Models of Corporate Governance Applied to Businesses in the Iberian Peninsula Stock Markets

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Abstract: This paper proposes to analyse models of corporate governance applied to businesses listed in the stock markets of the Iberian Peninsula, namely the ones of Lisbon and Madrid. The corporate governance subject is becoming increasingly important for businesses as it is difficult to manage the interests of every economic agents related to an organization. The corporate governance is characterized by a system in which organizations are managed and controlled with the objective to promote efficiency and competitiveness of businesses. This study is intended to examine the following issue: what are the determinants that may influence the choice of corporate governance models adopted by listed businesses within the Iberian Peninsula? To establish the determinants of the choice of model were selected nine variables that have differentiating characteristic between the models of corporate governance used by corporations in Portugal and Spain. Testing nine possible determinants, the sample employed consists of several businesses listed on the Iberian stock indexes PSI-20 and IBEX-35, over the years 2009 to 2011. The data was obtained through analysis of single annual and consolidated accounts from annual reports, including corporate governance reports. The statistical analysis was carried using the logistic regression model. The variables found to significantly influence the choice of corporate governance model in our study were: the sector of activity and firm size, contributing therefore to the justification of the choice of models of corporate governance adopted by Iberian businesses.

Key-Words: Corporate governance models, PSI-20, IBEX-35, Portugal, Spain, logistic regression model.

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1 Introduction

This paper is based on the analysis of the models of corporate governance based on the implications and motivations associated with the choice of these models by shareholder's businesses. This subject is becoming increasingly important for businesses as it is difficult to manage the interests of all economic agents in an organization.

In today's ever increasing competition and globalized business environment, manufacturers have been exploring innovative technologies and strategies to achieve and sustain competitive advantage [1]. The economy requires efficient and effective companies with the goal of creating wealth. For these purposes it is assumed the existence of a model of corporate governance that contribute decisively to achieving these ends and to introduce a transparent management [2].

There are two main systems of corporate governance: the Anglo-Saxon system, also referred to as external control system, and the Continental system, also referred as internal control system. The corporate governance emerges as a mechanism of protection of shareholders' rights and is fundamental for the company to create value and wealth for all groups, shareholders, directors and managers [3].

Given the complexity of the concept of corporate governance that has been developed, over time, to frame theories models and processes, being the most developed, and from which the models are adopted, the Agency theory [4]. This theory is to create systems of control and management that harmonize the interests between shareholders, administrators and managers within the company [5].

This research aims to assess the factors that drive companies from the Iberian Peninsula to choose among different models of corporate governance. This study is based on the introduction of relevant variables and in the analysis of the annual reports of consolidated accounts and annual reports of corporate governance during the period of 2009 to 2011 stock index companies PSI-20 and IBEX-35 so as to observe the factors that influence the choice of the policy the company follows.

This article includes three main sections, the first being the methodology consisting of the presentation of the hypotheses under study and the respective variables, as well as the statistical model used; the second section comes from the analysis of the empirical results, in particular, the characterization of the sample used, the presentation of the methods of data collection and the analysis of the models; and, finally, the third section presents the main results coming from the discussion of the conclusions of the research made.

2 A Corporate Governance model

The objective of this research aims to answer the question: what are the determinants that may influence the choice of corporate governance model adopted by companies of the Iberian Peninsula? To debate the issue one needs to analyse in detail some crucial variables for this topic.

More and more companies seek protection from a mechanism of shareholder rights specifying conditions for the creation of wealth and value on a sustainable basis for all groups. In this perspective it is essential to adopt corporate governance models to eliminate agency problems that may exist in companies [6]. The corporate governance structure consists of a set of specific functions and processes of inspection of the company's management actions [11].

The study of [9] concludes that the conflict between the owners and managers are important for the formation of the corporate governance structure and the delineation of strategies for the company.

The research made by [7] stresses the importance of disclosure of corporate governance information quality; this research contributes to the identification of the factors that explain the qualities in disseminating information to investors.

In accordance with the studies on this topic of strategic choices are not only taken by economic conditions or by the ability of the company but also by reflections from external and internal constraints of the company. This appears in the construction of the dependent variable of our study, as shown below.

2.1 Corporate Governance model choice

The corporate governance model variable is the variable explained by the model proposed in this paper, being classified as a dummy variable. This means, that the analysis is performed related to two different type of corporate governance models, the Latin model and the Anglo-Saxon model. The corporate governance model assumes the value of 1 if the model is Anglo-Saxon and 0 if the model is Latin, Continental type.

In relation to the determinants that influence the choice of the model of corporate governance an analysis was conducted of the variables which most influence this decision.

Therefore, the independent variables being studied in this paper are presented next, as well as the hypotheses that are to be tested and analysed.

2.2 Corporate Governance choice's explanatory variables

Supported in previous analyses on corporate governance, a set of relevant variables for the analysis of this topic was established. The variables subject to examination are: the stock market index (1), the company size (2), sector of activity (3), the ratio of the administration (4), the market capitalisation (5), shareholder concentration (6), and public capital (7). In this context, this research has as objective to develop a model based on the chance to examine empirically the relationship between these variables and the choice of a type of model of corporate governance. The explanatory variables, together with the presentation of the hypothesis under study, follow.

2.2.1 Portuguese and Spanish stock market

A company listed in the PSI-20 index or at index IBEX-35, [6], has a higher requirement in terms of disseminating information than other non-listed. This evidence may lead the company to choose a more transparent corporate governance model in which there is greater control, greater independence of the supervisory bodies and greater independent actors in the participation within the requirements of governing bodies, such as the case of the Anglo-Saxon model. This explanatory variable is given by the PSI-20 index indicators and IBEX-35 as a dummy variable that takes the value 1 if the company is part of the PSI-20 and 0 if the company is not part of the PSI-20, i.e. is part of the IBEX-35 index. In this case there should be a positive relationship between the dependent variable and the explanatory variable (Y = 1), leading to the following hypothesis:

H1: *the choice of corporate governance model is influenced by the stock market index*

2.2.2 Corporate size

According to [7] the company size is a relevant factor in corporate governance practices, as large companies have resources for the preparation of high-quality information [8] states that the size of companies is measured by sales, being an important factor for managers because it is one of the most important points to hint to all stakeholders about a company's indirect or direct performance. Thus, corporate managers may be encouraged, for example, to use financial techniques that will reduce the results of large companies in order to avoid transfers of funds of their societies. Following our literature review, the size of the company is determined by the following expression:

$$Company\ size\ i = \mathrm{Log}\ (sales\ i)$$

The size of the company is determined by the algorithm of the arithmetic average value of the sales and services of company *i* of the 2009 budget years, together with 2010 and 2011 [9]. According to [6], the larger or smaller company growth may explain the choice of a model of corporate governance that reflects better management by the board of directors and lower cost of business between the management and the shareholders.

In this case there should be a negative relationship between the dependent variable and the explanatory variable (Y = 0), leading to the hypothesis below.

H2: *the choice of corporate governance model is influenced by the size of the company.*

2.2.3 Sector of activity

According to [9] managers who achieve their goals in business take into account all sectors of activity shall they ensure compliance with the principles of corporate governance in the private sector and already translated to the public sector. To this purpose, managers must observe good corporate governance practices that enable greater efficiency, effectiveness and transparency of management.

This explanatory variable is a dummy variable that takes the value of 1 if the company *i* belongs to other services activities sector and 0 if the company *i* assume a different activity sector, apart from other services. In this case there should be a negative relationship between the dependent variable and the explanatory variable (Y = 0).

H3: *the choice of corporate governance model is influenced by economic activity sector of the company.*

2.2.4 Management ratio

The independent board of director's definition differs from one market to another; however, its main element remains the same. The general principle is that an independent administrator must enjoy full freedom in relation to management, and

other controllers that might influence their judgement [10].

Independent administrators should concentrate mainly on supervision function of society, which has led the move to put in the background other functions that were assigned to non-executive directors, such as the advice of society and of its portrait, or the strategic definition of corporate activity [2]. Following the literature review made, we adopted the expression below to determine the variable ratio of Directors:

$$\text{Ratio} = \frac{\text{admin nom executive}}{\text{independent admin}} /100$$

This variable is not aware of the impact on the choice of the model of corporate governance, but may impact it, therefore one can wonder whether:
H4: *the choice of corporate governance model is influenced by the ratio of the administration.*

2.2.5 Market capitalisation

The market capitalisation is a financial information that represents the value of a company from the point of view of the markets, being this value is related to the company's stock price. The market capitalization of a company is an estimate of the total value of the company from its listing on the stock exchange, being this estimate subject to possible abrupt variations resulting from speculative movements based on changing expectations about its financial results, or in anticipation of shocking events, such as mergers and acquisitions [2].

The market capitalisation is given by the following expression:

$$MC = No.of\ stocks\ of\ the\ year * Stock\ prices$$

In relation to this variable is unknown the impact on the choice of the model of corporate governance.
H5: *the choice of corporate governance model is influenced by market capitalisation.*

2.2.6 Shareholder concentration

According to [9], the concentration of shareholders is a relevant variable because of the importance that shareholders may have in an undertaking, in particular the internal conflicts.

As a measure of shareholder concentration, the analysis used was the Herfindahl index. This index is widely used as a method of assessing the degree of concentration in the market. The index is calculated as follows:

$$Hi = \sum_{i=1}^{n} (Si,t)^2$$

Where:

H^i – is the Herfindahl index for the company i

S^i,t – is Shareholder participation group in the company i

In this case the value of the index will vary between 1 and 0. The closer you are the 1 index, the higher the concentration shareholder. For each of the companies was tried to consider the five largest holdings. Some of the companies could not consider the five participations since there are a sufficient high number of significant shareholdings.

The base year for calculating the concentration shareholder is 2011, i.e. the year of reference for this study of the models of corporate governance. We consider that there should be a positive relationship between this explanatory variable and the dependent variable (Y = 1).
H6: *the choice of corporate governance model is influenced by the level of shareholder concentration.*

2.2.7 Governmental/public capital

Taking the company governmental public capital into consideration is needed for a corporate governance model in which the role of shareholders is prevalent, allowing shareholders to choice their executives and thus avoiding the more direct influence of public shareholders in the management of the company.

The best way to avoid the costs of business between shareholders and other public shareholders is the adoption of a model of corporate governance that allows greater power to the remaining shareholders [6].

The governmental/public capital variable is a variable dummy that takes the value of 1 if the company has governmental/state holdings and 0 if the company only has private equity. In relation to this variable we do not know what impact to expect on the choice of model.
H7: *the choice of corporate governance model is influenced by* governmental/*public capital.*

2.3 Logit model

The statistical model that will be used for the evaluation of the variables of this study is the logistic regression model. This econometric model is also known as logit model, being obtained on the basis that each test (*i* value) and on the set of explanatory variables/independent that can produce a final probability. This uses the logistic regression function. Through the linearization and logit transformation is obtained the following equation:

$$\log\left(\frac{\pi}{1-\pi}\right) = \beta_0 + \beta_{1x1} + \ldots + \beta_{pxp}$$

Where:

π - is the probability of occurrence of an event given

the occurrence of X in the observation i, of $1 \leq i \leq$ k,
k - is the number of existing observations,
β - is the coefficient of the independent variable X.

This transformation produces a model that is linear in the parameters. The unknown parameters are typically estimated via maximum credibility. β_i
The interpretation of the estimated values of the parameter is similar to additive effects on log β_i
odds ratio for a unit change in the explanatory variable. The statistical model of the problematic that we analyse here was determined based on the logit model.

With this econometric model we can analyse the variables that determine the choice of corporate governance model of enterprises within PSI-20 stock and IBEX-35 indexes, i.e. listed companies that belong the Iberian Peninsula area.

3 Analysis of the results

Presentation of the data collection methods and the characterization of the sample under study follow. In terms of analysis of the model, in particular, the results were obtained by means of statistical tests. The data collection methods are described below.

3.1 Data collection methods

Data collection was carried out through detailed analysis of the annual reports of the single and consolidated accounts and the analysis of the annual statement of corporate governance published by the companies under study, i.e. this analysis implied the collection of quantitative information. Other relevant information for this study was obtained through financial databases and annual reports published by Securities Market Commission (CMVM – Comissão de Mercado dos Valores Mobiliários) and the National Commission of the stock market (CNMV - Comisión Nacional del Mercado de Valores), for Portugal and Spain, respectively.

According to [8], the financial reports have important economic consequences at various levels, and increasingly the concern on the part of managers accountable to shareholders and creditors of the results of their decision making. Managers to maximize the value of their businesses are encouraged to reduce asymmetry in information and select financial techniques which make it possible to convert the reports published by the companies more informative to investors.

It should be noted that the disclosure of annual information corporate governance of listed companies in stock index PSI-20 and IBEX-35, by CMVM and CNMV, respectively, are not transmitted equally. While Portuguese companies are based on meeting the criteria of OECD indicating whether they are being applied correctly establishing a scale of compliance with these standards; in the case of Spanish companies, in addition, is detailed annual information being presented all the items with specific figures for each company based on clarifying the OECD's recommendations.

3.2 Sample characterization

The population under study consists of Portuguese and Spanish companies that are listed on the stock market, being the initial sample consisting of 20 companies of PSI-20 stock index and 35 companies IBEX-35 stock index. However, companies in the financial sector were excluded from this global sample, given the specificity of this sector, as it was not possible to analyse the fundamental aspect of the model, i.e. the financial structure measured by the interest coverage ratio [11]. And also due to the fact that the activities developed by financials do not create any real wealth or possessions, because they only play the role of financial intermediaries [12].

Furthermore, given the number of companies that adopt the dualistic model is reduced, and as we need to obtain statistically significant results in the study, we chose to also exclude companies that implement the policies of a dualistic model.

Therefore, using non-financial companies in the years 2009, 2010 and 2011 which could be found in the PSI-20 and IBEX-35 stock market indexes, the analysis was carried having as reference the date of December 31 of the respective year. It was verified the existence of input and output of non-financial companies stock market (i.e. entrance and exit from the indexes), resulting in a variation in the number of companies in the years under study.

These variations are due to the criteria that the stock market establishes for listed companies composing the indexes. If companies do not comply with the requirements of stock index, they may leave the index, giving rise to other companies that have attained these requirements, replacing the exiting companies.

3.3 Analysis of the logit model results

In this study 42 companies were observed in the year 2011. In the year of 2010, 43 companies were observed, together with 42 companies for the year 2009. In the table 1 we observe the results of the logit regression model for three years under review.

Table 1: results of logit model for the years 2010, 2011 and 2009

	year	11	year	10	year	09
V.	**Coef.**	**p**	**Coef.**	**p**	**Coef**	**p**
k	-0,61	0,61	-1,04	0,34	-0,71	0,51
(1)	0,60	0,53	0,13	0,89	-0,34	0,68
(2)	0,00	0,07	0,00	0,14	0,00	0,12
(3)	0,38	0,22	0,37	0,13	0,47	0,08
(4)	-76,8	0,15	-31,1	0,40	-21,0	0,43
(5)	0,00	0,51	0,00	0,43	0,00	0,51
(6)	-0,94	0,57	-0,76	0,57	-0,75	0,59

Vid. Section 2.2. for variables' definition.

In the year 2011 we find that only the variable company size is statistically significant with a significance level of 90% with $p \leq 0.05$ ($p = 0.074$). In the year 2010 we did not get any significant variable for the model, however, it is important to note that the sector of activity is the variable that has a lower default value for the other model variables. For the year of 2009, the sector of activity variable is statistically significant at a level of 90% with $p \leq 0.05$ ($p = 0.081$) and that the variable that has a default value lower is the size of the company.

In relation to the signs that the coefficients of the variables assume and the relationship between the dependent and independent variables it should be noted that over the years these signs remained the same for all variables, with the exception of shareholder concentration variable and the variable stock index, that in the year 2009 had negative sign and in other years have been given a positive sign. This variation of the signal of the variables and the significance of the model for the different years in study may be due to the entry and exit of firms in the PSI-20 and IBEX-35 stock market indexes.

As has already been mentioned, companies are evaluated every year and only remain in the stock market index if complying with the requirements, such as companies that request if they wish to enter the stock market. These evaluations are intended to contribute to the stability in the market, but may result in the instability of the corresponding indexes – if the level of exit and new entrances is high.

The variable shareholder concentration was not statistically significant, given that companies have a very concentrated shareholder structure as had already been referred to in the model analysed previously.

In relation to the sign of the relationship between the dependent and independent variables, it should be stressed that in the year of 2011 the relationship between company size variable and the dependent variable of the model of corporate governance is positive, i.e. a decrease in the size of the enterprise increases the probability of choice of the Anglo-Saxon model (Y = 1). This finding is in line with the previously argued; however, it should be noted that this conclusion cannot be statistically considered, despite being statistically significant at the 90% confidence interval, it cannot however be considered within the default significance level of 5%.

In the year 2009, the ratio of activity sector variable and the dependent variable of the model of corporate governance is positive, i.e. if not included in the activity sector of other services activities it increases the likelihood of being chosen the Anglo-Saxon model (Y = 1). This fact is consistent with the hypothesis defended earlier. However, it should be noted that this conclusion cannot be statistically considered, despite being statistically significant at the 90% confidence interval, cannot be considered when a significance level of 5%.

There are some important considerations to bear in relation to the analyses performed in this model. For example, it should be noted that the results were possibly skewed because the sample size is small. Moreover, companies are belonging to different market indices, implying different measures of disclosure of annual information from different corporate governance models. Portuguese companies are based in answering whether companies comply with the OECD criteria, and Spanish companies in the annual information offer

detailed information on the basis of clarifying and disclosing all OECD checklist and recommendations.

3.4 Variance inflation factors

The collinearity of the dependent variables is evaluated through the influencing factors of the variance in different years in analysis (VIF - variance inflation factors). Multiple correlation coefficients between the dependent variables and the independent variable must be less than 10, assuming values without collinearity problems. In the table 2 are shown the values relating to influencing factors of variance (VIF).

Table 2: Variance Inflation Factors (VIF) for the years 2009-2011

Variable	2011	2010	2009
(1)	1,345	1,16	1,174
(2)	1,186	1,153	1,28
(3)	1,31	1,077	1,04
(4)	1,079	1,037	1,077
(5)	1,093	1,057	1,275
(6)	1,088	1,088	1,093
(7)	1,087	1,027	1,112

Vid. Section 2.2. for variables' definition.

By analysing the collinearity of the variables tested in the model we can argue that there are no problems of collinearity between the variables for three years, that is, the values are relatively low, not exceeding the value of 1, which leaves no doubt as to the non-existence of problems of collinearity between the variables.

3.5 Evaluation of model's satisfaction

The evaluation of the satisfaction of a model is estimated through two indicators: the R-squared for McFadden and by analogy to the F-test based on credibility logarithmic (log-likelihood) and the test of credibility reasons.

R-squared of McFadden

	2011	2010	2009
R-squared of McFadden	0,23	0,23	0,20

Through the analysis of this indicator for evaluating the satisfaction and the quality of the model for three years under study, we can observe that the R-squared value of McFadden is approximately equal for both years, having a value of approximately 0,2. This value tends to approach zero.

F-Test

This test evaluates the model as a whole in order to compare the seven variables in a whole noting whether the model is statistically significant.

F-Test	2011	2010	2009
log	-21,407	-20,408	-20,778
Test	13,007	11,887	10,416
P-value	0,072	0,104	0,166

Through the test statistic we considered:
H0: $\alpha = \beta = 0$.
H1: $\alpha = \beta \neq 0$.
According to the statistical test and through the p-value analysis for the three years, looking if it rejects the null hypothesis for all years because $p \geq 0.05$. However, we can note that the year of 2011 it was obtained a value of $p = 0.07$ and the nearest value of $p \leq 0.05$. Thus, we can consider that the year 2011 has some combined statistical significance approaching a satisfactory model.

It is concluded that these models do not have a good level of satisfaction, i.e. the analysis model is not statistically significant and has no combined statistical significance.

3.6 Model prediction

We can observe that this model has a high level of forecast for every year under review. In the table 3 are presented the numbers of cases that the model can predict.

Table 3: Model prediction for the years 2011, 2010, 2009

Years	Cases provided	%
2011	29	69,00%
2010	30	69,80%
2009	31	73,80%

As for the prediction of this model we can see that it is good for every year, around 70%, or more. In the year of 2011, the number of cases "correctly predicted" is of 29 cases, it means that this template provides 69.0% of cases of the corporate governance model. For the year 2010, the number of cases "correctly predicted" is 30, this means that this model provides 69.8% of cases of the corporate governance model. As for the prediction of this model in the year of 2009, it is better than the previous years, predicting that this model forecasts correctly 73.8% of the cases of the model of corporate governance.

3.7 Residuals normality

As regarding residuals of the sample used, they were tested using the standard normality of residuals assessment, through the statistics of Chi-square test, where we considered:

H0: The error has normal distribution.
H1: The error does not have a normal distribution.

In the table 4 the results are presented concerning the tests of normality of the residuals.

Table 4: Test the normality of the residuals for the years 2011, 2010, 2009

Statistics	2011	2010	2009
Chi-square	4,148	11,877	10,855
P-value	0,126	0,003	0,004

According to the statistics of the Chi-square test for the different years of study it is concluded that the residuals' sample for the years of 2009 and 2010 have a normal distribution because the value of proof is $p \leq 0,05$. In the case of the year of 2011 the assumption of normality of the residuals may not be assumed.

4 Conclusions

There are many challenges in each area of scientific study [13]. The global market economy needs efficient and effective businesses for the purpose of wealth creation. For these purposes the existence of a model of corporate governance that contributes decisively to achieve these goals and that can helps to introduce transparent management is a critical factor [2]. The corporate governance models are increasingly recognized as an important component of sustainable economic development at international level [14].

In our study, we conclude that over the years there is a stream of incoming and outgoing stock market companies which implies instability not only for the markets of PSI-20 stock index, but also for IBEX-35, also influencing the determination of the model of corporate governance that can be applied for companies.

The main conclusions taken from the sample used is that there are only two years with statistical significance in relation to the variables studied, which are: in 2009 the sector of activity variable is statistically significant at a level of 90%, and in 2011 the variable size of the company has also a significance level of 90%. Nevertheless, the model is overall statistically significant and presents predictive power enough.

It is also concluded here that the choice of the model of corporate governance by companies is not performed randomly, because there are variables that influence this choice, as is the case of the variable activity sector, and the size of the company. It is estimated that over time the companies, according to several analysis ratios will do better while following OECD recommendations in order to approximate the management models from acceptable practices. Thus, it is likely that we are moving to an international market with listed companies on the stock exchange with an increasingly harmonious system while adapting the models of corporate governance at least at the European level.

The study faced several limitations. For example, we were only able to use a sample of 42 companies, not only because of the small size of Iberian stock markets, particularly the Portuguese one, but also because we eliminated financial companies, and, furthermore, because many non-financial companies did not provided some of the information needed for our study, particularly at the governance level. Concurrently, the jurisdiction is not always clear, or is even non-existent, in regard to the use and adoption of corporate governance models. This corporate discretionary power is often able to disguise shareholders' interests, particularly the non-controlling ones, assuming that controlling shareholders' deal directly with the management board. Therefore the identification of the governance model is not all times clear, sometimes is not even possible.

Despite limitations, one cannot forget that estimating the potential of dynamic economies and businesses is essential in order to understand not only what the perspectives now but as well which strategy to follow to get the most considerable results [15]. Knowledge is a crucial element in the life of a company, not only in daily activities, but especially to boost the innovation process and the implementation of new practices and processes, as is the case of corporate governance [16].

Finally, this article makes an important contribution to knowledge in general, and to business in particular, since there are still very few studies in corporate governance literature focused on the determinants that influence the choice of corporate governance models of the companies of the stock markets of the NYSE Euronext Lisbon, [17], and Madrid Stock Exchange. It is a topic that increasingly adds more importance to organizations

and to the public in general, which demands more transparency and fair practices.

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