For example Rubach & Sebora in 1998 stressed that companies in both emerging and established economies, during convergence, can earn competitive advantage by altering their governance structures to incorporate elements that global stake-holders appear to value. Conversely, in 2003 Lane analyzed corporate governance convergence in Germany. According to her empirical and theoretical analysis, in Germany, occurrence of convergence to liberal market capitalism will have extensive practical consequences, detrimental to the continued viability of the model of diversified quality production, to employees and to organized labor, as well as increasing the level of social inequality in German society.

The makeover of corporate governance in Europe is an interesting but fragmentary picture. The institutional layouts and most of the practices of corporate governance present diversity and homogeneity in the same time. In recent years European corporate governance law has set out on the journey of innovation with the aim of better integrate into international markets. As a consequence of globalization, numerous European countries have transformed their corporate laws and financial market regulations. Jeffers in 2005 suggested that corporate governance convergence amid European countries is boosted by different forces, the most important are the free circulation of capital and the introduction of the Euro as a common currency as well as the constitution of a unique European market that leads to a bigger competitive

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environment. Through this reorganization progression, a new culture among companies is being developed that goes above specific national features. According to Jeffers diverse factors affect corporate governance. In particular the establishment of common prudential rules (that is, rules designed to limit risk taking by investors), the usage of international norms of accounting, and, in Europe, the aim at harmonizing fiscal policy and corporate laws. On these latter laws, in addition to general convergence forces, there are some persisting diversities. Cernat in 2004 commented that the future convergence into a unique European corporate governance model is thwarted by the current diversity of national corporate governance models and the presence of different EU decision-making procedures. Conversely the European Court of Justice (ECJ) rules made cross-border mobility in incorporation in the European Union easier. Becht *et al* in 2006 published an analysis on how deregulation and the costs of regulation have affected the location decisions of firms. They found that incorporation costs, especially those due to minimum capital requirements and delays in incorporation, have significant influences on firms' location decisions.

Their results confirm that when a firm has to choose between different legal systems, the price is relevant and that cross-border incorporation has encouraged regulatory competition between EU member states to offer low-cost corporate law. Moreover, some authors (Khanna *et al* 2006) analysed cross-sectional data and tested the hypothesis that similarity in corporate governance between two countries is correlated with economic integration between those countries. The authors concluded that globalization may have encouraged the adoption of some common corporate governance standards but that there is little evidence that these standards have been implemented. What we wanted to explore is the convergence of the corporate governance law in European countries and we decided to do so with a comparative law analysis. As Hopt in 2006 noticed, only a few have engaged in comparative company law work (see for example Barca & Becht, 2001; Kraakman *et al*, 2004; Albert-Roulhac & Breen, 2005). Most of the existent standard company law documents and treatises are restricted to national law and seldom directed to the European company law harmonization. Furthermore we noted that recently, more comparative company law work on the European context is being done. Since the influence of international networks and academic journals on this topic is going to increase in the future, we decided to give an innovative contribute by comparing some European companies and their legal requirements.

3. The Sample

This article is inspired by the results of our previous work (Bettinelli and Chugh, 2008) in which we analyzed company law provisions in six European countries. We decided to extend it to some other European countries so that the sample is now composed of Spain, Germany, France, Italy, Austria, Portugal, Greece, Ireland, The Netherlands and United Kingdom. Some of the countries selected belong to the Romanistic-German legal system (Visegrádi, 2001) which formed the first legal family in the world. More specifically, France, Italy, Spain, The Netherlands and Portugal belong to the *Romanistic* legal system (the first sub-group of the Romanistic-German group). In the

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past, Italy, Spain and Portugal have been also greatly influenced by the German and the Swiss codes, this makes them an intermediary type. With respect to commercial code, we deem Greece as a member of the Romanistic family indeed -as Berkowitz and his colleagues in 2003 asserted- the French law is for Greece the main source whereas the civil code has been influenced also by the Germanic legal family (La Porta et al, 1998). Germany and Austria belong to the *Germanic legal family*, which is the second legal group of the Romanistic-German system. The United Kingdom and Ireland are part of the *Common Law system* which is modeled on the English law features: mostly not codified, judge-made and less theoretical than the Romanistic legal systems' law (Visegrádi, 2001).

We believe that this sample is assorted and complete enough to depict a first canvas which could encompass the principal aspects of corporate governance in Europe. The analysis of these countries will help understand the company law inside the European Union. This article will consider the law requirements for boards of directors in companies limited by shares. By companies limited by shares, we mean those in which each shareholder pays debts up to the amount of the shares they have bought if it fails; legally speaking, such companies have a legal personality, limited liability and transferable shares. Cultural differences lead to different definitions, in particular in some cases public companies are those that have transferable shares even if not listed, in some other cases, public companies are those that are listed. Our focus is on companies limited by shares, both listed and not listed. The aim is to compare the legal requirements for boards of directors in all these countries, to assess the level of legal intervention and to appraise whether in the EU the convergence among different legal families is being strengthened.

Table 1 specifies the exact types of companies that we have considered it shows the acronyms and names used for indicating this type of company and shows also which corporate governance model can be applied. The countries in which only one model it is applicable are Spain, Germany, Austria, Greece and UK (exceptions for European companies formed in these countries exist).

Table1: Board Structures

SPAIN	SA (Sociedad anónima)	Unitary
GERMANY	AG (Aktiengesellschaft)	Two-tiered
FRANCE	SA (Société Anonyme)	Unitary or Two-tiered
ITALY	SPA (Società per Azioni)	Traditional or Unitary or Two-tiered
AUSTRIA	AG (Aktiengesellschaft)	Two-tiered
PORTUGAL	SA (Sociedades anónimas)	Unitary or Two-tiered
GREECE	SA (Anonymi etairia)	Unitary
IRELAND	SA (Public Company)	Unitary (two tiered allowed only for listed co.)
THE NETHERLANDS	NV (Naamloze Vennootschap)	Two-tiered or Unitary
UNITED KINGDOM	(Public Limited Company)	Unitary

4. Methodology

We have considered some aspects that we believe to be of primary importance in describing the typical features of the boards of directors. First of all, we measured with an index (*legal rules index*) the extent to which legislation intervenes in the composition of boards of directors for each country, then, we compared all the different laws and finally we pointed out some legal divergences and convergences among the European countries examined. The legal rules index has been built by exploring nine different aspects of the composition of the boards that are prescribed by law. In particular, we verified whether the country's laws refer to employees' representation in the board, the required number of directors, directors' age restrictions, non-executives or independent figures requirements, the prohibition of appointment of the chairman as CEO of the same company, directors' terms of appointment and directors' ownership. With the purpose of building the legal rules index, we gave a value to each of the aspects analyzed: one point when the topic was regulated by the law and zero points when it was not regulated; in specific cases, the points given were 1.5 (i.e. high law intervention) and 0.5 (i.e. low law intervention).

5. Results And Comments

5.1. The Law Requirements Country By Country.

We will consider now, each of the nine board of directors' composition aspects that we have analyzed for the ten European countries that compose our sample. *The Employees' representation* is mandatory -when certain conditions regarding the number of employees are met- on the supervisory boards of Germany, Austria and France (for France, if the unitary system is implemented, the employees' representation is required on the board). In all the other countries analyzed this type of representation is not required. According to Fauver and Fuerst, such representation on boards offers precious first-hand operational knowledge for board decision-making (Fauver and Fuerst, 2006). The authors found that labor representation helps monitor and reduces agency costs; the governance effectiveness obtained through the requirement of employee representation is high and there is good co-ordination between all the company's parties in the firm. On this topic, we espouse Roe's point of view according to whom both the strengths and weaknesses of employee representation are important for facilitating corporate governance arrangements Roe's (2003). For this reason the cases in which the law requires the presence of employees on the board of directors could be considered as rules that improve corporate governance.

Regarding *the minimum or maximum number of members on the board*, each country's laws refer to this but different rules are applied. From a theoretical point of view, the experts affirm that, in general, boards with a small number of members are more desirable because in large groups individual responsibility tends to dissolve (Neubauer and Lank, 1998). The board members' liability is indeed connected with the size of the board. Additionally, many authors claim that excessively large boards can be ineffective in terms of teamwork and communication. Larger boards can lead to difficulties in the

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co-ordination of board meetings and may inhibit the full participation of each member. On the other hand, boards should be big enough to offer adequate resources to govern. Indeed, the board of directors has to be seen as a team in which persons with different skills, experiences and backgrounds meet together to deal with complex problems (Corbetta and Minichilli, 2006). Moreover, board size is affected by the number of committees (if the company needs to have different committees the board size can be bigger), the workload for the board and the ownership structure. For the abovementioned reasons concerning board size, we suggest that the optimal size is impossible to identify as it depends on a company's characteristics and goals. There is no consensus in the literature on the relationship between board size and performance. The lack of consensus about the relationship between board size and performance can be attributed to the fact that too many variables interact in determining the performance of a company and it is necessary to consider the complexity of each of them.

On the subject of *age restrictions*, Lorsch and his colleagues contend that board effectiveness could be improved if each board established a mandatory retirement age for independent directors (Lorsch et al. 1992). We believe that all members of the board should retire at a certain age, which is up to each board to determine. Unfortunately amid the analysed countries, few boards set retirement ages : France, Ireland and the United Kingdom. In France SA's unless otherwise specified in the company articles, no more than 1/3 of the board of directors and of the supervisory board can consist of directors of over seventy years of age while the chairman of the board of directors, the general manager and the members of the management board must not be over sixty-five years of age. Ireland's directors of public company must retire from office at 70 unless the shareholders approve their continuation in office. In the UK directors of public companies must retire at the age of 70 unless shareholders approve their appointment or continuation in office. Under the UK's proposed reforms (expected to be brought into force by 2008) the 70 years restrictions will be removed and there will be a new requirement that the minimum age of directors is 16. Nonetheless having a director's age limitation is one of the criteria generally used by corporate governance and board rating systems (Van den Berghe and Levrau, 2004). Indeed, the presence of an age limit improves the corporate governance effectiveness because it helps guarantee a proper turnover on the board.

With regard to *independent directors*, we considered board composition (obligation to include non-executive or independent members), the recognition of non-executive or independent figures within the board, and the definition of independence. Relating to the last two points, in most of the countries analyzed, both the recognition of non-executive or independent members and the definition of independence is provided either by the law or by the codes). Nonetheless, in France and in Portugal, this definition does not exist or there is no consensus on it. In the literature the effect of outsider-dominated boards on performance is controversial. Greater representation of outside directors on the board results in a negative impact on firm performance (Agrawal and Knoeber, 1996; Coles *et al*, 2001). Some authors found a negative relationship between a higher proportion of independent directors and performance or firm value (Rosenstein and Wyatt 1990; Baysinger and Butler, 1985; Wagner *et al*, 1998). Other scholars affirm that

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there is virtually no relationship between board composition and firm performance (Dalton *et al*, 1998; Hermalin and Weisbach, 2003). We believe that inconclusiveness of these results' is due to the fact that finding the right mix of independent and non-independent directors is a very complex issue. On the one hand, the inclusion of insiders in the board may be useful because they have access to information relevant in assessing both strategic and managerial performance. On the other hand, independent directors can bring external skills and competencies to the company and have an important role to play, chiefly in those fields where conflicts of interest may arise (i.e. financial control, nomination and remuneration). As Van den Berghe and Levrau in 2004 asserted, almost all rating systems pay attention to *board independence*. To conclude, the proper balance inside the board may depend on the company's characteristics (company structure, size, age etc.) and needs: the board of directors should pursue a balance between executive directors, shareholders' representatives and outside independent directors. In the legal rules index building process we decided to give 1 point in all the cases where either the law or the codes dealt with the directors' independence issue. Even if the codes are not coercive we consider their influence on the independence topic as important as the law.

The *prohibition of appointment of the chairman as CEO* of the same company is another issue that we have taken into account. Other than Austria, France and Germany, the law does not forbid appointing the chairman as CEO. Austrian and German laws instead explicitly require the strict separation of the roles of the management board and supervisory board (in these two countries the only model that can be implemented is the two-tiered one). In France the position of chairman is separated from the position of general manager in principle but the board can decide to give the two functions to the same person. The separation of the roles of CEO and chairman reduces the power of the CEO and the potential for management to dominate the board. It has to be recognized, however, that when the CEO also serves as the chairman, his or her role-duality provides unified firm leadership, builds trust and stimulates the motivation to perform (Muth and Donaldson, 1998).

With regard to law requirements for *terms of appointment*, all the countries other than Portugal (where no limits are defined) fix either by law or by codes some terms of appointment. We consider this as an element that improves the quality of corporate governance. The precise length of a director's term depends on a number of unique factors that are not only connected with the company's characteristics but also with the individual business' characteristics. In one sense, fixed terms of service have to be long enough to allow the sharing of knowledge among all members and to provide a long-term perspective on the running of the company. In another sense, they have to be short enough to permit the board to be effective and ready to adapt to new scenarios. The fact that the law prescribes some terms of appointment is enfeebled by the possibility, allowed for by the same law, of re-electing the same director. We gave 1 point to the cases in which the law prescribes terms of appointments and 0.5 point to the cases in which the prescription is by codes.

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The role of directors as owners is another point that we analyzed. We wanted to investigate whether the law allows directors to be owners or not. We found that in every country directors are allowed but not required to own shares in the company. The only case in which directors and members of the supervisory board have to own at least one share in the company is France. This information shows that ownership by directors is not considered as a danger for the company. In fact, in the literature it is recognized that having owners as directors can positively affect performance. For example, Bhagat *et al.* found that the greater the value of an outside director equity ownership, the better the company's overall performance.

5.2. The Legal Rules Index.

The legal rules index is a numerical construct that we created to measure law intervention on the features of boards of directors. The higher the value of this index, the deeper the law intervention is. As shown in table 2, we gave one or zero points to each analyzed aspect of boards of directors (employees' representation, number of directors, and so forth) country by country. The attribution of points depended on the depth of the law intervention. When particular situations required a different consideration, we gave 0.5 or 1.5 points. This happened for example when we had to assess the number of directors' regulation, we gave 0.5 points when the law has a low intervention and 1.5 when the intervention is high. We added up all the figures and we found, for each country, the value of the legal rules index. Spain's index is 5.5, Italy 4.5, France 6.5, Germany 7.5, Austria 7.5, and Portugal 0.5, Greece 4.5, Ireland 5.5, The Netherlands 4.5, the UK 5.5. These results demonstrate that, in spite of the European Union, the impact of law intervention on board's aspects is still quite different in each of these European countries. Moreover, Germany and Austria, from the Germanic legal family, have laws that more minutely prescribe what the characteristics of the board have to be. While Italy, Greece and The Netherlands have indices that are more similar, this concurs with the fact that they belong to the romanistic legal region. France is in an intermediate position. The peculiar result is Portugal's index. It is the lowest and very different from all the other countries. Company law in Portugal does not contain many definite rules about the characteristics of boards of directors and this is reflected in a low legal rules index. Ireland and UK have the same legal rules indices as Spain, for the first two countries this is explainable by considering their geographic and cultural position, moreover, their indices are quite close to the romanistic family ones. This could indicate a first step to convergence.

5.3. Conclusions.

We have defined some features of boards of directors and we have considered how they are regulated. The relationships between board of directors composition and corporate governance quality have been discussed. Some divergences emerged among these ten European countries, for example on the employees' representation on the board, on the number of directors and on independence recognition. Germany and Austria have the highest legal rules indices, Portugal has the lowest, the interesting finding is that even if the UK and Ireland belong to the *common law* legal family, their

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legal rules index have the same value as the Spain's legal rules index and their values are similar to a good part of the romanistic legal family countries. This could support our idea that a new culture among companies is being developed that goes above specific national features. On board of directors composition and on what makes a good board of directors, there is not always homogeneous theoretical support. This facet and the fact that some cultural and historical differences remain strong can explain the law divergences that we found. More research has to be done on this topic, and it would be interesting to extend the analysis to all the members of the European Union.

Table 2: Comparative analysis

	SPAIN	S	ITALY	I	FRANCE	F	GERMANY	G	AUSTRIA	A	PORTUGAL	P	GREECE	G	IRELAND	IR	THE NETHERLANDS	NET H	UNITED KINGDOM	U K	
Employees' representation on the board (mandatory)	NO		NO		YES on the board (unitary syst.) or on the supervisory board (two tiered) of companies with more than 50 employees or when employees hold more than 3% of the share capital.	1	YES on the supervisory board of companies with more than 500 employees	1	YES on the supervisory board of companies with a works council (which is mandatory with at least 5 employees)	1	NO		NO		NO (except in certain State owned co.)		NO		NO		
Number of directors or members			Traditional model minimum NO maximum NO																		
			Two-tiered: on the management board minimum 2 maximum: NO on the supervisory board minimum 3 maximum: NO.		Two-tiered: on the management board minimum 1 maximum 5, on the supervisory board minimum 3 maximum 18.		Two-tiered: on the management board minimum 2 (when share capital >Eur3million or when the representation of employees' representatives is mandatory) maximum NO, on the supervisory board minimum 3 maximum: depends on the AG's capital, but it must be a number divisible by 3.		Two-tiered: on the management board minimum 1 maximum NO, on the supervisory board minimum 3(exclusive of employees' representatives) maximum: depends on the AG's capital.(for listed minimum 10 excluding the employee's representatives)		Two-tiered: on the management board minimum NO maximum NO, on the supervisory board minimum 3 maximum: NO						Two-tiered: on the management board minimum: 1 maximum: NO supervisory board minimum 1 (in large companies minimum: 3) maximum NO.				
	Unitary: minimum: 3 maximum: NO (for listed companies the Report on Good Governance suggests a minimum of 5 and a maximum of 15)		Unitary: minimum: NO (for listed min 3) maximum: NO		Unitary: minimum: 3 maximum :18						Unitary: minimum: NO maximum: NO		Unitary: minimum: 3 maximum: NO		Unitary: minimum: 2 maximum: NO				Unitary: minimum: 2 maximum: NO		
		1		0.5		1.5		1.5		1.5		0.5		0.5		0.5			0.5		0.5

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Age restrictions (superior limit)	NO		NO		YES	1	NO (but recommended by the Code)		NO (but recommended by the Code)		NO		NO		YES	1	NO		YES	1
Recognition of non-executive or independent figures	YES (in the Report on good governance)	1	YES (by the Code and the Law)	1	NO		YES (by the Code)	1	YES	1	NO		YES	1	YES (by the Code)	1	YES (for two-tiered, not expressly for Unitary).	1	YES	1
Board composition (obligation to include non-executive or independent)	suggested by the Report on Good Governance	1	only for listed companies and for companies with unitary board	1	NO		suggested by the Code	1	YES the supervisory board (composed only of non executive directors) must define the criteria that defines independence.	1	NO		YES	1	suggested by the Code	1	YES	1	YES	1
Independence definition	YES	1	YES	1	NO consensus on it		YES	1	YES	1	NO		YES	1	YES	1	YES	1	YES	1
Prohibition of appointment of the chairman as CEO of the same company	NO (not mandatory but suggested by the code)	0.5	NO		YES (both in the Two tiered and in the Unitary model)	1	YES (roles of the management board and supervisory board are strictly separate)	1	YES (roles of the management board and supervisory board are strictly separate)	1	NO		NO		NO (not mandatory but suggested by the code)	0.5	NO (not mandatory but suggested by the code)	0.5	NO (not mandatory but suggested by the code)	0.5
Terms of appointment	YES (maximum term is 6 years but re-election is possible) For listed companies (Report on good governance) independent directors should not serve for a continuous period of more than 12 years)		YES (maximum term is 3 years but re-election is possible)		Unitary structure: maximum term 6 years- Re-election is possible.								Unitary: maximum 6 years but re-election is possible.		NO (but the Code recommends re-election at intervals of no more than three years.)					NO (not mandatory but suggested by the code)
					Two tiered structure: for supervisory directors maximum term 6 years, for management directors: term of 2 to 6 years. Re-election possible.		Two tiered structure: for supervisory directors and for management directors: maximum term of 5 years. Re-election possible.		Two tiered: for managing directors :maximum terms 5 years. For supervisory directors :between 4 years and 4 months, and 5 years and 8 months for supervisory directors, depending on when the annual shareholders' meeting for the election and the re-election of sup.directors takes place		NO					NO (in large companies maximum term for supervisory board is 4 years but re-election is possible and for other companies the Code recommends limits).				
		1		1		1		1		1				1		0.5		0.5		0.5
Directors as owners	Directors are allowed but not required to own shares in the company.		Directors are allowed but not required to own shares in the company.		Directors (in a unitary structure) and members of the sup.board. (in a 2 tiered str) must own at least one share in the company. Members of the management board are allowed	1	Managing directors and supervisory directors are allowed but not required, to own shares in the company.		Directors are allowed but not required to own shares in the company.		Directors are allowed but not required to own shares in the company.		Directors are allowed but not required to own shares in the company.		Directors are allowed but not required to own shares in the company.		Directors are allowed but not required to own shares in the company.		Directors are allowed but not required to own shares in the company.	

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				but not required to own any shares in the company.																
LEGAL RULES INDEX		5.5		4.5		6.5		7.5		7.5		0.5		4.5		5.5		4.5		5.5

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