

# **Forschungsstelle Osteuropa an der Universität Bremen**

Research Centre for East European Studies at the University of Bremen

## **Changing Europe Summer School III Central and Eastern Europe in a Globalized World**

**Bremen, 28 July – 2 August 2008**

sponsored by the Volkswagen Foundation

[www.changing-europe.org](http://www.changing-europe.org)

### **Maria Aluchna: Corporate Governance and Performance. The Case of Companies Listed on the Warsaw Stock Exchange**

About the author:

Maria Aluchna is an Assistant Professor at the Department of Management Theory, Warsaw School of Economics.

Email: [maria.aluchna@sgh.waw.pl](mailto:maria.aluchna@sgh.waw.pl)

©

Publikationsreferat / Publications Dept.

Forschungsstelle Osteuropa an der Universität Bremen

Research Centre for East European Studies at the University of Bremen

Klagenfurter Straße 3

28359 Bremen

Germany

e-mail: [fsopr@uni-bremen.de](mailto:fsopr@uni-bremen.de)

Language editing: Hilary Abuhove and Christopher Gilley

## Abstract

Developing a system of corporate governance is currently perceived as a way to enhance investor protection, increase corporate disclosure and formulate a best practice code. However, the main efforts observed in developing and transition countries mostly focus on providing stable frameworks for corporate activity, a stronger institutional order and effective enforcement of laws and recommendations. The creation of a sound corporate governance system is considered one of the top priorities on the transition agenda. Therefore, the stage of corporate governance development in a given country reflects at least to some extent the scope and depth of its institutional reforms and relative success or failures of its attempts to produce systemic change.

This paper analyses the development of corporate governance in transition economies, focusing on the current situation in Poland. It presents the main characteristics of corporate governance in Poland, addressing issues of ownership concentration, investor protection, development of the stock market and incentive mechanisms applied by listed companies. Additionally, the paper discusses corporate governance guidelines recommended in the best practice code prepared at the Warsaw Stock Exchange. Finally, it discusses the rating of public listed companies according to compliance with corporate governance rules and attempts to answer the question of whether companies with better corporate governance standards perform better and bring higher returns to their shareholders.

## 1. Introduction

Developing a system of corporate governance is currently perceived as a way to enhance investor protection, increase corporate disclosure and formulate a best practice code. The main aim of this process is to improve the control, monitoring and incentive structure based on three fundamental roles of corporate governance: transparency, accountability and legitimacy.<sup>1</sup> In developed countries, corporate governance reforms mostly entail changes described as 'fine tuning', i.e. compliance with detailed guidelines from the best practice code, such as the definition of directors' independence, the proportion of independent directors, the functioning of audit and compensation (or other) committees, regulations describing the board meetings, procedures of board evaluation, etc. However, in developing and transition countries, corporate governance efforts tend to concentrate on providing stable frameworks for corporate activity, a stronger institutional order and effective enforcement of laws and recommendations. Although the statistics collected in developing or transition countries may sound optimistic in terms of the capitalisation of the stock market and the number of listed companies, a deeper analysis usually reveals a lack of business awareness, a limited understanding of the ideas of corporate governance, problems with investor activism and lax enforcement of the law on the books and code recommendations. Although the creation of a sound corporate governance system has ranked as one of the top priorities on the transition agenda, the current analysis tests the actual effectiveness of the reforms undertaken to accomplish this task. Moreover, research on transition countries that keep up-to-date data shows the various stages of economic development and challenges associated with this process, i.e. large number of IPOs of companies founded after 1989 (instead of IPOs of privatised companies). Therefore, the stage of corporate governance development reflects, at least to some extent, the scope and depth of the concurrent institutional reforms and relative success or failure of the systemic change. It also shows the process of separation of ownership and control or lack of this phenomenon among the first generation of entrepreneurs of newly established companies.

This paper analyses the development of corporate governance and efficiency of the control structure in transition economies, focusing on the current situation in Poland. Section 1 presents the main characteristics of corporate governance in transition economies, addressing the issues of ownership concentration,

---

1 Monks, Robert: Corporate governance and value: appearance and reality, in: European Business Forum, Issue 5, Spring 2001.

investor protection, development of the stock market and incentive mechanisms applied by listed companies. Moreover, this section identifies the current stage of development of the corporate governance system in Poland, including a discussion of the guidelines recommended in the best practice code prepared at the Warsaw Stock Exchange. Section 2 focuses on the aspect of efficiency in corporate governance from the perspective of company performance. Section 3 presents the research on the relationship between corporate governance and performance and discusses the rating of Polish publicly listed companies according to their compliance with corporate governance rules. This section also attempts to answer the question of whether companies with better corporate governance standards perform better and bring higher returns to their shareholders. The paper presents the initial research results regarding the efficiency of the corporate governance system in Poland and indicates the practical challenges attendant to the process of understanding and adopting corporate governance guidelines.

## 2. Corporate Governance in Transition Countries

### 2.1. Characteristics of Corporate Governance in Transition Countries

The development of a sound corporate governance system is one of the main goals on the reform agenda in transition countries. Creating such a system necessitates rebuilding the meaning of ownership in societies that were deprived of private ownership for 45 years. In these countries, ownership is shifting from public to private hands via different privatisation schemes (mass privatisation, case-by-case privatisation, re-privatisation, liquidation, etc.). These reforms have led to major institutional and regulatory changes that now cater to market mechanisms instead of central planning in aspects of consumption, management (e.g. production), control (e.g. executive appointment) and allocation (e.g. investment) decision processes. Moreover, these nascent corporate governance systems were meant to be based upon a wide range of expertise-based elements (e.g. financial reporting), institutional developments (e.g. stock market and its supervision), the implementation of new laws and, finally, the rebuilding of the capital market and human capital. Despite these reforms, corporate governance systems in transition economies in Central and Eastern Europe are lagging behind the level of developed economies. Moreover, different approaches to systemic reforms and privatisation schemes have led to different control structures and problems across the region – including dominant vs. minority shareholder conflicts<sup>2</sup> resulting from the case-by-case privatisation method based on the involvement of strategic investors (Poland, Hungary); significant ownership changes due to the huge scale of mass privatisation programmes<sup>3</sup> (Czech Republic, Slovak Republic); and the rise of insiders known as oligarchs as a result of the loans for shares for managers to buy out the previously state-owned companies (Russia, Ukraine). Generally, corporate governance in CEEC is characterised by:

- control structures based mostly upon internal mechanisms, i.e. hierarchies such as ownership structure and boards, whereas external mechanisms, i.e. markets such as the stock market and market for corporate control, are weaker and do not play important governance functions;
- highly concentrated ownership concentration<sup>4</sup> as a result of weak investor protection (investors want to secure their position in the company, buying larger stakes of shares), civil laws, catch-up stages of transition economies and the growing importance of founder (family)-controlled companies;

2 Aussenegg, Wolfgang (1999), 'Going public in Poland: Case-by-case privatization, mass privatization and private sector initial public offerings', William Davidson Working Paper, no. 292, <http://eres.bus.umich.edu/docs/workpap-dav/wp292.pdf>

3 Coffee, John C. Jr.: Inventing a corporate monitor for transitional economics: The uncertain lessons from the Czech and Polish experiences, Columbia Law School, Center for Law and Economics Studies, Working Paper no. 106, 1996, <http://www2.law.columbia.edu/law-economicstudies/papers/workp106.pdf>

4 Berglöf, Erik, Pajuste, Anete: Emerging Owners, Eclipsing Markets? Corporate Governance in Central and Eastern Europe, conference Law and Governance in the Enlarged Europe, 2002, Columbia University.

- a low degree of transparency in publicly listed companies<sup>5</sup>;
- boards of companies that are dominated by shareholder representatives and creditors; the participation of worker representatives (usually in state-owned or commercialised companies) and independent directors is marginal<sup>6</sup>;
- weak incentive schemes for executives;
- weak law enforcement and poor investor protection.<sup>7</sup>

Table 1 summarises corporate governance mechanisms in developing and transition countries, illustrating their relative importance as well as their scope for policy intervention.

Table 1: Corporate Governance Mechanisms in Developing and Transition Countries

<b>Corporate governance mechanism</b>	<b>Relative importance in developing and transition countries</b>	<b>Scope for policy intervention</b>
Large blockholders	Likely to be the most importance governance mechanism	Strengthen rules protecting minority investors without removing incentives to hold controlling block
Marker for corporate control	Unlikely to be important when ownership is strongly concentrated; can still take place through debt contracts, but requires bankruptcy system	Remove some managerial defenses; disclosure of ownership and control; develop banking system
Proxy fights	Unlikely to be effective when ownership is strongly concentrated	Technology improvements for communicating with and among shareholders; disclosure of ownership and control
Board activity	Unlikely to be influential when controlling owner can hire and fire board members	Introduce elements of independence of directors; training of directors; disclosure of voting; cumulative voting possibility
Executive compensation	Less important when controlling owner can hire and fire and has private benefits	Disclosure of compensation schemes, conflicts of interest rules
Bank monitoring	Important, but depends on health of banking system and the regulatory environment	Strengthen banking regulation and institutions; encourage accumulation of information on credit histories; develop supporting credits bureaus and other information intermediaries
Shareholder activism	Potentially important, particularly in large firms with dispersed shareholders	Encourage interaction among shareholders; strengthen minority protection; enhance governance of institutional investors
Employee monitoring	Potentially important, particularly in smaller companies with high-skilled human capital where threat of leaving is high	Disclosure of information to employees; possibly require board representation; assure flexible labour markets
Litigation	Depends critically on quality of general enforcement environment, but sometimes work	Facilitate communication among shareholders; encourage class-action suits with safeguards against excessive litigation

5 Pajuste, Anete: What do firms disclose and why? Enforcing corporate governance and transparency in Central and Eastern Europe, in: Beyond Transition. The newsletter about reforming economies, The World Bank, December, 2004.

6 Aluchna, Maria, Mechanizmy corporate governance w spółkach giełdowych [Corporate governance mechanisms in public listed companies], Warsaw School of Economics, 2007.

7 Berglöf, Erik, Claessens, Stijn: Enforcement and good corporate governance in developing countries and transition economies', World Bank Observer, vol. 21, no. 1, 2006, pp. 123–150.

Corporate governance mechanism	Relative importance in developing and transition countries	Scope for policy intervention
Media and social control	Potentially important, but depends on competition among and independence of media	Encourage competition in and diverse control of media; active public campaigns can empower public
Reputation and self-enforcement	Important when general enforcement is weak, but stronger when environment is stronger	Depend on growth opportunities and scope for rent seeking; encourage competition in factor markets
Bilateral private enforcement mechanisms	Important as they can be more specific but do not benefit outsiders and can have downsides	Requiring functioning civil/commercial courts
Arbitration, auditors, other multilateral mechanisms	Potentially important, often the origin of public law; but the enforcement problem often remains; audits sometimes abused; watch for conflicts of interest	Facilitate the formation of private third party mechanisms (sometimes avoid forming public alternatives); deal with conflicts of interest; ensure competition
Competition	Determines scope for potential mistreatment of factors of production, including financing	Open up all factor markets to competition, including from abroad

Source: Berglöf and Claessens, 2006, p. 10.

## 2.2. Corporate Governance in Poland

As in other Central European countries, the starting point for the (re)emergence of the Polish corporate governance system is dated at 1989–1990 and includes systemic, institutional and regulatory reforms. As mentioned earlier, the case-by-case privatisation in Poland resulted in the presence of strategic and dominant shareholders in the ownership structure of privatised companies. The system that had emerged by the late 1990s revealed several shortcomings<sup>8</sup>:

- The dominant shareholders systematically adopted wealth transfer practices (transfer pricing, tunnelling) and abused minority rights (by blocking dividend payouts, denying minority shareholders representation on the supervisory board and providing limited access to corporate data, which all led to constant conflicts). These problems appeared to be relatively severe in cases of foreign or domestic strategic investors in privatised companies. This phenomenon has been analysed by Berglöf and Pajuste<sup>9</sup> and discussed from the perspective of weak external mechanisms and eclipsing capital markets.
- Some obstructive investors used to block or change general shareholder meetings and supervisory board agendas (due to a lack of procedures and company bylaws) and form short-term coalitions to take control over the company.
- The state was still present, sometimes with a controlling stake, in many public listed companies, which led to the appointment of politically connected colleagues instead of professionals to the supervisory board. Naturally, these individuals were replaced every time a new party won the parliamentary elections.<sup>10</sup> Therefore, the short-term-oriented, inexperienced and politically connected directors did not fulfil the control and monitoring functions of a supervisory board.

8 Aluchna, Maria: Shareholders fight for corporate control. Case studies from Poland, in: *Journal for Social Responsibility*, vol. 2, no 1, 2005, pp. 50–61.

9 Berglöf Erik, Pajuste Anete: *Emerging Owners, Eclipsing Markets? Corporate Governance in Central and Eastern Europe*, conference Law and Governance in the Enlarged Europe, 2002, Columbia University.

10 Since the start of the transition process, i.e. since 1989, none of the ruling party members in Poland managed to win in the subsequent parliamentary elections. Therefore, every four years (sometimes every two years in case of early elections), other parties formed the government and elected their 'representatives' to the supervisory boards of companies controlled by the state.

- Polish companies suffered from a lack of transparency, publishing very limited data. Many of them did not create internet websites and showed neither an interest nor willingness to enhance their information policies. As analysed by Pajuste<sup>11</sup> in terms of corporate disclosure, Polish companies were ranked last along with Bulgarian companies. Improving the transparency of listed companies remains the most important challenge for Polish corporate governance.<sup>12</sup>

The problems presented above were identified by the Polish Forum for Corporate Governance established at Warsaw Stock Exchange and were used as starting points for formulating a code of best practices<sup>13</sup> (2002, 2005). Current research and observation reveal that the second problem was fully eliminated whereas the first and third problems were significantly reduced: in several cases strategic investors withdrew from the stock exchanges; in other instances they managed to reach consensus with minority shareholders. Moreover, state involvement is lower and the Ministry of the Treasury has adopted a transparent competition procedure for the appointment of directors. However, companies still demonstrate inadequate awareness of corporate governance and a lack of understanding of control structures. Business practices do not indicate any major changes in terms of the role and position of independent directors, the establishment of an audit and remuneration committee and observance of the auditor rotation requirement.<sup>14</sup> What is more, the problematic dominance of strategic investors has been replaced by the dominance of founders, who in many cases fully control listed companies.

### 3. Efficiency of Corporate Governance in Transition Economies

The majority of corporate governance research has related a given control structure to corporate performance. The literature review delivers several recommendations for efficient corporate governance, pointing, for example, to the positive role of dominant investors, incentive compensation, an effective board and independent directors.<sup>15</sup> Additionally, on the macro level, a liquid stock market, strong investor protection, transparency and strong enforcement all lead to better corporate performance. The other research area refers to the efficiency of corporate governance in transition countries, because due to their varying stages of development and their specificity, this relation may not be obvious. Several analyses reveal that:

- Dominant shareholders do not always have a positive impact on corporate performance, and the position and role of the second biggest shareholder proves to be crucial.<sup>16</sup>
- The identity of the shareholders matters – financial and foreign investors prove to be more efficient than insiders<sup>17</sup> (e.g. CEOs, employees).

11 Pajuste, Anete: What do firms disclose and why? Enforcing corporate governance and transparency in Central and Eastern Europe, in: Beyond Transition. The newsletter about reforming economies, The World Bank, December, 2004.

12 Sroka, Iwona: 'Investor relations – teoria i praktyka w Polsce i w Unii Europejskiej' [Investor relations – theory and practice in Poland and the European Union] in: Ostaszewski Janusz, Zalewska Małgorzata. W stronę teorii i praktyki finansów [Theory and practice of finance], Warsaw School of Economics, 2006, p. 241–250.

13 'Dobre praktyki w spółkach publicznych 2002' [Good corporate governance practice in public listed companies 2005] – Committee of Good Practice Forum Corporate Governance, Polish Institute of Directors, 2002 Warsaw; 'Dobre praktyki w spółkach publicznych 2005' [Good corporate governance practice in public listed companies 2005] – Committee of Good Practice Forum Corporate Governance, Polish Institute of Directors, 2004 Warsaw.

14 Campbell, Kevin, Jerzemowska, Magdalena, Najman, Krzysztof: 'Wstępna analiza przestrzegania zasad nadzoru korporacyjnego przez spółki notowane na GPW w Warszawie w 2005 roku' [The initial analysis of compliance with the corporate governance guidelines by the companies listed on Warsaw Stock Exchange in 2005] in: Rudolf, Stanisław (eds.), Tendencje zmian w nadzorze korporacyjnym [Latest tendencies in corporate governance], Łódź University Press, 2007.

15 Mallin, Christine: Corporate governance, Oxford University Press, 2004.

16 Aluchna, Maria: Ownership concentration and corporate performance, in: Mickiewicz, Tomasz (ed.), Corporate governance and finance in Poland and Russia, Palgrave Macmillan, 2006, p. 194–214.

17 Grosfeld, Irena, Tressel, Thierry: Competition and corporate governance: Substitutes or complements? Evidence from the Warsaw Stock Exchange, William Davidson Institute, Working Paper no. 369, 15 March 2001, <http://eres.bus.umich.edu/docs/workpap-dav/wp369.pdf>

- The presence of shareholders on the board improves corporate performance.<sup>18</sup>
- Incentive compensation is correlated with performance and higher shareholder value.<sup>19</sup>
- Managerial independence is positively associated with financial performance.<sup>20</sup>

The other groups of studies focus on the correlation of the corporate governance index and performance. There are, however, few analyses covering transition countries and the efficiency of their control structures. Research conducted by KPMG suggests that in developing economies investors are willing to pay an extra corporate governance premium for shares of companies complying with internationally recognised recommendations. Another study conducted on the data on firm-level corporate governance ratings across 14 emerging markets (not covering transition countries) reveals that better corporate governance is correlated with better operating performance and market valuation.<sup>21</sup> These results support the findings of Credit Lyonnais Securities Asia in its study conducted on the sample of emerging Asian markets in 2001. Corporate governance proves to be crucial for transition countries from the perspective of economic development.<sup>22</sup> However, the number of studies on the relationship between corporate governance and performance is still limited.

## 4. Corporate Governance and Performance – Initial Stage

### 4.1. Research question

Since 2004 the Polish Institute of Directors has been conducting corporate governance ratings that cover companies listed on the Warsaw Stock Exchange. The rating is based on evaluations of companies prepared by institutional investors such as investment funds, pension funds asset management groups and banks, which together represent roughly 80% of the assets on the Polish market. All companies included in this rating fulfilled the requirement of having a minimum of 5 different evaluations delivered by institutional investors. The evaluation is based on four main criteria derived from OECD Principles of Corporate Governance<sup>23</sup>, which cover the following aspects:

1. Ownership structure
  - a. the transparency of the ownership structure
  - b. ownership concentration and shareholder control (influence)
2. General shareholder meetings
  - a. information providing for equal treatment of shareholders during the general meetings
  - b. voting and procedures applied at the general meetings
  - c. shareholder rights
3. Financial transparency and availability of the information
  - a. the quality and scope of financial information disclosed by the company
  - b. disclosure on time and access to financial information disclosed by the company
  - c. auditor independence and status

18 Aluchna, Maria: Mechanizmy corporate governance w spółkach giełdowych [Corporate governance mechanisms in listed companies], Warsaw School of Economics, 2007.

19 Kato, Takao, Long, Cheryl: Executive compensation, firm performance and corporate governance in China: Evidence from firms listed in Shanghai and Shenzhen stock exchanges, Sept. 2005, [ssrn.com/abstract=555794](http://ssrn.com/abstract=555794)

20 Filatotchev, Igor, Isachenkova, Natalia, Mickiewicz, Tomasz: Corporate governance, managers' independence, exporting and performance of firms in transition economies, William Davidson Institute Working Paper 805, 2005.

21 Klapper, Leora F., Love, Inessa (2002). 'Corporate governance, investor protection and performance in emerging markets, World Bank Policy Research Working Paper 2818.

22 Zheka, Vitalyi: Corporate governance determinants: the firms-level evidence from transitional country, Ukraine, 2006, [papers.ssrn.com/sol3/papers.cfm?abstract\\_id=979523](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=979523)

23 OECD (2004). Principles of corporate governance, <http://www.oecd.org/dataoecd/32/18/31557724.pdf>

4. Supervisory board structure and its processes
  - a. structure and composition of the supervisory board
  - b. the role and efficiency of supervisory board activity
  - c. function and role of independent members of the supervisory board
  - d. executive compensation

According to the rating procedures each company may receive a grade from –5 (unsatisfactory) to 5 (satisfactory), with 0 representing a neutral grade. The companies that received the required number of grades (at least ratings from 5 institutional investors in each category) were grouped into five different subgroups receiving from 1 to 5 ‘corporate governance stars’ as their final rating.<sup>24</sup>

## 4.2. Methodology

The research was based on a sample of companies listed on the Warsaw Stock Exchange that had been rated by institutional investors and had received ‘corporate governance stars’ (52 companies in 2004, 63 in 2005, 65 in 2006 and 33 in 2007). Additionally, the sample covered a control group of listed companies of similar size not classified in the rating. The main idea was to build a sample of companies complying with corporate governance best practices along with a sample of companies that do not follow the suggested standards at a satisfactory level. A few of the companies became de-listed and the information of their performance in the respective years was not available; these companies were thus excluded from the sample. There were 403 companies in the sample. The corporate governance rating was the independent variable, whereas the return on investment (ROI) calculated by the Warsaw Stock Exchange was taken into the analysis as the dependent variable. The rationale behind using return on investment based on the increase/ decrease of the share price was connected to the expected positive perception of the companies following best practices by investors. Positive investor reactions towards a company that was found ‘reliable’ were expected to be manifested in an increase in the share price. Additionally, the variable describing the year of the analysis was taken into account. The companies were analysed with standard SPSS software. The variables showed the normal distribution. Then regression analyses were conducted.

## 4.3. Research – Initial Results

The first analysis focused on the correlation between the corporate governance rating and return on investment. Additionally, the year variable was included. The regression reveals statistically significant negative relations. The model is presented in the table below [ $F(2,391)=5.24$ ;  $p<0.01$ ;  $R^2=0.03$ ].

Table 2: Regression Results (1)

Variable	RETURN ON INVESTMENT		
	B	Beta	T
Corporate governance rating	-14.93	4.67	-3.20***
Year	-5.12	8.31	-0.62
Const.	105.08		8.99***
Adj R <sup>2</sup>	0.03		

\*\*\*  $p<0.001$

The second analysis was conducted separately for four years (2004, 2005, 2006 and 2007). The regression reveals mixed results – the correlation is negative in all four years measured separately but the statistical significance varies. The model is presented in the table below [ $F_{2004}(1,91)=5.53$ ;  $p<0.01$ ;  $R^2=0.06$ ;  $F_{2005}(1,105)=2.53$ ;  $p=0.01$ ;  $R^2=0.02$ ;  $F_{2006}(1,126)=2.29$ ;  $p=0.014$ ;  $R^2=0.02$ ;  $F_{2007}(1,64)=3.74$ ;  $p<0.01$ ;  $R^2=0.06$ ].

24 Krupa, Krzysztof: Ład korporacyjny [Corporate governance], in: Forbes (Polska), June, 2006, p. 70–72; Polish Institute of Directors: Corporate Governance XXII – wręczenie nagród Spółka Godna Zaufania 2005 [Awarding ceremony for company worth trust], Warsaw Stock Exchange, 2005, p. 9–13.

Table 3: Regression Results (2)

		RETURN ON INVESTMENT		
2004	Variable	B	Beta	t
	<b>Corporate governance rating</b>	-20.14	-0.24	-2.35**
	<b>Const.</b>	107.22		4.93***
	<b>Adj R<sup>2</sup></b>	0.06		
2005	<b>Corporate governance rating</b>	-21.08	-0.15	-1.59*
	<b>Const.</b>	89.78		2.68**
	<b>Adj R<sup>2</sup></b>	0.02		
2006	<b>Corporate governance rating</b>	-9.69	-0.13	-1.49
	<b>Const.</b>	111.81		6.34***
	<b>Adj R<sup>2</sup></b>	0.02		
2007	<b>Corporate governance rating</b>	-6.94	-0.24	-1.94**
	<b>Const.</b>	41.29		4.74***
	<b>Adj R<sup>2</sup></b>	0.06		

\*\*\* p<0.001; \*\* p<0.01; \*p=0.1

As shown in Table 3, the negative correlation between corporate governance rating and ROI remains negative across the analysed period. The strongest statistical significance is observed in the first and the last year of analysis, i.e. 2004 and 2007. The correlation proved to be statistically insignificant in the third year of analysis, i.e. for 2006.

Finally, the separate regression conducted on the sample of companies included ratings by institutional investors (those which received 'corporate governance stars'). The results were positive but statistically insignificant. The model is presented in Table 4 [F(1,212)=0.43; p=08; R<sup>2</sup>=0.00].

Table 4: Regression Results (3)

		RETURN ON INVESTMENT		
Variable	B	Beta	t	
<b>Corporate governance rating</b>	0.6	0.14	0.21	
<b>Const.</b>	35.97		3.77***	
<b>Adj R<sup>2</sup></b>	0.00			

\*\*\* p<0.001

#### 4.4. Discussion

The results obtained from the initial stage of analysis between corporate governance and performance reveal statistically significant negative relations, which is inconsistent with theory and previously conducted research on both developed and developing countries. The discussion of these results should be outlined according to two possible explanations: 1) methodological shortcomings and the initial stage of analysis and 2) the specificity of the Polish stock market and the weak corporate governance system.

First, the paper presents the initial results of the analysis on corporate governance rating and performance measured by return on investment. The research could have used other performance indicators such as Tobin's q or accounting measures. Moreover, the control variables of company size were not included in the research. An additional solution would be to conduct event studies. Another possible methodological shortcoming could be the rating procedures: the institutional investors conducting the evaluations might have included well-known companies or companies with certain characteristics (e.g. higher liquidity, bigger trading volume, larger company size). It is important to emphasise that the number of companies cov-

ered by the last rating dropped significantly to only 33 companies out of 350 listed on the Warsaw Stock Exchange.

The second group of possible explanations is rooted in the characteristics of the Polish corporate governance system. The significant ownership structure may limit the information role of the stock market (and the stock price). Moreover, the trading is heavily biased by several huge companies such as PKN Orlen (national oil company), PKO BP (the biggest bank), KGHM (copper conglomerate) and TPSA (national telecommunications company). The analysed period covering the time of substantial increase of the share prices of listed companies stopped in late 2007 as result of the international effects of the subprime mortgage crisis in the US. Yet another relevant insight into the Polish system is that companies are resistant to corporate governance reform. The new code of best practices<sup>25</sup> aimed at increased transparency and harmonisation with EU directives<sup>26</sup> that became binding in January 2008 is often criticised or rejected. Some of the criticism comes from academics, who point out the lowering of the transparency standards as well as the reduction of the requirement of the proportion of independent directors and audit committees.<sup>27</sup> The resistance has also been observed by the listed companies, which report noncompliance with many newly introduced guidelines<sup>28</sup> (auditor rotation, supervisory board self-evaluation and risk report, increased transparency). Therefore, corporate governance may not be the strong determinant describing corporate performance (as seen in the research results in low  $R^2$ ) or may incur certain costs for companies complying with best practices.

## 5. Conclusion

This paper presented the development process of corporate governance systems in transition economies, focusing on the current situation in Poland. It discussed the main characteristics of corporate governance in Poland, addressing issues of ownership concentration, investor protection, development of the stock market and incentive mechanisms applied by the listed companies. Moreover, the paper attempted to identify the role of corporate governance rating in the process of improving control structure in Poland. More precisely, it analysed whether companies with better corporate governance standards perform better and bring higher returns to their shareholders.

The obtained initial results reveal a negative and statistically significant relationship between corporate governance rating and corporate performance measured as the return on investment, which indicates that compliance with standards of corporate governance does not lead to higher returns for investors (as a matter of fact, the reverse is true). Such outcomes are inconsistent with previous research and might to some extent be explained in the early stages of the standard-setting process in Poland and the relative underdevelopment of its corporate governance system. The other explanations for this finding are rooted in methodological shortcomings and limitations.

---

25 Code of best practice for WSE listed companies, Warsaw Stock Exchange, 2007.

26 Sobolewski L. (2007). 'Listed on WSE: corporate governance', CEO presentation on seminar organized by Warsaw Stock Exchange and Polish Institute of Direktor, March 5th.

27 Campbell, Kevin, Jerzemowska, Magdalena: The politics of corporate governance reforms in Poland, EURAM Conference, 14–17 May, 2008, Lublijana, Slovenia.

28 Kuchenbeker, Jacek: Dobre praktyki 2008: Zbiór zasad czy raczej lista pobożnych życzeń [Best practice 2008: A set of principles or wishful thinking], 5 May 2008, [www.bankier.pl/wiadomosci/print.html?article\\_id=1747027](http://www.bankier.pl/wiadomosci/print.html?article_id=1747027); Krukowska, Magdalena: Spór o lifling praktyk [Debate of best practice lifting], Forbes, July 2007.