

CORPORATE GOVERNANCE PERFORMANCE MEASUREMENT – KEY PERFORMANCE INDICATORS

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Abstract

Paper is focused to the current questions regarding to the corporate governance inwardly the actual professional scientific sources. The aim of the paper is finding out key performance indicators as a base for the Corporate Governance Performance Measurement. The paper includes also theoretical and practical insight of corporate governance in the Czech Republic. Contemporary cognition implicates the fact, that the questions regarding to corporate governance are very actual especially in relation to another pillar – sustainability of success (long term viability). Conclusions of theoretical and empirical insights are summarized in several selected results of the research made that deal primarily with the identification main questions of the corporate governance in companies from selected sectors in Czech Republic. Corporate governance in the Czech Republic is such that companies are very reluctant to pass on good governance models, recommended by international standards and it often leads to reduced performance and competitiveness in the market compared to foreign companies. The rankings of competitiveness of Czech Republic are lagging behind and one of the causes is also the poor corporate governance practice. There is often criticized vague judiciary, lack of regulatory interventions; there are criticized links of municipalities with the private sector and rampant corruption. In connection with the results of research and the requirements of the OECD we establish amount of key indicators of Corporate Governance, which will be later processed via multi-factor analysis and measurement. The paper is written in the framework of research project “Construction of Methods for Multifactor Assessment of Company complex Performance in Selected Sector” supported by Grant Agency Czech Republic (GACR) Reg. Nr. P403/11/2085 “

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JEL Classification: G38, L25.

Introduction

The issue of corporate governance (CG) takes currently on significance and becomes an important measure of tracking the performance and competitiveness of business companies. The field of corporate governance of companies is not only important for the functioning of the economy as a whole, but it touches all interested groups. Currently, the European Union intensively addresses the issue of corporate governance and is governed by a set of principles and rules of corporate governance. It seems to be that good corporate governance should help companies to be sustainable. The rules of the corporate governance are issued from the law and other different codices prepared by group of professionals according to the traditions of the partial countries. Legal base for the corporate governance is created within the framework of following EU directives and rules (Code of the Criminal Responsibility, Code of the Business Activities on the Financial Markets, Commercial Law, Principles of Auditors, and Bank Law) and from others codices (directions about offers undertaking 2004/25/ES), about the transparency of the listed corporation (direction 2004/109/ES), right of shareholders (direction 2007/36/ES), about market exploitation (direction 2003/6/ES) and about the audit (direction 2006/43/ES). The aim of the documents are achievement the transparency of the remuneration and coordination of the internal aims and interest of the stakeholders (employers, managers and members of the Board) with the strategic aims of the corporation. The creation of reliable methods of company performance measurement where concurrent acting of multiple factors is in play can be considered a prerequisite for success not only in decision making, but also with regard to corporate governance, comparison possibilities, development of healthy competition environment etc. There is a need for creation of such indicators for evaluation and comparison of the integrated performance in companies, which would be informing with a reasonable explanatory ability about the ESG-performance of the company. KPI indicators must meet the basic criteria: effectiveness, uniformity, determinability of the indicator, comparability and unambiguous interpretation. Selection of important and appropriate set of corporate governance indicators, which will become part of the ESG-performance indicators for the companies in the processing industry is the priority of the first stage of our research.

Research aim and research question: to accomplish comparative analysis (literature review and key documents relevant to Corporate Governance) and to select set of the key performance indicators as a base for the appropriate corporate governance performance measurement in selected industrial sector.

Research methodology: logical, content analysis of scientific sources, situational analysis based on the comparative method.

Definition of Corporate Governance

Corporate governance is defined by many of authors. Important publication in the field of corporate governance has been the work from authors Berle and Means (1933) where they analysed the impact of corporations and their managers influence not only on the venture but on the entire company. Mizruchi (2004) evaluated book of the authors: „In their book the authors warn against concentration of economic power of the emerging class of powerful professional managers who are isolated and protected against pressures from the shareholders, but also from society as a whole. Cadbury (1992) defines corporate governance: „system, whereby companies are managed and controlled. For management of the company are responsible statutory authorities. The responsibility of authorities includes setting up strategic goals, leadership pursuing these goals, control of management and information for shareholders about the performance of duty of economic manager". Keasley, Thompson and Wright (1997) defined CG as the complex of the structures, processes, cultures and systems, which stimulate successful progress of the company. New trends in corporate governance can be seen according to Kay, Silberston, (1999) in a single common goal, namely "to give the executive management the greatest possible freedom to develop long-term business in any way that seem them appropriate once they will have exactly specified responsibilities to all stakeholders involved in this business for their long-term performance. Herewith the hostile takeovers of companies will become really impossible; when from ownership of a majority share won't imply any rights for appointment of executive management."

According to ASX Principles of Good Corporate Governance and Best Practices Recommendations (2003) is corporate governance the system by which companies are directed and managed. It influences how the objectives of the company are set and achieved, how risk is monitored and assessed, and how performance is optimised. Good corporate governance structures encourage companies to create value (through entrepreneurship, innovation, development and exploration) and provide accountability and control systems commensurate with the risks involved.

The one of the general definition is issued from the documents of OECD Principles of Corporate Governance (2004), in which is CG define as progresses and processes according to that is the organization managed and controlled. Structure repair companies stress division of the rights and responsibility among various single parts organization, as are members board, managers, auctioneer et al. interested men, and establishes rules and progress for decision-making process (OECD, 2007). According to the OECD definition in KPGM CR (2005) "Corporate governance is a system by which is the company managed and controlled. The system defines the distribution of rights and responsibilities between stakeholders in society such as shareholders, executive management, statutory bodies, employees and customers or other interested person".

Monks and Minow (2008) focused on the structure and role of boards of directors and supervisory boards in corporations.

Corporate governance by authors Baker, Anderson (2010) examines the ways in which corporations are led, administered and controlled. Corporate governance also addresses the relations among different internal and external stakeholders as well as the processes of corporate governance that are designed to help the corporations to achieve their objectives. The centre of interest is such mechanisms and provisions that are designed to help to reduce or eliminate the problem of conflict of interest.

Deakin and Monks (see What is corporate governance? Defining corporate governance., 2012) said that corporate governance is about how companies are directed and controlled. Good governance is an essential ingredient in corporate success and sustainable economic growth. Research in governance requires an interdisciplinary analysis, drawing above all on economics and law, and a close understanding of modern business practice of the kind which comes from detailed empirical studies in a range of national systems.

Corporate governance (CG) is one key element in improving economic efficiency and growth as well as enhancing investor confidence. Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives

and monitoring performance are determined. The term “Corporate Governance” and its definition vary from country to country and reflect cultural differences. Although CG is defined differently in the variety of national economies, in basic level it includes following items: the mechanisms by which corporate managers are held accountable for corporate management and performance and the mechanism by which business is organized, directed, and controlled. (Krivogorsky and Dick 2011).

The Conceptual Framework of Corporate Governance

As we can see, there have been many opinions of different authors in the theoretical and practical sources analysis. In the past decades the various instruments have been introduced, involved in the corporate governance, either the reports discussing the risks and deficiencies of the companies and the codes of the good governance and management, the recommendations, setting the objective of more efficient governance and management of the companies. Besides the improvement of the effectiveness and company performance their objective is also to protect the owners, shareholders, creditors and other stakeholders. These recommendations contain the best practices, empirically verified codes of conduct (decision-making, target identification), facilitating the company to enhance higher efficiency.

The first four key documents, as specified by Kislíngerová and Novy (2005), have their roots in the Great Britain. The last document, so-called OECD Principles, is the result of the effort to introduce an internationally recognized document without explicitly defined field of action, which the individual states could join voluntarily. The basic documents (Kislíngerová and Novy, 2005): Cadbury Report, Greenbury Report, Hampel Report and Combined Code, Turnbull Report, OECD Principles of Corporate Governance.

Cadbury Report, published in 1992, presents the best practices and is involved in the financial aspects of the governance and management. Above all, it emphasizes the principles of the information openness, honesty and responsibility within the governance and management. The report comprehensively solves the relations of the parties in the company and introduces the best practices for their competence and conduct. The core components of the voluntary code, surnamed Cadbury Code, are as follows: a distinct division of the top management powers (mainly the post of the chairman of the board of directors must be separated from the post of CEO, or a strong independent element must figure in the board of directors), most of the members of the board must be the independent directors, the committee established for the remuneration of the members of the board must be formed by the majority of the non-executive directors, the board should appoint the audit committee, consisting of three non-executive directors as a minimum.

Another document, *Greenbury Report*, released in 1995, continued to keep up the tradition of the Cadbury report, and was interested in the remuneration of the top management members. The part of the Greenbury Report is also the best practice code, involved in the remuneration of the company directors, focusing mainly on: the formation, membership and role of the remuneration committees for the specification of the remuneration packets of the company directors, determinants of the remuneration policy for the executive directors and other managers, required level of data necessary for the shareholders as regards the details of the remuneration of directors as well as the fact whether the general meeting approval is necessary, duration of contracts on the post execution and specification of the compensation for the case of the cancellation in case of the inadequate results of the work of the particular director. Such recommendations were prepared especially in co-operation with large corporations; nevertheless, the principles can be applied to smaller companies as well.

Hampel Committee, established in 1996, was entrusted with the analysis of the impacts of the introduction of the previous recommendations and their re-formulation into the *Combined Code*. Against Cadbury and Greenbury reports, it primarily focused on the long-term increasing of the value of the interests of the shareholders, which was understood as the major objective. In comparison to previous two reports, focusing on the prevention of the abuse of the powers delegated to the management, this represented a fundamental shift. Another considerable step was the focus on the responsibility and audit. The board of directors bears the responsibility for the internal audit system development, which should guarantee (safeguard, monitor, protect) the investments of the shareholders. Moreover, the board of directors is responsible for all aspects of the risk management compared to mere financial audits recommended by Cadbury.

Combined Code was issued in 1998 for the first time, and is regularly updated. This code introduced the main and specific principles of the corporate governance, concerned with four areas: directors and board of directors, remuneration of directors, responsibilities and audit and relations with the shareholders. The code demands a clear division of responsibilities of the chairman, running the board, and the CEO, whose

main task should be the company's business. The roles of chairman and CEO should not be exercised by the same individual. Moreover, the code also discusses the procedure of the appointment of the board of directors, requirements to its development, re-election and assessment. The directors should be remunerated in a way attractive to them, able to keep and motivate them. Moreover, the code also formulates the financial reporting principle; the board must present a balanced and understandable assessment of the financial condition of the company's position and future prospects. Further, the board must also identify a clear system of the internal control, safeguarding the company's assets and the investments of the shareholders. The board shall establish an audit committee and shall maintain good relationships with the company auditors. The board shall also regularly inform the company shareholders.

In the year 1999 the Turnbull committee drew up a report "*Recommendation for Implementation of the Combined Code*", containing 14 best practices and 45 conditions, which all companies, listed in the London Stock Exchange, had to satisfy. The recommendations of the Turnbull report informs directors of their obligation to describe in detail the contents of the internal audit, to regularly evaluate and review the efficiency, to issue the annual reports on the function of the mechanism and - provided that no system of the internal audit is established in the company - to regularly evaluate its need.

The *OECD Principles* were formulated on the basis of the mandate of the ministerial Council from the year 1998 and were adopted in the year 1999. The principles represent a set of the basic principles, which the managers and members of the boards of the companies should apply in relation to the public, stock exchange, shareholders, trade units and stakeholders. The OECD Principles pay the attention mainly to the following key problems of the governance and management of the corporations: representative democracy in the corporations, protection of the rights of the owners, investors and creditors, capital management, especially increasing and decreasing of the capital, providing of the information and transparency, monitoring and evaluation of the company performance, accounting and financial management, self-assessment of the members of the boards, influence of the informal regulation- culture, ethics. The list is not exhaustive; the principles solve the issue as a complex, and in our view they contain all relevant fields of the corporate governance.

In view of the fact that the principles of the management of companies are closely linked with the cultural aspects of a certain society (business ethics, legal environment), the OECD Principles are formulated rather generally with the fact that their implementation in the national level would take into consideration all these aspects, thus facilitating the establishment of the regulations best fitting the particular business environment. Nevertheless, the OECD endeavors to support the implementation of these principles in the regional level by the organizing of the so-called regional roundtables, creating the space for the open discussion and exchange of the information among the experts both from the public and private sector and decision-making bodies. The results of these discussions are the so-called White Books, containing the factual recommendations for the correct setting of the principles of the *Corporate Governance*. At present time, the roundtables for the following regions are organized: Asia, Eurasia, Latin America, Russia and South East Europe (Kudělková, 2006).

The main OECD principles aim at: the provision of the effective legal and regulatory framework for the proper company management; protection and facilitation of the exercise of the rights of the shareholders; equitable treatment of the shareholders; enforcement of rights of the shareholders; arrangement of the disclosure and transparency of the information connected with the company, namely as regards its financial condition, ownership and company management; the responsibilities of the board of directors.

To harmonize the national CG codes a special forum was set up (*European Corporate Governance Forum*), presided by the Committee, with the participation of the prominent personalities involved in the issue of the *Corporate Governance* all over the Europe. The representatives of the member states, regulatory bodies, issuers, investors, academic world and other parties in the market participate. The forum was set up already in October 2004.

Corporate Governance in the Czech Republic

The concept of corporate governance in the Czech Republic was almost unknown a decade ago and this was reflected in the practice. Recently, however, awareness and education in this field begins to improve, especially due to pressure from European Union and initiatives of institutions such as the Securities Commission, the Institute of administrative authorities (CIoD), Czech Institute of Company Secretaries and others. There are companies that are specialized directly on education and advisory in this field as e.g. CG Partners.

The international standards *Corporate Governance* were applied in the national level within the framework of the Corporate Governance and Management Code. The corporate Governance and Management Code, based on the OECD principles, was released in the Czech Republic in the year 2001 for the first time; an amended version was published in 2004. The working group of the Securities Commission (Komise pro cenné papíry) under the supervision of Mr. Tomáš Ježek formulated the code. Mentioned code lays down a summary of the rules for the due practice of the governance and management of the company, some of them are already included in the rule of court of the Czech Republic. The code is intended especially for the companies traded in the public market; nevertheless, it is also the interest of other capital companies to follow the rules presented in the Code. The fundamental principles, upon the Code is based on, are as follows: personal responsibility of the executive directors, transparency of the acts of the board of directors, accountability of the governance and management by the shareholders, public and government. (Ježek, 2006)

In Czech Republic we may find companies that inclined to the Anglo-Saxon model, but also companies that inclined more to the German model. Important role in the ownership control of companies still play the banks. The current state of functioning of corporate governance shows some surveys from auditing firms and institutions, such as in 2005 the company KPMG ČR. The KPMG survey of corporate governance addressed 500 largest joint stock companies in the country. Total 76 members of supervisory boards responded and 166 members of the boards of directors from total of 242 public limited companies.

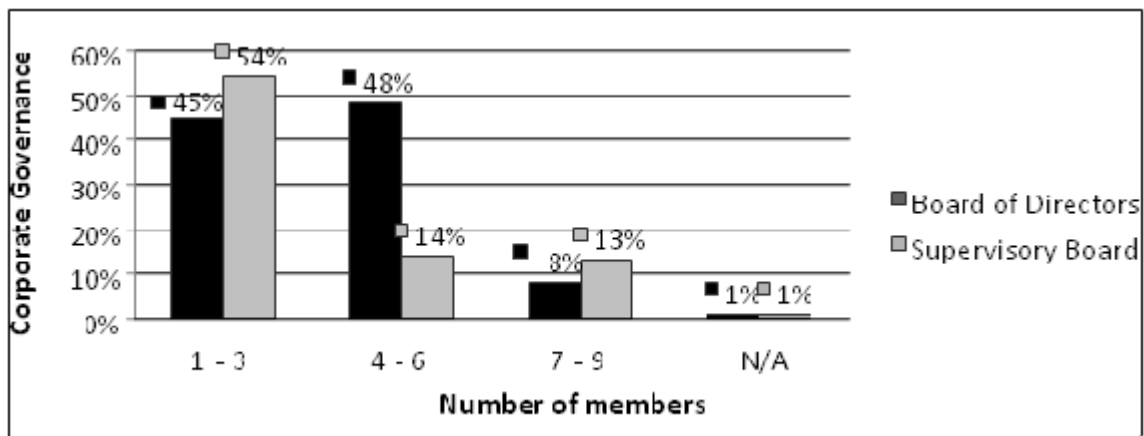


Figure 1. Number of members of the Corporate Governance in the ČR
Source: KPMG, 2005

The KPMG survey (2005) shows that among the surveyed companies has a typical Board of Directors in CR three members, the second most usual number of members is five, see Fig 1. Typical supervisory board has three members or six members. Average number of members of administrative authorities (9.6) does not reach the values current in EU, where the average is (12.5) members (see Haspeslagh, 2005).

The average size of the Board observed in investigated joint stock companies is 4.1 members; the number of members of the Supervisory Board is 5.5. Typical is a Board with three members (45 %), typical Supervisory Board has three members (54 %).

The characteristic form of corporate governance in the Czech Republic, according to Blazek (1999) is the result of a specific form of voucher privatization method. Although the Czech model of corporate governance may commemorate the Anglo-Saxon model, it is different in many ways. Above all, it is the position of banks, which became after privatization significant owners, but also creditors of many enterprises. Confused capital market is another difference of the Czech model from Anglo-Saxon model of corporate governance. This could imply that the Czech model is rather similar to the German model, but there are also some differences. In the Czech model, however, due to lack of legal regulation is in many cases exactly the opposite situation. So, the chairman of the Board can be also one of the principal owners. Such an arrangement reduces the powers of the management and disrupts the integrity of management, but also reduces their responsibility for bad decisions.

According to Kavalir (2005) there is the level of good corporate governance plays an increasingly important role in the assessment and valuation of companies by investors. High importance of corporate governance comes from the fact that most large companies are owned by one group of people (owners) and governed by entirely different group of people (executive management). Adherence to the principles of good

governance is one factor that increases the owners' confidence in the executive management and contributes to the protection and development of their investment.

Table 1. List of Selected Indicators of the Corporate Governance

Indicator		Source
Title	Description	
Management	Frequency of the executive body sessions	Corporate Governance and Management Code
Ownership concentration	Concentration of owners – right to vote per models	The OECD principles of CG, Annex: Indicators of Corporate Landscape OECD 2007
	Percentage distribution of the ownership per various categories of the investors	
Members of the board	Number of members from the point of the professional competences	Green Book - a governance and management of the company in the financial institutions and remuneration policy
	Percentage representation from the point of the international representation	
	Percentage representation of the members from the point of both sexes	
Stakeholder effectiveness	Percentage representation of the independent members	Corporate Governance and Management Code
	Separation of the posts CEO/chairman	IFAC (International Federation of Accountants)
	Independency of the board members and audit bodies	Corporate Governance and Management Code IFAC
	Duration of the membership in the board	IFAC
	Remuneration of the board -stimuli	IFAC
	Remuneration of the board – quantity of bonuses	Recommendation of the Council 2009/385/EC dated April 30, 2009, amending the recommendations 2004/913/EC and 2005/162/EC
	Remuneration of the board – offer (purchase, sale of shares)	IFAC
	Remuneration of the board – quantity of shares versus salary	
	Remuneration of the board - long term and short term obstacles	
	Percentage of women in the board	
	Signs of the risk management and policy implementation- division of competencies for the risk management	
	Stakeholder engagement	Frequency of the involvement of the stakeholders
Existence of the mechanisms of the involvement of the stakeholders		
Methods of the responses to the feedback from the stakeholders		
Conduct, litigation risk corruption	Records on the breaching of the regulations and extra costs	IFAC
	Corruption in comparison to the percentage of revenues in the region	
	Corruption - number of the analyzed business units	
	Total sum spent on the correction, penalties, expenses and putting out of operation	
	Payments to the state and the total value of the financial and subsistence contributions to the political parties, politicians and allied institutions	
	Right of vote equality	

Source: authors

Generally, various advisory sources exist for selection and application of the measures of performance and key performance indicators. An important aspect seems to be mainly the responsibility for performance to strategic objectives, including sustainable performance. This requires an understanding of causal relations between various activities and their impact on both financial and non-financial performance. The link to assessment and performance measurement is usually a feature of majority successful companies. Naturally, assessment and efficiency measurement arise in earlier stages of the identification of key impacts of sustainability and identification and monitoring of the progress towards the objectives. In the framework of the research project was paid attention into huge of sources to looking for appropriate set of corporate governance indicators. The results of the current monitoring of the indicators in the area of corporate governance can see in the table 1. Via comparative analysis were selected 5 areas of CG indicators, all of them are included mainly in key sources regarding to corporate governance (IFAC, Corporate Governance and Management Code, The OECD principles of CG and Green Book). There are descriptions of the indicators in the second column of the table 1, which could be base for the further sophisticated analysis of the key corporate governance indicators. Selection of key performance indicators depends on the industry in which the particular company is active. Our research will be focused on the selection of indicators for the processing industry. The results should be further empirically verified together with the verification of indicators from other spheres – economic, environmental and social.

Discussion

Currently, the European Union intensively addresses the issue of corporate governance and is governed by a set of principles and rules of corporate governance. Corporate governance in the Czech Republic is such that companies are very reluctant to pass on good governance models, recommended by international standards and it often leads to reduced performance and competitiveness in the market compared to foreign companies (Bartes, 2011). The rankings of competitiveness of Czech Republic are lagging behind and one of the causes is also the poor corporate governance practice.

There is often criticized vague judiciary, lack of regulatory interventions; there are criticized links of municipalities with the private sector and rampant corruption. Freedom of corporate governance is impossible without compliance with legal requirements such as legal, economic, environmental and social, i.e. also ethical standards. The consequence of unethical behaviour is often a failure of governance.

Questions of the following research in the area of corporate governance concern about well-governed corporation and good practices (Klirova, 2008; Klirova, Kavalir, 2009; Krivogorsky, 2011), principles of good corporate governance (ethical approach-culture, society, organisational paradigm; balanced objectives-congruence of goals of all interested parties; each party plays his part-roles of key players: owners/directors/staff; a decision-making process is in place which is based on a model reflecting the above giving due weight to all stakeholders; stakeholders are treated with equal concern- albeit some have greater weight than others; accountability and transparency: to all stakeholders).

In 2010 a relation between CG and voluntary reporting from the point of stakeholders (e.g. investors, financial bodies, municipalities etc.) was investigated within the framework of our research project. One of the partial output is that the reporting seems to be another very essential tool for the improvement of the situation in the field of the Corporate Governance, especially making the contribution for the shareholders, interpreting - at the same time - the important data to the external stakeholders, such as investors, financial bodies etc. especially as regards the company performance evaluation.

Conclusion

Another key area, in which the research is interested, is the field of the sustainable success; this particular field is connected with the identification and construction of the key indicators in the environment, economic, social spheres and corporate governance.

In connection with the professional and scientific sources, results of research and the requirements of the environments it is now in the centre of the company performance monitoring necessary to establish key indicators of Corporate Governance (Kiernan, 2007; Kocmanova, Nemecek, 2009; Kocmanova, Hornugova Klimkova, 2010; Hrebicek, Stencl, Trenz, Soukupova, 2011; Chvatalova, Kocmanova, Dočekalova, 2011; Kocmanova, Dočekalova, Němeček, Šimberova, 2011; Kocmanova, Dočekalová, 2012) which would be part of key performance indicators ESG and would characterize the global environmental, social and governance (Corporate Governance) issues that investors are considering in the context of corporate behaviour. The

sphere of the indicator construction seems to be simple at first glance; nevertheless, the identification and list of the indicators is a rather complex issue as various theoretical as well as practical starting points, mentioned e.g. also in this paper (such as cultural and national differences, time shift in the awareness of the corporate governance issues, best practices etc.) must be taken into account; furthermore, a question of the measurement of the individual indicators must be answered (clarification of the content from the point of the definiteness, setting of limits, specification of the measurement units etc.) and last, but not least, also the field of the overlapping of the individual indicators with other spheres (e.g. especially social sphere).

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