Corporate Governance in Alternative Investment Market (AIM) Companies

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CORPORATE GOVERNANCE IN ALTERNATIVE INVESTMENT MARKET (AIM) COMPANIES

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AIM is the world’s leading market for smaller, growing companies from all over the world. Since its launch in 1995, over 2,500 companies have chosen to join AIM, creating a unique community of innovative and entrepreneurial companies. One of AIM’s key features is its simplified regulatory environment specifically designed for the needs of smaller companies. This means that AIM companies are not obliged to abide by the UK’s Combined Code. However, it is considered best practice for AIM companies to comply with good corporate governance practice as far as possible and to this end the Quoted Companies Alliance (QCA) has produced Guidelines on Corporate Governance for AIM Companies, based on the UK’s Combined Code.

This report elicits the views of AIM company directors; AIM investors and AIM nominated advisors (NOMADs) on corporate governance issues. The study includes a detailed analysis of corporate governance statements in the annual reports of 300 AIM companies to assess the overall compliance with the QCA guidelines and to determine which areas may prove problematic for these smaller companies.

The study identifies that the ‘lighter touch’ on corporate governance for AIM companies seems to be working quite well with institutional investors recognising that full compliance with the Combined Code is not always appropriate for AIM Companies. The report however does highlight a concern that, with the rapid expansion of AIM and the increasing number of overseas companies, from countries whose culture of good governance may be weaker than that of the UK, a damaging financial collapse or scandal is only a matter of time. This concern suggests that although the current framework seems to be
working the sector should not be complacent. The authors therefore conclude with the following important and potentially far reaching policy implications:

- the role of the NOMAD should be re-examined;
- the admission of overseas companies to AIM should be more closely scrutinised;
- small boards which may not be able to institute all the features of ‘good’ corporate governance should consider increasing the number of directors on their board, subject to resource constraints; and
- the regulatory authorities should monitor more closely the governance of AIM companies which have yet to start trading.

This project was funded by the Scottish Accountancy Trust for Education and Research (SATER). The Research Committee of The Institute of Chartered Accountants of Scotland (ICAS) has also been happy to support this project. The Committee recognises that the views expressed do not necessarily represent those of ICAS itself, but hopes that the project will contribute to the development of corporate governance practice in this vibrant and important sector.

David Spence
Convener of Research Committee

March 2008
We would like to thank the directors of Alternative Investment Market (AIM) companies, the institutional investors, nominated advisors and brokers, and other market participants who gave their time for personal interviews.

We would also like to thank Bashar Al Z’ubi, our research assistant on this project, for his enthusiasm in compiling an extensive database from AIM companies’ annual reports and accounts.

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EXECUTIVE SUMMARY

Background to the project

The Alternative Investment Market (AIM) was launched in June 1995 as a market for small and medium sized companies, when ten companies valued at a total of £82.2m registered on the first day. The market offers opportunities to smaller and fast-growing companies to raise new capital, allowing their shares to be traded widely and for their owner/managers to liquidate some of their shareholdings. The more relaxed admission rules have proved attractive not just for UK companies but also for overseas companies wishing to obtain a listing in the UK. The post-Enron climate in the USA, which led to the introduction of the Sarbanes-Oxley Act (2002), also saw many companies discouraged from trying to list in the USA and a resultant surge of interest by overseas companies in the UK’s AIM. The popularity of AIM with overseas companies is evidenced by the fact that by the end of October 2007, of the 1,678 companies on AIM, 334 were international companies whilst 1,344 were UK companies.

AIM is important for market confidence as significant failures of companies on this market would have a negative impact on the confidence in the UK market as a whole. A consequence of the deliberately light regulatory burden placed on AIM companies means that they are not obliged to abide by the UK’s Combined Code (2006). However the Quoted Companies Alliance (QCA) has produced Guidelines on Corporate Governance for AIM Companies, which are based on the UK’s Combined Code. It seems fair to say that AIM companies are expected to comply with corporate governance best practice as far as possible because,
as companies on AIM, they have access to a wide base of investment ranging from institutional investors to private shareholders so there are certain expectations as to how AIM companies will be governed.

**Research objectives and research approach**

Several research objectives are addressed in this research project as follows:

- to assess the overall level of compliance by AIM companies with the QCA Guidelines on Corporate Governance;
- to determine which areas may prove problematic for these smaller companies; and
- to elicit the views of AIM company directors, AIM investors and other AIM participants on corporate governance issues.

Face-to-face interviews were carried out with: AIM company directors; institutional investors who invest in AIM companies; and nominated advisors (NOMADs)/brokers of AIM companies. The interviews provide a rich source of material for discussion and insights into the Alternative Investment Market.

A detailed analysis of the corporate governance statements in the annual report and accounts of 300 AIM companies was also carried out. A multiple regression model was constructed and data collected from Hemscott and Datastream databases as well as from the 300 sample companies’ annual reports to determine the significance of specific firm and market-related variables on the extent of corporate governance disclosure practice.
Findings of the research

The interviews provide some interesting findings. Firstly, the AIM company directors indicated that their main reason for joining AIM was to enable them to raise money for future financing of the business or for acquisitions, and to gain access to institutional investors. It is perhaps then not surprising that one of the main objectives of corporate governance was identified as being to protect the interests of shareholders and other stakeholders. Good corporate governance was generally seen as something that would give investors more confidence in the company and help with the risk management aspects of the business. Equally, some of the directors felt that the costs of corporate governance in terms of directors’ time were quite high and opinions as to whether corporate governance per se added value were divided.

Interestingly, and of some concern, is that a common theme from the AIM company directors, and the institutional investors, was a worry that, with the rapid expansion of AIM, and with the admittance of an increasing number of overseas companies, the standards of corporate governance were sometimes not all that might be expected and a damaging financial collapse or scandal was only a matter of time.

The findings from the interviews with the NOMADs/brokers show that they do not perceive their NOMAD role as being as important as their role as a broker to AIM companies, and the fact that they do not tend to actively give corporate governance advice is perhaps another aspect that may give added weight to concerns about the quality of governance in some AIM companies.

From the detailed analysis of the corporate governance statements in the annual report and accounts, it was found that the basic elements of good governance practice, such as including a corporate governance statement, the presence of board sub-committees, identifying the directors and their responsibilities, and splitting the role of chairman and CEO are disclosed by the majority of the sample AIM companies.
The QCA Guidelines on what independence means and having at least two independent non-executive directors (NEDs) were moderately adopted. The level of disclosure was low for aspects of governance that reveal more personal matters like evaluating directors’ performance and their attendance at their board meetings.

Overall, the sample of AIM companies disclosed less corporate governance practice than expected from the recommendations stated in the QCA Guidelines. This indicates that AIM companies can, and should, increase their disclosure levels especially in the areas that influence investors’ decisions like the issue of NEDs’ independence and reporting on the formal evaluation of directors’ performance.

The regression of the firm and market related factors on the disclosure score produces some interesting results. First, young AIM companies are more likely to disclose more of their governance practices than older AIM companies. Second, larger companies disclose more. Third, the presence of institutional investors does not affect disclosure levels. Fourth, a higher gearing ratio reduced disclosure levels. It suggests that equity investors in AIM companies with no long-term debt borrowings may expect better governance structures to protect their claims as there are no debt holders to monitor companies.

The reporting of governance practices increases with board size and shows that wide adoption of the QCA Guidelines may be impaired if companies have small boards. The type of nominated adviser and audit firm are not influential in determining the disclosure level. Ex-main market companies have higher disclosure scores indicating that they generally continue to maintain the governance structures and disclosures that they had when they were listed on the main market. The relatively low level of disclosure by the majority of sample companies in the basic materials and oil and gas sector industries with no reported trading revenue, may indicate potential weakness in their corporate governance. Hence, these companies may be more vulnerable to financial problems. In summary, the findings suggest that the internal dynamics of AIM
companies like company size, board size and gearing levels exert a greater influence on voluntary corporate governance disclosures than market-related factors like the type of external advisor or auditor.

**Issues for consideration**

There are a number of issues for consideration and policy implications arising from the findings of this research into the current corporate governance practices in AIM companies. The issues revolve around: the adoption of best practice corporate governance by AIM companies; their relationship with institutional investors; the role of NOMADs; the reputation of AIM as a whole; and corporate governance disclosures in the annual reports of AIM companies.

A summary of the findings are:

- The ‘lighter touch’ on corporate governance for AIM companies seems to be working quite well, with directors’ own sense of best practice and investor expectations usually helping to ensure that appropriate governance practices are adopted.

- Institutional investors seem to act with an appropriate degree of flexibility towards corporate governance in AIM companies, recognising that the standards expected of a company with a full listing are generally not appropriate for AIM companies.

The policy implications are as follows:

- Given the significant role to be played by a NOMAD, both for companies coming to AIM and for those already on AIM, the role of the NOMAD, in relation to corporate governance practices and disclosure, could usefully be re-examined to see whether they are carrying out their role appropriately, and showing due diligence in
their relationship with their AIM clients. With the rapidly growing AIM market, the role of the NOMAD as originally envisaged may not still be viable. An appropriate monitoring mechanism may need to be put in place to try to ensure that there is a fruitful relationship between the NOMAD and its AIM clients.

- The admission of overseas companies to AIM should be more closely scrutinised, particularly when the company’s home country has much weaker corporate governance than in the UK.

- AIM companies with small boards should increase the number of directors on their board, subject to practicability/resource constraints, as small boards may not be able to institute all the features of ‘good’ corporate governance such as key board committees being comprised of independent non-executives; and splitting the roles of Chair and CEO.

- The regulatory authorities should monitor more closely the governance of AIM companies which have yet to start trading so that the monies raised during admission are not being misused.

In general, the voluntary adoption of the QCA best practice should be maintained.
The Alternative Investment Market

The Alternative Investment Market (AIM) is attractive to smaller and fast-growing companies wishing to raise new capital, have their shares traded more widely and provide the opportunity for their owner/managers to liquidate some of their shareholdings. Although AIM was established to succeed the Unlisted Securities Market (USM), its admission requirements and on-going rules are less onerous than those of the now defunct USM. For example, there is no minimum market capitalisation requirement, no minimum trading record and no minimum percentage of shares required to be held in public hands. AIM membership rules have been kept simple to encourage a wide variety of companies to join and keep capital raising and membership costs to a minimum. To dispel the investor community’s concern over these ‘relaxed’ admission rules, the London Stock Exchange (LSE) introduced an unofficial class of sponsors, called nominated advisors (NOMADs), to effectively verify their AIM clients’ financial soundness and health.

The more relaxed admission rules have proved attractive, both for UK companies and for overseas companies wishing to obtain a listing in the UK. In addition, the introduction of the Sarbanes-Oxley Act (2002), with its onerous requirements, saw many companies discouraged from trying to list in the USA and, as a result, there was a surge of interest by overseas companies in the UK’s AIM. The popularity of AIM with overseas companies is evidenced by the fact that by the end of October 2007, of the 1,678 companies on AIM, 334 of these were international companies whilst 1,344 were UK companies. In terms of international
companies on AIM, Australia account for 13.5%, the USA for 13.2%, Canada for 12.9%, Republic of Ireland for 12.3%, and the Cayman Islands for 9.6%.

The equity market value of companies on AIM as at April 2007 ranged from companies with less than a million pounds in equity market value to companies with a value in excess of £1,000 million. However, 38% of companies fall in the equity market value range of £10m-£50m, whilst 65% fall in the equity market value range of £5m-100m.

From Table 1.1 and Figure 1.1, it can be seen that companies joining AIM are most often in the financials, industrials, and consumer services sectors.

Table 1.1  AIM summary statistics

<table>
<thead>
<tr>
<th>Industry sector</th>
<th>Number of companies</th>
<th>Market capitalisation as at April 2007 (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financials</td>
<td>354</td>
<td>30,584.2</td>
</tr>
<tr>
<td>Industrials</td>
<td>293</td>
<td>14,872.8</td>
</tr>
<tr>
<td>Consumer services</td>
<td>244</td>
<td>12,238.9</td>
</tr>
<tr>
<td>Basic materials</td>
<td>216</td>
<td>20,155.6</td>
</tr>
<tr>
<td>Technology</td>
<td>187</td>
<td>5,927.0</td>
</tr>
<tr>
<td>Health care</td>
<td>115</td>
<td>4,883.9</td>
</tr>
<tr>
<td>Oil &amp; gas</td>
<td>110</td>
<td>12,024.3</td>
</tr>
<tr>
<td>Consumer goods</td>
<td>78</td>
<td>2,526.9</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>29</td>
<td>846.5</td>
</tr>
<tr>
<td>Utilities</td>
<td>11</td>
<td>1,673.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,637</strong></td>
<td><strong>105,733.1</strong></td>
</tr>
</tbody>
</table>

Rationale for this research

AIM is important for market confidence as significant failures of companies on this market could have a negative impact on the confidence in the UK market as a whole.

A consequence of this deliberate light regulatory burden placed on AIM companies means that they are not obliged to abide by the UK’s Combined Code (2006). However, because small companies should be just as interested as larger ones in practicing good governance, the Quoted Company Alliance (QCA), an organisation formed to promote the interests of smaller quoted companies including those on AIM, has produced a set of Guidelines on corporate governance for these companies. The objective of this research is to assess the level of compliance by AIM companies with the Combined Code in general, and QCA Guidelines in particular, and to determine which areas may prove most problematic for these smaller companies.

To answer these research questions, the report has been structured as follows. The following chapter reviews the development of corporate governance and the AIM market and previous research in this area.
Chapter three provides an outline of the research objectives of this study and the methods used. Chapter four details the findings of interviews carried out with AIM company directors, institutional investors, and nominated advisors (NOMADs)/brokers. Chapter five provides a detailed analysis of the corporate governance statements in the annual reports of AIM companies. Finally chapter six summarises the issues emerging from the findings of the research, considers the implications for policymakers and other interested parties, and mentions possible future areas of research.
Introduction

In this chapter the development of corporate governance in the UK is reviewed, with a particular emphasis on how it may impact on smaller companies. The main provisions of the UK’s Combined Code on Corporate Governance 2003 (as amended in 2006), are reviewed as well as the Guidelines of the Quoted Companies Alliance (QCA) for corporate governance in AIM companies. These Guidelines are based on the provisions of the Combined Code on Corporate Governance, but recognise some of the problems that may confront smaller companies which try to implement ‘best practice’ corporate governance structures.

Development of corporate governance in the UK

Over recent years, the governance of organisations, in particular listed companies, has attracted discussion, debate and promulgation of codification and regulation by various public committees and regulatory bodies. In the UK, a number of committees were set up to investigate and recommend principles of good corporate governance and Guidelines for best practice (Cadbury, 1992; Greenbury, 1995; Hampel, 1998; Higgs, 2003). Under the listing rules, a company listed on the main UK stock exchange is required to comply with the provisions of the Combined Code (1998) drawn up from the recommendations of the Cadbury, Greenbury and Hampel reports. The Combined Code was later revised in 2003 to incorporate the recommendations of the Turnbull Report on Internal Control (revised and republished as the Turnbull Guidance
in 2005), the Smith Guidance on Audit Committees and elements of the Higgs Report. The Combined Code was further revised in 2006 and applies to reporting years beginning on or after 1 November 2006. A consultation for further proposed changes was issued by the FRC in December 2007, requesting responses by March 2008.

The Combined Code on Corporate Governance (2006) contains broad principles and specific provisions. It is divided into two main sections. The first section is on companies with parts on:

- directors;
- remuneration;
- accountability and audit; and
- relations with shareholders.

The second section is on institutional shareholders.

According to the website of the Financial Reporting Council, the main changes to the 2003 Combined Code are to:

- amend the existing restriction on the company Chairmen serving on the remuneration committee to enable them to do so where considered independent on appointment as Chairman (although it is recommended that they should not also chair the committee);
- provide a ‘vote withheld’ option on proxy appointment forms to enable shareholders to indicate if they have reservations on a resolution but do not wish to vote against. A ‘vote withheld’ is not a vote in law and is not counted in the calculation of the proportion of the votes for and against the resolution; and
• recommend that companies publish on their website the details of proxies lodged at a general meeting where votes are taken on a show of hands.

A company listed on the UK main stock exchange is required to report in its annual report, via a statement of corporate governance, how it has applied the principles of the Code, and to either confirm its compliance with the Code’s provisions or, where it has not, to provide a proper public explanation as to why it has not complied. It is recognised in the Combined Code that companies outside the FTSE-350 may find it more difficult to comply with some of the provisions of the Combined Code. Nonetheless all companies listed on the main exchange are expected to ‘comply or explain’. Companies on AIM are not deemed to be listed, hence the London Stock Exchange AIM Rules for Companies (2006) do not mention corporate governance. However, companies on AIM are also encouraged to comply with the Combined Code through guidance issued by the QCA and also through the expectations of their investors and advisors. The extent of both this expectation and the level of compliance will be examined in this research project.

**Quoted Companies Alliance and corporate governance for AIM companies**

As mentioned above, companies on AIM are not required to comply with the principles of the Combined Code. However ‘good’ corporate governance as embodied in the recommendations of the Combined Code is considered desirable for AIM companies too.

The QCA, formerly the City Group for Smaller Companies (CISCO), is an association representing the interests of smaller companies and their advisors. The QCA fully embraces the principles of corporate governance contained in the Combined Code and advocates that these principles should be adopted by all public quoted companies insofar as it is practicable for their size. QCA Guidance for Smaller Companies
(2004) urges smaller companies to comply with the Combined Code as far as they are able but where they are unable to comply fully, then they should explain why they are unable to comply.

In July 2005, the QCA published a set of corporate governance Guidelines for AIM companies. These QCA Guidelines are less rigorous than those applicable to companies listed on the main exchange under the Combined Code. All AIM companies are expected to comply at least with the QCA Guidelines with larger AIM companies aiming for higher standards of good governance practice nearer those of the Combined Code.

The QCA Corporate Governance Guidelines for AIM companies contains several sections:

(i) Matters reserved for the board – there should be a formal schedule of matters reserved for the Board’s decision.

(ii) Timely information – the board should be provided with timely information of a quality appropriate to enable it to discharge its duties.

(iii) Internal controls review – the board should carry out a review, at least annually, of the effectiveness of the system of internal controls and report to the shareholders on this.

(iv) Chairman and chief executive – the roles should be split but if they are not, then there should be an explanation of what procedures are in place to provide protection against the concentration of power within the company.

(v) Independent non-executive directors – there should be at least two independent non-executive directors, one of whom may be the Chairman. The Board should not be dominated by one person or a group of people.
(vi) Re-election – all directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance. There should be planned and progressive refreshing of the board.

(vii) Audit committee – there should be an audit committee of at least two members who should all be independent non-executive directors.

(viii) Remuneration committee – there should be a remuneration committee of at least two members who should all be independent non-executive directors.

(ix) Nomination committee – recommendations for appointments to the board should be made by a nomination committee, or the Board as a whole, after due evaluation.

(x) Dialogue with shareholders – there should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for this.

The QCA also give guidance on reporting corporate governance including that companies should publish an annual corporate governance statement describing how they achieve good governance which can be published on a company’s website and/or in the annual report and accounts. As well as describing how good governance is achieved that report should also include what the QCA term ‘basic disclosures’ which include, inter alia, a statement of how the board operates, the identity of all the board and board committee members including identifying those directors who are independent, biographical details for all directors, and the number of meetings of the board and board committees and directors’ attendance at them. Furthermore, the terms and conditions of appointment of NEDs should be made available on the company’s website, or available to shareholders on request, as should the terms
of reference for the audit committee, remuneration committee and nomination committee.

As can be seen from the above summary of the QCA Corporate Governance Guidelines for AIM Companies, there is an expectation that AIM companies will have good governance, and as the QCA states:

*It is anticipated that all AIM companies will wish to follow good governance and should be able to apply all of the QCA Guidelines set out in this Code. The Corporate Governance statement should, at a minimum, describe how each of the QCA Guidelines is put into practice by the company and also describe any additional corporate governance standards and procedures that the company applies beyond this basic level. It is anticipated that a company should be able to (and will) apply all of the QCA Guidelines. Where this is not the case, the statement should describe how the features of good governance are being achieved.* (QCA (2005) Corporate Governance Guidelines for AIM Companies, p.8-9)

**AIM companies and corporate governance**

There has been little academic research into corporate governance in AIM companies. However Mallin & Ow-Yong (1998) found that AIM companies brought onto the market by a nominated advisor that had also acted as the nominated broker paid more attention to the Cadbury Code on corporate governance. Their findings suggested that the nominated advisors cum brokers were concerned about their reputational risk and hence expected their AIM client companies to follow the Cadbury Code more closely.

In a limited survey of AIM companies’ annual reports (restricted to AIM listed companies in the South West), Grant Thornton (2005) found a quarter of companies reviewed did not make a statement outlining
how they had applied the key principles of the Combined Code. These companies appear not to make such a statement because it is not mandatory to report their compliance or otherwise. Grant Thornton’s survey found that 70% of sample AIM companies did not have two or more independent NEDs. The lack of independent NEDs means these companies are unable to comply with a minimum of two independent NEDs on both remuneration and audit committees. Similarly, low numbers of NEDs on SME boards were reported by Berry & Perren (2000) who suggested that NED appointments related more directly to the number of employees than to turnover or the age of the company.

A recently published report by Baker Tilly and Faegre & Benson (2006) surveyed 150 AIM companies and found that around two thirds had established an audit committee, appointed non-executive directors, and made changes to their corporate governance since floating on AIM. The report states:

...all but one of the AIM-listed companies we spoke to in 2006 had at least one non-executive director (NED) and almost half had at least three.

Another issue promoting good governance is ensuring that non-executive directors are independent of the board to ensure objectivity. However, defining what ‘independence’ means is a matter of subjective judgement. Any NED who is an ex-director may be perceived as being less than wholly independent (Weir & Laing, 2001). In addition, the Combined Code states that NEDs who have served more than nine years on the same board are not deemed to be independent. However, Pass (2004) found that there was no reliable evidence to indicate NEDs long-term involvement with their companies reduced their effectiveness on their boards.

AIM companies may often have a high degree of family ownership and influence. However, corporate governance is just as important for
these firms. Cadbury (2000) states that establishing a board of directors in a family firm:

...is a means of progressing from an organisation based on family relationships to one that is based primarily on business relationships. The structure of a family firm in its formative years is likely to be informal and to owe more to past history than to present needs. Once the firm has moved beyond the stage where authority is vested in the founders, it becomes necessary to clarify responsibilities and the process for taking decisions. (pp24- 25)

Mallin (2003) also points out that:

The advantages of a formal governance structure are several. First of all there is a defined structure with defined channels for decision-making and clear lines of responsibility. Secondly the board can tackle areas which may be sensitive from a family viewpoint but which nonetheless need to be dealt with – succession planning is a case in point (deciding who would be best to fill key roles in the business should the existing incumbents move on, retire, or die). Succession planning is important too in the context of raising external equity as once a family business starts to seek external equity investment, then shareholders would usually want to know that succession planning is in place. The third advantage of a formal governance structure is also one in which external shareholders would take a keen interest: the appointment of non-executive directors. It may be that the family firm - depending on its size - appoints just one, or maybe two, non-executive directors. The key point about the non-executive director appointments is that the persons appointed should be independent - it is this trait that will make their contribution to the family firm a significant one. Of course, the independent non-executive directors should be appointed on the basis of the knowledge and experience that
they can bring to the family firm: their business experience, or a particular knowledge or functional specialism of relevance to the firm, which will enable them to ‘add value’ and contribute to the strategic development of the family firm. (pp55-56)

Firm level characteristics such as size may serve to differentiate large and small firms. Larger firms tend to be more complex whereas smaller firms adopt simpler systems and structures; smaller firms tend to have more concentrated leadership, whilst in a larger firm control may be more diffuse, or more subject to question by a larger board (Fama and Jensen, 1983; Begley and Boyd, 1987). It can be expected that, in general, small and medium sized firms will have simpler corporate governance structures than large firms - this may include combining various key committees (audit, remuneration, nomination); a smaller number of non-executive directors; a combined Chair/CEO; and longer contractual terms for directors due to the more difficult labour market for director appointments into small and medium size companies.

The above review of the literature highlights some of the corporate governance issues facing AIM companies. Whilst they are expected to comply with fairly rigorous corporate governance best practice, they may have problems with recruiting and retaining an appropriate number of independent NEDs and hence with establishing board committees with an appropriate number of independent NEDs. Splitting the roles of Chair and CEO may also prove problematic for many AIM companies.

Summary

Corporate governance has evolved at an amazing rate in the last decade. At the same time, there has been rapid growth of AIM with over 1,600 companies now listed. There is, though, a dearth of research looking at AIM companies and corporate governance. This study
provides a timely contribution to the literature by, firstly, contributing a rounded analysis of AIM companies’ corporate governance from a number of perspectives: AIM company directors; institutional investors in AIM; nominated advisors and brokers to AIM companies. Secondly, a detailed analysis of the corporate governance statements of 300 AIM companies is undertaken to determine which areas of corporate governance best practice are most commonly in evidence and which areas seem to be more problematic and are seen less often.
3 Research Objectives and Methods

Introduction

AIM has become a popular market for companies, both from home and overseas, to join. It has achieved significant growth in the last decade and is seen as an excellent example of this type of market that encourages smaller companies to come to market. The implication of the high profile that AIM has achieved is that any significant failures on AIM might have a negative impact, not just on AIM, but on the wider UK market. Corporate governance is, therefore, an important area for AIM companies as, although not obliged to comply with the Combined Code (2006), there is an expectation that AIM companies will try to follow corporate governance best practice. AIM companies have access to a wide base of investment ranging from institutional investors to private shareholders, and so there are certain expectations as to how AIM companies will be governed. Equally, it is recognised that there may be areas of corporate governance best practice that small and medium size enterprises (SMEs) have problems with, such as splitting the roles of Chair and CEO, or having three independent non-executive directors.

The QCA, an organisation formed to promote the interests of smaller quoted companies including those on AIM, has produced a set of Guidelines on corporate governance for these companies. The objective of this research is to assess the level of compliance by AIM companies with the Combined Code in general and QCA Guidelines in particular, and to determine which areas may be problematic. This is done in a number of ways which are discussed in more detail below.
Research objectives

There are several research objectives that are addressed in this research project as follows:

(i) to assess the overall level of compliance by AIM companies with the QCA Guidelines on Corporate Governance;

(ii) to determine which areas may prove problematic for these smaller companies; and

(iii) to elicit the views of AIM company directors, AIM investors and other AIM participants on corporate governance issues.

Interviews with AIM company directors and other AIM participants

The use of face-to-face interviews can help elicit information which other methods cannot. The information obtained in the interviews provides supporting material, and additional information, to that obtained via the analysis of the companies’ annual reports which is the second research method adopted in this study. Face-to-face interviews were carried out with AIM company directors, AIM investors and AIM nominated advisors (NOMADs) and brokers. Their views about current corporate governance issues, and potential issues in the future, were examined in the context of the AIM setting. As might be expected, there were certain commonalities of viewpoints but also some fundamental differences of opinion, and these commonalities and differences are examined further in chapter four.
Selection of interviewees

Interviews were carried out with a sample of 19 AIM company directors, four AIM institutional investors and two nominated advisors cum Brokers. The companies were chosen on a random basis from the list of AIM companies on the London Stock Exchange website supplemented with additional information about each company from Hemscott, an information service provider. Institutional investors and other market participants were selected randomly from those that have an interest in AIM companies. These institutional investors were identified from a number of sources including the London Stock Exchange website, the QCA website and various professional publications.

Each interview usually lasted an hour, occasionally longer, and was guided by a semi-structured questionnaire. Generally two interviewers were involved and interviews were recorded as a back-up to written notes.

The analysis of the interviews in chapter four reports the findings from the interviews with AIM company directors, then the findings from the interviews with AIM investors, then the NOMADs/brokers; and finally a comparison between the groups is made, highlighting common themes and differences.

Usually the Finance Director of the AIM company was interviewed and in some companies the Finance Director was also the Company Secretary. All interviews were given on the basis of confidentiality and, therefore, individual companies, investors and other market participants are not identified.
Background information about sample AIM companies

Table 3.1 shows the key characteristics of the companies interviewed. As can be seen the companies cover a range of ages, industry sectors, and size (as measured by turnover). The majority of the companies visited had been on AIM for less than three years, although a reasonable number of companies had been listed for more than five years.

Companies in eight out of the ten industry sectors were interviewed, the exceptions being the telecommunications and utilities’ sectors where it was not possible to arrange interviews despite numerous attempts.

In terms of the size of AIM companies interviewed, the size (as measured by turnover) spanned a range from the smaller companies with a turnover of less than £1 million to larger companies with a turnover of between £26 million and £40 million.

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Number of companies</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Length of time on AIM</strong></td>
<td></td>
</tr>
<tr>
<td>Less than 3 years</td>
<td>10</td>
</tr>
<tr>
<td>3 – 5 years</td>
<td>2</td>
</tr>
<tr>
<td>More than 5 years</td>
<td>7</td>
</tr>
<tr>
<td><strong>Sector</strong></td>
<td></td>
</tr>
<tr>
<td>Oil and gas</td>
<td>3</td>
</tr>
<tr>
<td>Industrials</td>
<td>3</td>
</tr>
<tr>
<td>Financials</td>
<td>2</td>
</tr>
<tr>
<td>Basic materials</td>
<td>1</td>
</tr>
<tr>
<td>Technology</td>
<td>3</td>
</tr>
<tr>
<td>Healthcare</td>
<td>2</td>
</tr>
<tr>
<td>Consumer goods</td>
<td>1</td>
</tr>
<tr>
<td>Consumer services</td>
<td>4</td>
</tr>
<tr>
<td><strong>Turnover</strong></td>
<td></td>
</tr>
<tr>
<td>Less than £1m</td>
<td>4</td>
</tr>
<tr>
<td>£1m - £10m</td>
<td>4</td>
</tr>
<tr>
<td>£11m - £25m</td>
<td>7</td>
</tr>
<tr>
<td>£26m - £40m</td>
<td>4</td>
</tr>
</tbody>
</table>
It was interesting to see the various factors which motivated companies to join AIM. Table 3.2 indicates the main reasons given by the directors for their companies joining AIM.

Table 3.2  Motivations for joining AIM

<table>
<thead>
<tr>
<th>Motivation</th>
<th>Number of companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Raise money for future financing of the business/ acquisitions; access to institutional investors</td>
<td>15</td>
</tr>
<tr>
<td>Raise the profile of the company</td>
<td>4</td>
</tr>
<tr>
<td>Allow exit for venture capital providers/founders</td>
<td>3</td>
</tr>
<tr>
<td>Boom in technology sector so wished to take advantage of this</td>
<td>3</td>
</tr>
<tr>
<td>Onerous requirements of main market meant AIM more attractive</td>
<td>1</td>
</tr>
<tr>
<td>Value of options/grants for employees</td>
<td>1</td>
</tr>
</tbody>
</table>

Note: The total is more than the number of companies interviewed as companies often gave more than one reason for being motivated to join AIM.

As can be seen from Table 3.2, the main motivation for joining AIM was to raise money for future financing of the business, for various projects and acquisitions. This money could be raised through institutional investors or through private individuals investing in AIM. Four directors cited raising the profile of the company as being one of their motivations for joining AIM. Three directors indicated that they had chosen to join AIM as it was seen as a route that enabled the exit of venture capitalists from the business, or for the founders to exit or partially exit. Three directors indicated that the boom in technology stocks had encouraged their companies to join AIM as they were able to take advantage of the higher share price for technology stocks at the time they joined.
Two motivations were cited only once. One of these was that the onerous requirements of the main market had led one company to move from the main market to AIM as it was more attractive. On the main market the company concerned would have had to issue Class 1 circulars for various transactions which are both costly and time-sensitive. By the time the appropriate circular had been done, the business opportunity might well have been lost and the cost of around £400,000 per transaction effectively wasted. The other motivation cited by only one company was the ability to issue options/grants to all its employees, and these would have a value as the company was now on AIM.

It is interesting to compare the above analysis to the reasons cited by Burton et al. (2003) for companies undertaking an Initial Public Offering (IPO). Their study highlights a number of reasons why companies seek a listing on either the Official List or the AIM. These reasons include: increasing the visibility of the firm and getting its names known to future investors, customers and suppliers; raising funds; allowing an exit route to existing shareholders; widening the shareholder base; facilitating a strategy whereby share options and bonus schemes can be offered to employees; and taking advantage of a window of opportunity where the stock market seems to have an appetite for shares of companies in a particular sector. They also point out that for AIM companies, market trends are often crucial and also that smaller companies tend to list on AIM because it is cheaper to do so. The findings of this research project are, therefore, consistent with those found by Burton et al.

**Interviews with institutional investors**

Interviews were carried out with four institutional investors who invest in AIM companies. The four institutional investors, for the purposes of this report are called: A, B, C, and D, and have each invested in AIM companies since the inception of AIM itself, and invest across all the industry sectors of AIM. Further details of each of the four institutional investors are not provided as confidentiality was a condition of the interviews being granted.
Interviews with NOMADs

The two NOMADs’ companies that were interviewed also each acted as brokers to more than 80 client AIM companies covering all industry sectors; together the two NOMADs advise more than 160 AIM companies, or more than ten per cent of UK incorporated AIM companies. Both NOMADs have been advising AIM clients since AIM was founded in 1995. They act as NOMAD cum broker for the majority of their AIM clients with a broker only service to a handful of them. There is no AIM client for which they only acted as a NOMAD. The two NOMAD companies are designated NOMAD A and NOMAD B in this report.

There were nine areas in corporate governance that the NOMADs were asked, namely:

- Their roles pre- and post- AIM listing as a NOMAD;
- Factors that influenced their decision to become a NOMAD to their client companies;
- The impact of the AIM company’s corporate governance on their decision to accept being a NOMAD;
- Important characteristics of an executive director;
- Important characteristics of a non-executive director;
- Difficulties that AIM companies faced in complying with good corporate governance practice;
- Frequency of meetings with AIM company directors;
- Whether they would intervene in an AIM company to try and ensure good practice in corporate governance was followed; and
- Issues that were important to being a NOMAD to AIM companies.
Analysis of AIM company annual reports

The method and analysis of AIM companies’ annual reports is discussed in detail in chapter five. The chapter analyses the level and quality of voluntary corporate governance disclosure recommended from the QCA Guidelines in a sample of 300 AIM companies’ annual reports. To enable this analysis, the QCA Guidelines are divided into 23 key question items and organised for ease of discussion into six categories. The items in each of these six categories are then analysed to determine the level of voluntary corporate governance disclosure.

Secondly, specific firm and market related characteristics significant in determining the level of voluntary disclosure of corporate governance practice in AIM are examined. The level of voluntary disclosure is based on an unweighted score of 23 items analysed earlier from the QCA Guidelines. A multiple regression model is constructed and data collected from Hemscott and Datastream databases as well as from the 300 sample companies’ annual reports to determine the significance of these specific firm and market-related variables on the extent of corporate governance disclosure practice.

Summary

This chapter has considered the research methods used to help determine the adoption of corporate governance best practice and the perceptions of the importance of corporate governance for AIM companies. The interviews were undertaken with a range of 19 AIM company directors, two large institutional investors in AIM companies, and two NOMADs/brokers.

The detailed analysis of the corporate governance statements in the annual reports of 300 AIM companies utilised regression analysis to determine the extent of corporate governance disclosure levels by AIM companies.

The two approaches above resulted in some interesting findings and the richness of the findings and analyses is discussed fully in the following two chapters.
Introduction

The directors of AIM companies, institutional investors who invest in AIM and nominated advisors (NOMADs) who also act as brokers were interviewed to elicit their views on corporate governance in AIM companies. Interviewing a range of participants in AIM that includes these various groups is a significant way of gaining useful insights into the areas that are important to AIM company directors and other market participants. On some issues there is a commonality of views whilst on other issues, as might be expected, there are differences of opinion. The approach followed when selecting the interviewees has already been discussed in chapter three.

Quotations from various directors are included in the following sections and the industry sector of the company, together with the company’s size, is indicated with each quotation. Size is based on the bandings for turnover shown in Table 3.1, using the following categorisations:

- very small = less than £1m
- small = £1m - £10m
- medium = £11m – £25m
- large = £26m - £40m
General aspects of corporate governance

General aspects of corporate governance were covered in the first part of the interviews. The AIM company directors were asked what the main objective of corporate governance was for their companies. Table 4.1 shows the responses of the directors and highlights that one of the main objectives of corporate governance for AIM companies is to protect the interests of shareholders and other stakeholders.

Table 4.1  Main objectives of corporate governance

<table>
<thead>
<tr>
<th>What is the main objective of corporate governance for your company?</th>
<th>No. of directors mentioning it</th>
</tr>
</thead>
<tbody>
<tr>
<td>To show that the company is going about business in a professional and ethical way</td>
<td>9</td>
</tr>
<tr>
<td>To protect the interests of shareholders and other stakeholders</td>
<td>6</td>
</tr>
<tr>
<td>Because shareholders expect it</td>
<td>5</td>
</tr>
<tr>
<td>Because institutional investors expect to see independent NEDs in place and to have them heading up the Audit and Remuneration Committees</td>
<td>4</td>
</tr>
<tr>
<td>To maintain a reasonable degree of investor confidence</td>
<td>2</td>
</tr>
<tr>
<td>To help with a rational decision-making process</td>
<td>2</td>
</tr>
<tr>
<td>To enable risk mitigation</td>
<td>1</td>
</tr>
</tbody>
</table>

Note: The total is more than the number of companies interviewed as some companies stated there was more than one main objective of corporate governance.
Interestingly one director stated that: ‘corporate governance is a state of mind’ (oil and gas, medium), something that most people would agree with that should be practiced in everyday business life. That is, there should be the substance of corporate governance as well as the form so that it was not just box-ticking. One director summed it up nicely when he said:

*Corporate governance is behaving in a professional and proper manner in full obedience of the legal and regulatory requirements [in the jurisdiction] where the company is functioning. It should be intrinsic in everything you do in business but I’m not a great believer in over-regulation of it. Corporate governance is a label that’s been put on the way you should practice business.* (Basic materials, medium)

Other directors expressed similar sentiments:

*Corporate governance is a way of monitoring, managing and setting up the ethical behaviour of your company in the round…. which stakeholder groups are you trying to give information to, and how do you do it.* (Technology, large)

*The purpose is to give shareholders comfort and reassurance that the company is utilising capital in the best way it can.* (Healthcare, very small)

On the other hand, one director stated:

*We do not have a large institutional following, most [of our shares] are owned by other private shareholders [and] for the small shareholders, corporate governance is not something they’re overly aware of.* (Industrials, medium)
Important aspects of corporate governance

Table 4.2 shows aspects of corporate governance that directors consider important. From Table 4.2 it seems that the directors place most emphasis on aspects relating to independent NEDs, including their role in providing a ‘dispassionate’ voice on the board.

Table 4.2 Important aspects of corporate governance

<table>
<thead>
<tr>
<th>What aspects of corporate governance are important to your company today and in the near future?</th>
<th>No. of directors mentioning this</th>
</tr>
</thead>
<tbody>
<tr>
<td>Independent NEDs: a dispassionate voice on the board and seeing things from a different angle</td>
<td>3</td>
</tr>
<tr>
<td>Increasing corporate governance compliance</td>
<td>3</td>
</tr>
<tr>
<td>Holding an appropriate number of board meetings, appointing NEDs, ‘etc.’</td>
<td>2</td>
</tr>
<tr>
<td>Appointment of future NEDs to reflect future activities of company</td>
<td>2</td>
</tr>
<tr>
<td>Need to keep shareholders informed</td>
<td>2</td>
</tr>
<tr>
<td>Separation of Chairman and CEO roles</td>
<td>2</td>
</tr>
<tr>
<td>‘Transparency Directive</td>
<td>2</td>
</tr>
<tr>
<td>Attracting external shareholders</td>
<td>1</td>
</tr>
<tr>
<td>Internal controls and segregation of duties</td>
<td>1</td>
</tr>
<tr>
<td>Keeping abreast of the changes</td>
<td>1</td>
</tr>
</tbody>
</table>

One director described the important aspects of corporate governance as being:
The whole gamut of things. Holding ‘correct’ board meetings etc. and following best practice such as [appointing] non-executive directors [and] having a good mix of people. (Oil and gas, medium)

Interestingly in terms of corporate governance in the future, one director stated:

*I fear that AIM will become a victim of its own success unless the rules governing AIM are tightened. [There are] fears that institutional investors will not invest in AIM companies. I would like to see NOMADs applying stricter criteria to those companies that want to come to AIM.* (Healthcare, small)

**Influence of good corporate governance on company wealth**

In terms of the influence that good corporate governance practice might have on the company’s ability to prosper and increase its wealth, opinions were generally quite supportive as the following quotes from the directors interviewed show:

*You could call corporate governance ‘risk management’ and so a good board, used properly, can add a huge amount.* (Industrials, small)

*Good governance should be reflected in the quality of the decisions that the board takes.* (Technology, large)
Good corporate governance protects the business’s reputation. Half of it is common sense, you have to treat people properly and fairly. (Industrial, large)

If you don’t think that corporate governance adds value, then you should get out of business. If you think of it as just a box tick exercise, then at some point you’ll come unstuck. (Industrial, small)

It [good corporate governance practice] opens doors for certain transactions….people take comfort from the fact that you are AIM-listed. (Consumer services, very small)

On the other side of the coin, there were a few divergent views such as:

Very little. Compliance costs time and effort without increasing performance. (Consumer services, small)

We create wealth by our deals, not by corporate governance. NEDs don’t add value, they are comfort/watchdogs for external investors. (Financial, medium)

Nonetheless, the same company director stated:

If we paid no attention to corporate governance, then arguably the share price would be lower. (Financial, medium)

Similarly another director stated that corporate governance practice was ‘marginal’ in terms of its influence on the ability of the company to prosper but he also said:
*The times when good corporate governance happens is in crisis times to ensure market confidence.* (Technology, small)

**Influence of Combined Code/QCA Guidelines on corporate governance**

When asked how the Combined Code/QCA Guidelines on Corporate Governance for AIM companies had affected the way that the company viewed the practice of good corporate governance, there was a range of views as the following responses show:

*Codes are things to try to aspire to but you need to be realistic about the size of the company.* (Oil and gas, medium)

*As a very young [AIM] company, [we’ve] not really had chance to assess its implications yet but the leap to listing obviously brought in new corporate governance requirements.* (Basic materials, medium)

*The QCA Guidelines are helpful in showing what the minimum to be done is, what is recommended, etc.* (Technology, large)

*It gives a framework from which to hang individual and corporate behaviour.* Consumer services, very small)

Another view was that the Combined Code/QCA Guidelines had not affected the way that companies viewed the practice of corporate governance and that, instead, a lot of advice was taken on corporate governance from the company’s NOMAD.
Formal policy on corporate governance

When asked whether their companies had a formal corporate governance policy and whether they adopted the provisions of the Combined Code/QCA Guidelines, and disclosed this adoption, or non-adoption, in the annual report, responses varied from affirmative on all counts to newly listed companies that said they would have one in the future. However, one director of an established AIM company was fairly dismissive of the Code:

*We have a page in the annual report and put in what the auditors tell us to… [we] are going through the motions, paying lip service.*

(Oil and gas, very small)

Benefits and costs of corporate governance

The directors were asked about the benefits and costs of complying with the QCA Corporate Governance Guidelines for AIM companies. The following quotes highlight these perceived benefits and costs.

Benefits

Benefits were often viewed as reputational in the sense that, by having a good corporate governance structure in place, a company would portray its professional approach to business and would open up the pool of potential investors, especially institutional investors and give them confidence in the company. There would be perceived benefits to the company too from having high-calibre independent NEDs on the board.
It’s how you go about your business. The professionalism of following the correct corporate governance means it’s never been raised as an issue. The ethical aspect/approach means people in the company tend towards being more ethical. You can liken it to safety, if you get it wrong, the cost is enormous. (Oil and gas, medium)

And similarly:

The guidelines are built up based on years of experience of other companies, so it’s helpful for us to draw on other companies’ experiences. We don’t find it burdensome, you know the value of it if you didn’t follow it and something went wrong. (Healthcare, very small)

The benefits are to get access to funds…..if you’re in business, you need to show you’re competent, trustworthy, etc. and our board exudes that. (Industrial, small)

The benefits are to be seen as a business that goes along with the rules and has a high probity, is transparent, has high calibre NEDs, and good professional advisors. (Consumer goods, very small)

It gives a degree of credibility. The requirement to be transparent means that adequate systems and processes are in place to run a business of this size. (Healthcare, small)

There are no tangible or measurable benefits. It is an opportunity cost in the sense of what would be the cost if we didn’t comply? It would deter investors from investing. (Consumer services, medium)
The benefits of having non-executives… nice to have a few older greyer people on board who’ve been there, done that, etc. The formalising of risk (control) is important as it helps the business not to try to expand too quickly. (Technology, medium)

Costs

The costs were mainly identified as monetary costs of directors’ time, the cost of NED appointments, and administrative costs. In relation to the directors’ time, one director stated that the costs of corporate governance were:

Solely the aggravation and misery caused to the Finance Director and Company Secretary. (Technology, large)

Whilst others stated:

The costs are significant at this point in time but in getting things right there will ultimately be a benefit for financial performance. (Consumer goods, very small)

Opportunity cost in the sense of what would be the cost if they didn’t comply. It would deter investors from investing. (Consumer services, medium)

The costs of time spent understanding it, or getting advice on it. The cost of keeping abreast of developments, and the cost of compliance. (Consumer services, very small)

The cost of NEDs… the time to put reports together, update them, etc, but the costs are not out of proportion. The thing about AIM and corporate governance is that it allows you to put some judgement in there. (Technology, medium)
Compliance costs time and effort without increasing performance. It can consume board time and focus that would be better spent focused on other business matters. (Consumer services, small)

**Other comments about AIM**

The directors generally thought that there were potential issues with AIM. The over-riding reservation expressed by directors was about the quality of some of the companies listing on AIM, especially some of the overseas companies, as the following quotes from different directors indicate:

*Overseas companies on AIM: someone will get their fingers burnt big-time.* (Industrials, small)

*AIM doesn’t tend to differentiate between the ‘good’ companies and, say, the Russian oil companies.* (Financials, medium)

*Regarding the growth of AIM, I’m slightly dubious about whether we’re letting the right companies in. For example, some companies are ‘on a wing and a prayer’ as to whether they will succeed. Maybe there’s a place for another market for ‘blue sky’ companies (for example, some of the companies are very speculative).* (Basic materials, medium)

*As there are some bad/dodgy businesses on AIM, corporate governance is one of the ways to get yourself noticed as a great company. If bad companies crash, it means a negative limelight for other companies. Having good corporate governance is one way to differentiate yourself on AIM, it indicates you are a well-run and honestly managed company.* (Industrials, large)
AIM is fantastic as a way of accessing the capital market. I don’t think that the light touch regulation is bad. However the authorities should think carefully about the extent and geographical reach; where companies are coming from, countries which historically have weak governance, authorities should consider imposing tighter regulation. (Consumer services, large)

Some companies are not being governed as well as they could be (with the growth of the market), and you will always find some companies which are not ‘whiter than white’. I have a concern that poorly governed companies may have a negative impact on the market and the share price. (Consumer services, medium)

I’m slightly nervous about how it’s taken off in the last year or two with some of the companies coming on to AIM from overseas. Some of these are high risk, and it only takes one or two to go ‘pop’, and it affects the whole market. It’s not just AIM’s responsibility, it’s the responsibility of NOMADs too. (Technology, medium)

The corporate governance structures of some AIM companies were also mentioned:

Companies should have a split Chair and CEO, [they] shouldn’t have former CEOs becoming Chairman. (Industrials, small)

Other directors indicated that there were certain aspects that they wished to put in place, such as having a whistle blowing policy which they essentially viewed as a risk management issue:

Corporate governance, should look at it, not as a burden, but as a risk management tool, an opportunity to manage your business well. (Industrials, small)
The directors did not generally feel that the current Guidelines were over-burdensome, although one director stated:

One of the biggest challenges for everyone is to make corporate governance regulations workable and make them workable for all parties. There is scope to simplify it as there is an increasing volume of things that you need to do, and the cost of doing it adds up. (Consumer services, very small)

And another director spoke for a number of them when he stated:

I would hope that corporate governance on AIM stays where it is, i.e. encouraged to do it but wouldn’t want a ‘big stick’ approach. (Technology, medium)

And another stated:

A lot of stuff that comes out is aimed at fully listed companies. I look for the footnotes regarding the application of certain parts to AIM companies, but there aren’t any! (Industrials, medium)

In relation to the role of NOMADs, one director observed:

NOMADs answer questions if companies ask them, but in the early days of being a public company [i.e. on AIM], the company might not know that the question is there to be asked. (Financials, medium)

Finally one director commented on the market-makers:

The biggest gripe with AIM is the lack of scrutiny, and regulation, affecting market-makers and their practices. Market-makers drive the price rather than the market. (Healthcare, small)
When asked about their NOMAD’s involvement in corporate governance issues, the directors generally stated that the NOMAD was helpful in informing them of changes to do with corporate governance or other AIM issues, such as the new regulations regarding web disclosure. Whilst some companies found their NOMAD very helpful others said that they had not heard from their NOMAD since they floated on AIM. One director stated:

*NOMADs are part of the assets of the business as they can add a lot of value to your business if you choose them carefully and use them properly. They can be a great source of advice for the company.* (Industrials, small)

**Institutional investors and AIM company’s corporate governance**

Institutional investor A stated that in terms of the percentage held in each AIM company invested in, that a 15% investment was not unusual. When deciding which AIM companies to invest in, institutional investor A stated:

*The rationale is that we’re looking for well-managed companies with good growth prospects, i.e. the quality of the company is most important.*

Institutional investor B took a similar approach seeking to maximise returns subject to risk but they also said that they ‘take account of [corporate] governance: for example, can the accounts be trusted?

The institutional investors were asked which aspects of an AIM company’s corporate governance were most important to them. Table 4.3 indicates the weighting on a scale of one to five that the institutional investors gave to each of the factors. The most important factors were the presence of independent NEDs, the presence of an audit committee, and
disclosure and transparency in reporting. The presence of a nomination committee was not seen as being an important factor.

Table 4.3  AIM company’s corporate governance

<table>
<thead>
<tr>
<th>Ranking</th>
<th>5</th>
<th>4</th>
<th>3</th>
<th>2</th>
<th>1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aspect of corporate governance</td>
<td>No. of institutional investors</td>
<td>No. of institutional investors</td>
<td>No. of institutional investors</td>
<td>No. of institutional investors</td>
<td>No. of institutional investors</td>
</tr>
<tr>
<td>Split roles Chair/CEO</td>
<td>1</td>
<td>3</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Independent NEDs</td>
<td>2</td>
<td>2</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Board size</td>
<td>3</td>
<td>1</td>
<td></td>
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</tr>
<tr>
<td>Board composition</td>
<td>1</td>
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</tr>
<tr>
<td>Audit Committee</td>
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<td>2</td>
<td>1</td>
<td></td>
<td></td>
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<tr>
<td>Remuneration committee</td>
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<td>1</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nomination committee</td>
<td></td>
<td></td>
<td>1</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Disclosure/transparency in reporting</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Effective system internal controls/risk management</td>
<td>1</td>
<td>2</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Quality of NEDs</td>
<td></td>
<td></td>
<td></td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Quality of management</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Compensation scheme</td>
<td></td>
<td></td>
<td></td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>Ownership structure</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: 5 = most important, 1 = least important

The institutional investors emphasised that the people involved in an AIM company and a company’s size might impact on how they interpreted the importance of various factors. For example, if a company was quite small, then institutional investors might accept a combined Chair/CEO role. Equally, if there was a very good person who was key to the company and held both positions, then the institutional investors might again be more tolerant. Also, whilst the institutional investors
placed great importance on the presence of independent non-executive directors, they also stated that the quality of the NEDs was important. However, in the words of institutional investor A: ‘nothing is make or break’. Institutional investor A also mentioned that:

Ownership structure is important – a strong founder etc. - particularly with overseas companies and the danger of asset stripping.

and continued:

We have very few foreign-owned companies in our AIM portfolio as we have been burnt in the past. The quality of due diligence [for these companies] was inferior to what we thought.

Institutional investor D felt that:

Overall, AIM companies seem to be adopting the standards set for higher up.

**NOMADs and AIM company’s corporate governance**

Both NOMADs inferred that an AIM company’s corporate governance structure affected their decision to accept a client, more so in NOMAD B than NOMAD A. NOMAD A noted:

There’s no use in having clients which have a dysfunctional board, or run by people with little regard to what is deemed as sensible corporate governance. It not only makes it much harder to get them to the governance level we want them to but also makes it unattractive to institutional investors. Institutional investors pay attention to corporate governance structures that are deemed important – proper full board etc. This might be box-ticking but
it's important. Chair/CEO split is not crucial for small companies. It's important to look at the personalities involved.

However, NOMAD B’s view was that:

Most private companies will not have an appropriate level of corporate governance at that stage pre-IPO. A lot of them come with one or no NEDs, that’s something we bolt onto the company. We tend to take a pragmatic approach, for AIM companies technically do not need the same level of corporate governance as main companies. However, there are effectively a minimum which our audience, the institutional shareholders expect. We generally try to get all of our clients to have a level of corporate governance well above this minimum. If a company for any reason does not want to have corporate governance, we will undoubtedly listen to them and assess whether their reasons for not wanting to are appropriate or not. It comes down to fundability of the company rather than suitability because we can get away with suitability if we want to but not if it affects the funding.

NOMAD B went on to say that:

The minimum criteria of corporate governance are the QCA Guidelines. Never had an AIM company baulk at taking on the QCA Guidelines.

On the issue of the expected level of corporate governance, NOMAD B said that

The market is a balance of risk and reward. Over-governancing a company can damage a company as much as under-governancing it.
Their responses again further supports the inference that corporate governance is seen as a secondary issue for these NOMAD cum broker companies to that of fund raising via their broking activity. However, where possible, they would prefer to accept companies that practised good governance. The responsibilities of NOMADs, as indicated by the London Stock Exchange under Schedule 3, can be found in appendix three.

**Difficulties faced by AIM companies in adopting good corporate governance practice**

The institutional investors thought that many of the investee AIM companies did a good job in complying with corporate governance requirements and that the difficulties were not that great and that, to a certain extent, it was an educative process. Institutional investor A mentioned that ‘it’s often difficult to differentiate good governance and good management’. However, there was also a recognition that sometimes they had to be flexible regarding, for example, board composition. For example, institutional investor C felt that:

More generally AIM companies (newly listed) often are simply not aware of some of the interests that minority shareholders might have. This may be due to a lack of advice from NOMADs. Remuneration practices stick out in my mind as an area of concern.

Institutional investor D recognised that the size of the company might play a part:

If they’re small, they don’t have the resource/dedicated staff; they don’t have the familiarity; and when they are recruiting Company Secretaries, they tend to take newer people or combine it with another role.
However, institutional investor D thought that AIM companies were disclosing a lot more about corporate governance than they had 3-4 years ago.

When asked what difficulties AIM companies might have in complying with corporate governance good practice, NOMAD A replied that:

*Company size has a huge impact in corporate governance in terms of cost especially for pre-profit or pre-revenue companies. For example, if you are a one million company that is going backwards, you are going to have difficulty to find an NED. You would not have the necessary resources to support a large board. It’s much easier to recruit a NED if you are a company growing strongly. Foreign companies may have difficulties in complying because they have different cultures. However, if they wish to raise money here, they have to follow UK corporate governance rules because institutional investors are our clients.*

In NOMAD B’s view, AIM companies generally did not comply with good corporate governance practice:

*AIM companies generally don’t have the depth of management resources, don’t produce board briefing packs, don’t brief NEDs enough, don’t pay NEDs enough for them to spend sufficient time in the business and dominant CEOs prevent NEDs to get across what they require.*

NOMAD B went on to note that a lot of the difficulties stemmed from the attitude of NEDs:

*Attendance of NEDs on sponsored seminars highlighting key topics that they should be aware of, are woefully attended. They are not interested in putting in the time, and so the NED class can be of low quality. NEDs do not understand the risk that they have personally and also the obligations that they have to their companies.*
Thus, the difficulties faced by AIM companies in complying with practising good corporate governance according to NOMAD A, were due to a company’s size and for foreign companies, their business culture and practice. In contrast, NOMAD B had a general litany of problematic weaknesses that were found in the way that AIM companies practiced their corporate governance. Many of these difficulties lay with the attitude and behaviour of NEDs in fulfilling their obligations.

**Intervention in AIM companies**

NOMAD A was asked whether his company would intervene in an AIM client company to try and ensure that good corporate governance practice was followed. NOMAD A replied that, for example, if there was a board conflict due to personalities, he would:

*Ask if a NED resigned, discuss why it happened. We are worried more about the broking rather than the NOMAD relationship. We would advise them to find a replacement as soon as possible. This is probably a good time to revisit what the board structure should be like.*

NOMAD B noted that:

*There’s not a lot we can do to intervene. We can encourage and cajole them. We can also request any information if we need to acquit ourselves with our duties.*

Their views suggest that they do not take effective steps as a NOMAD to intervene to ensure that good corporate governance practice is followed. It highlights the relative passive advisory role that NOMADs perform for their AIM clients.
Board and committee matters

The next part of the interviews with the AIM company directors covered board and committee matters including board structure and composition, factors influencing the appointment of NEDs, board sub-committees, and remuneration issues.

Board structure

Table 4.4 shows the board structure of the companies interviewed. Panel A shows the total number of directors and how many companies have each total number of directors. For example, six of the companies whose directors were interviewed have a board comprised of a total of five directors. The smallest board size is three (one company) and the largest board size is nine (also one company).

Panels B and C show the number of executive and non-executive directors. For nine of the 19 companies interviewed there were two executive directors, whilst one company had only one executive director and two companies had the largest number of executive directors of five. When looking at the non-executive directors, 13 of the 19 companies had either two or three non-executive directors, whilst two companies had one non-executive director and one company had five non-executive directors.
Table 4.4  Board structure

<table>
<thead>
<tr>
<th>Panel A</th>
<th>Panel B</th>
<th>Panel C</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total no. of directors</td>
<td>No. of companies</td>
<td>No. of exec. directors</td>
</tr>
<tr>
<td>3</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>4</td>
<td>4</td>
<td>2</td>
</tr>
<tr>
<td>5</td>
<td>6</td>
<td>3</td>
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<td>6</td>
<td>4</td>
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<td>7</td>
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<td>8</td>
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<td>6</td>
</tr>
<tr>
<td>9</td>
<td>1</td>
<td>7</td>
</tr>
<tr>
<td>19</td>
<td>19</td>
<td>19</td>
</tr>
</tbody>
</table>

The most commonly occurring board size and composition across the companies interviewed was either a total board size of four with two executive directors and two non-executive directors (three companies) or a total board size of five with two executive directors and three non-executive directors (three companies).

Independence of NEDs

The directors were asked whether they subscribed to the notion of ‘independence’ as mentioned in the Combined Code. In general they recognised that some of their non-executive directors would not necessarily be classed as independent under a strict interpretation of the Combined Code guidance, for example, where a non-executive had been in post for more time than might be considered desirable, or had worked with the executive directors previously, or was an individual with a significant shareholding. Also whilst some of the directors stated they would like more NEDs on the board, they indicated that it was ‘a struggle to find the right combination of people willing to join in’.
Factors influencing NEDs’ appointments

The directors were asked which factors were the most influential when it came to the appointment of NEDs. Table 4.5 indicates the number of directors who mentioned each factor. The column indicating total number of companies can be more than the number of companies interviewed as companies often gave more than one reason for appointing a NED.

<table>
<thead>
<tr>
<th>Factors</th>
<th>No. of companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Objectivity and integrity</td>
<td>14</td>
</tr>
<tr>
<td>Relevant business skills and experience</td>
<td>12</td>
</tr>
<tr>
<td>Business relationship and networking opportunities</td>
<td>11</td>
</tr>
<tr>
<td>Reputation</td>
<td>11</td>
</tr>
<tr>
<td>Personal compatibility with board members</td>
<td>9</td>
</tr>
<tr>
<td>Advice from consultants or NOMADs</td>
<td>4</td>
</tr>
<tr>
<td>Professional qualifications</td>
<td>2</td>
</tr>
</tbody>
</table>

Overall the most important factors seemed to be: the objectivity and integrity of the individual being appointed; relevant skills and business experience; business relationship and networking; and the individual’s reputation. The personal compatibility of new NED appointments with the existing board members was generally not viewed as so important although one director did say that this was extremely important. Advice from consultants/NOMADs was generally not seen as that significant in NED appointments which is perhaps somewhat surprising given
the emphasis placed on the role of NOMADs in the AIM market. Professional qualifications/financial expertise were specifically mentioned by some of the directors as being essential for appointment of NEDs who would serve on the audit committee. One director echoed the view of a number of directors that NED appointments should be of those people who could make a difference to the company:

*The single quality we look for is for the NED to bring something to the business: knows the industry, sector, etc.* (Technology, large)

Another director stated:

*You need to make sure that the person has what you want. NEDs need to make sure that the board is running effectively, you need someone to question the board.* (Consumer services, very small)

Interviewees were also asked if there were any other factors apart from those listed in Table 4.5 which might influence the appointment of NEDs. The additional factors that were mentioned were: the board’s needs at the time; where the board wanted to be in X years time; consultations with major shareholders; the ability to generate new contacts for raising funds; and money to invest in the company. One director also commented that NED appointments were usually selected from within the sphere they already knew and, therefore, knowledge of business and market contacts were important; another director backed up this view when he stated that personal recommendations from another board member were important in NED appointments.
Board sub-committees

The directors were asked about the key board sub-committees of audit, remuneration, and nomination, in their companies. Table 4.6 shows that all of the companies interviewed had adopted audit committees and remuneration committees whilst only a minority had a nominations committee. The majority of companies had two independent NEDs on the audit and remuneration committees. One company had four independent NEDs on its audit and remuneration committees.

Table 4.6  Board sub-committees

<table>
<thead>
<tr>
<th>Type of committee</th>
<th>Yes</th>
<th>No</th>
<th>No. of independent NEDs</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>0* 1 2 3 4</td>
</tr>
<tr>
<td>No. of co’s</td>
<td></td>
<td></td>
<td>No. of co’s</td>
</tr>
<tr>
<td>Audit committee</td>
<td>19</td>
<td>-</td>
<td>1  2 10 5 1</td>
</tr>
<tr>
<td>Remuneration committee</td>
<td>19</td>
<td>-</td>
<td>1  2 10 5 1</td>
</tr>
<tr>
<td>Nominations committee</td>
<td>6**</td>
<td>13</td>
<td>1  - 2 2 1</td>
</tr>
</tbody>
</table>

Notes:  * ‘0’ Independent NEDs indicates where a committee exists but there are no independent NEDs on the committee.

** Includes one combined Remuneration/Nominations Committee

The directors stated that they tended to use the Combined Code/ Higgs criteria for identifying the independence of NEDs.

The directors interviewed confirmed that, should the need arise, NEDs had access to independent professional advice at the company’s expense. Some companies’ NEDs had used independent professional advice in relation to their duties on the remuneration committee.
However, the majority of directors stated that their NEDs had so far not needed to utilise this facility.

In relation to whether there was a clear division of responsibilities at the head of the company between running the board and executive responsibility for running the company’s business, the majority of directors confirmed that they achieved this by splitting the roles of Chair and CEO.

**Remuneration**

The directors were asked what type of remuneration schemes their companies offered board members. The majority of companies paid a salary or stipend to their Chairman and also offered share options. The CEOs and other executive directors were paid a salary and a bonus/incentive payment (assuming that certain criteria were met), and share options. Some companies operated performance-related pay schemes and the performance criteria/targets included both time-based (where it vests after a period of time) and performance-related criteria (for example, drilling a particular well; the profitability of a particular deal; achieving target earnings schemes). There could also be more general targets, such as whether a company had met its budgetary requirements, and individual performance. In some companies all employees were eligible to be awarded share options. The NEDs were generally paid a fee and a minority (seven) of companies also offered share options.

One director stated that the company paid its directors:

...low salaries, so offered lots of stock options, but when it comes to NEDs, it’s in direct contrast/opposition to their independence... [but]..it’s a struggle to get people who would put the effort in without giving them potential upsides [stock options]. (Oil and gas, medium)
Some directors specifically stated that they had other benefits such as pension or healthcare schemes.

The institutional investors were asked about the performance-related pay schemes available for AIM company board members. Institutional investor A stated:

For any company, the scheme should be appropriately aligned to strategy and provide realistic remuneration for doing a good job.

Whilst institutional investor B stated:

We encourage providing the right performance measures; we look for something that measures company performance over a longer time period. Ideally 5-7 years but everyone tends to go for 3 years, shorter in a few cases.

The institutional investors were generally in agreement that there should not be stock option schemes for NEDs although institutional investor C mentioned that:

If it’s a relatively new company that wants to conserve its cash, it may remunerate the executive and NEDs in options or restricted share options.

Whilst institutional investor D stated:

We don’t like to see options to NEDs but we do see it in mining companies, bio/pharma companies, and electronics companies. It often occurs if there is a negative cash flow, so if it’s instead of pay, and not too much, then we don’t mind too much.
Internal control and risk management

In terms of how often a company’s internal controls and risk management were reviewed, the responses ranged from internal controls being reviewed annually by the auditors, or risk management being done on an ad hoc basis, to the board being appraised monthly on the position of the company. Also, one company reviewed internal controls and risk management at each audit committee meeting (twice a year), whilst another completed a full level risk review matrix prior to the start of each accounting year that was formally reviewed and updated on a quarterly basis. The internal control/risk management review tended to be reported to shareholders via the company’s Corporate Governance Statement in the company’s annual report, although it was generally not reported in any detail.

Shareholder dialogue

The directors tended to fall into three groups: those that kept in regular contact through formal and/or informal meetings; those that met their investors once a year at the company ‘roadshow’ when they discussed their results; and those that tended not to have contact with their investors except at the annual general meeting (AGM), despite AGMs being very poorly attended.

The directors were asked about the dialogue that they had with their institutional shareholders and how important they thought corporate governance was to their shareholders. Table 4.7 shows that almost all of the companies scheduled meetings with their institutional investors ranging from annually/bi-annually to every couple of weeks, although this was unusual. The vast majority of the directors interviewed thought that corporate governance was important to shareholders.
Table 4.7 Shareholder dialogue

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>No/Not sure</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No. of companies</td>
<td>No. of companies</td>
</tr>
<tr>
<td>Do you have scheduled meetings with shareholders?</td>
<td>17</td>
<td>2</td>
</tr>
<tr>
<td>Is corporate governance is important to shareholders?</td>
<td>17</td>
<td>2</td>
</tr>
</tbody>
</table>

Sometimes when companies come to the market, or when there is a significant strategic change, some restructuring of their existing board is necessary and this can be after shareholder dialogue. For example, one director stated:

*The new board has been key to institutional investors subscribing to the company.* (Industrials, small)

And another director stated:

*Corporate governance is important to institutional investors and especially you need to have the basics: two independent non-executive directors, an audit committee and a remuneration committee.* (Financials, medium)

Furthermore, three directors stated:

*Corporate governance is quite important. If they [investors] can see that the directors take it seriously, it gives confidence in the directors, and instils confidence in their investment.* (Industrials, large)
It is very important. I suspect that they look out for companies who aren’t following good corporate governance. (Healthcare, very small)

It is very important, it’s a kind of insurance policy as it would be impossible for them to vet every company on every detail, so corporate governance helps in this respect. (Healthcare, small)

However, another director was not too sure how important corporate governance was to his investors:

Not sure how much they think about it, they tend to focus on the people running the business, and they like face-to-face meetings with the directors. To get the share price up, you deliver on what you say you’ll deliver. (Basic materials, medium)

And another director stated:

Not sure. As long as nothing goes wrong they don’t really care. Institutional investors only really care about their return in x years, they’re not bothered about corporate governance, ethics, environmental issues, etc. (Technology, large)

One director summed the situation up from his viewpoint when he stated:

Corporate governance is in the background in the meetings [with shareholders] but it’s assumed that we do it. (Consumer services, medium)

The institutional investors tended to see their investee AIM companies at least twice a year, and on more occasions when there were deals ongoing or other specific issues. In terms of voting at the AIM
companies’ AGMs, all the institutional investors without exception said that they voted on resolutions as a matter of course. They were willing to vote against, or with-hold votes, on contentious issues.

When asked to what extent they would intervene in an AIM company to try to ensure corporate governance best practice was followed, or whether they would choose to exit, the responses were quite similar. Institutional investors A, B and C said that they would talk to the companies about areas they were not comfortable with, and would with-hold votes, or vote against these issues, if necessary. Areas where they might vote against would be if they were not happy with the Remuneration Report, or the Annual Report and Accounts, or if they didn’t like a particular transaction. An example of the latter would be if a company was proposing to withdraw pre-emption rights at more than five per cent.

Institutional investor C stated that there would be a cost-benefit analysis, and that he would look at how widely held were a company’s shares. If the shares were widely held, then they would ‘stick around and see if changes could be made’, if the shares were not widely held, then there would be less incentive to stay involved.

**Frequency of meetings with AIM company directors**

The NOMAD interviewees were asked how frequently they met with AIM company directors. NOMAD A responded by saying that he always met AIM company directors before accepting them as clients. Once accepted, they might attend some of the board meetings depending on the company client’s view. NOMAD A replied further that:

*Face to face meetings are reasonably regular, hopefully once a week to all AIM clients because if you are a NOMAD, things come up regularly. Issues discussed on are firm performance, what needs to be done from a regulatory perspective. Every NOMAD client of ours is also a brokering client too, which in some ways, is more important to us.*
As for NOMAD B, he noted that:

[I] meet up with executive directors face to face three or four times a year but typically speak to the financial director or CEO every other week, partly because of broking and partly to inform them of the new obligations that come up from time to time. I try not to attend board meetings other than say, to approve an acquisition. Last thing I want to do is to put myself in the frame of a shadow director.

This suggests that face to face meetings with AIM company directors are much more frequent with NOMAD A than with NOMAD B who typically contacts its client company directors more by phone.

**Corporate governance and business performance**

The institutional investors were supportive of the view that good governance practice in their AIM client companies led to better business performance. Institutional investor B stated:

I suspect there is a greater likelihood of good performance if there’s good governance.

Similarly institutional investor C stated: ‘It’s hard to deny there’s a link but difficult to identify what it is.’

Institutional investor D viewed it as a potential damage limitation exercise: ‘If they’re aware of the risks, they don’t fall on so many holes.’

**Investment decision influences**

The institutional investors were asked about the factors which influenced their investment decisions. Table 4.8 shows that in general institutional investors do not view an AIM company’s NOMAD as
being a significant factor in their investment decisions. Similarly a company’s auditor and legal advisors do not impact on investment decisions. However, if the institutional investor had had a bad experience with a particular NOMAD or company advisor in the past, then they would look a bit more carefully at the company. Institutional investor B stated:

Some NOMADs are not trusted.....NOMAD/brokers are more trusted than NOMADs only.

Similarly institutional investor C stated:

We may be put off by a poor NOMAD who we have had bad experiences with.

Institutional investor D stated that:

The auditors could influence the investment decision if they were not a Big Four audit firm.

Similarly institutional investor B stated:

If a small accountancy firm has a poor track record that would be an area of concern.

and institutional investor C noted:

On a secondary level, if the AIM company were given bad advice by the accountant/lawyer that might impact on the strategic decisions of the company.
Table 4.8 Investment decision influences

<table>
<thead>
<tr>
<th>Influences</th>
<th>Generally Yes/Significant</th>
<th>Generally No/Minor</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No. of institutional</td>
<td>No. of institutional investors</td>
</tr>
<tr>
<td></td>
<td>investors</td>
<td>investors</td>
</tr>
<tr>
<td>NOMAD</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Company auditor/legal advisor</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Corporate governance</td>
<td>4</td>
<td>-</td>
</tr>
<tr>
<td>Other:</td>
<td></td>
<td>2</td>
</tr>
<tr>
<td>Company/sector-related</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Overseas company location</td>
<td>1</td>
<td></td>
</tr>
</tbody>
</table>

All the institutional investors stated that an AIM company’s corporate governance was important in their investment decisions. Institutional investor A stated:

Yes it’s significant. It goes with the assessment of the management. We see corporate governance as the way the company is managed.

In terms of other factors which might influence the investment decision, institutional investor A stated:

…all the important factors to do with the quality and trustworthiness of management; and the industry in which they operate. The company has a reason to exist: what makes them ‘special’ to do that business? Are there particular people [in the company]? Is it a niche market?
Institutional investor B put more emphasis on the location of the company:

*For non-UK companies, the location of the company is considered links in with shareholder rights, for example, Russia, there is a lot of risk involved.*

**Directors’ characteristics**

The institutional investors were asked about which characteristics they considered most important in executive directors and in non-executive directors. Their responses are summarised in Tables 4.9 and 4.10.
Table 4.9 Important characteristics in executive directors

<table>
<thead>
<tr>
<th>Important characteristics</th>
<th>Mentioned by interviewees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Clear understanding of what they’re to do: to run the company in interests of all the stakeholders (by putting long-term shareholder interests first). Recognise sensitivities around minority interests</td>
<td>A, C</td>
</tr>
<tr>
<td>Excellent operational understanding</td>
<td>B, C</td>
</tr>
<tr>
<td>Excellent execution and strategic thinking</td>
<td>B, C</td>
</tr>
<tr>
<td>Shareholder friendly</td>
<td>B</td>
</tr>
<tr>
<td>Financial understanding</td>
<td>B</td>
</tr>
<tr>
<td>Good leadership and management skills</td>
<td>B, D</td>
</tr>
<tr>
<td>Understanding of markets in which they operate</td>
<td>B</td>
</tr>
<tr>
<td>Integrity</td>
<td>C, D</td>
</tr>
<tr>
<td>Sense of open-mindedness and willing to listen to other viewpoints</td>
<td>C</td>
</tr>
<tr>
<td>Good at anticipating development of markets</td>
<td>D</td>
</tr>
<tr>
<td>Competence</td>
<td>D</td>
</tr>
</tbody>
</table>

Overall the institutional investors were looking for executive directors who had a sound understanding of the business, its finances and the market in which a company operated. Institutional investor C mused:

*What separates those who are impressive from those who aren’t? A strategic grasp of the company's future and a command of the details; integrity and the ability to recognise sensitivities around minority interests. A sense of open-mindedness which means they are willing to listen to other viewpoints.*
Table 4.10  Important characteristics in non-executive directors

<table>
<thead>
<tr>
<th>Important characteristics</th>
<th>Mentioned by interviewees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Questioning, articulate and able to challenge executive directors</td>
<td>A, C, D</td>
</tr>
<tr>
<td>Wider experience to widen the perspectives of the company</td>
<td>A, D</td>
</tr>
<tr>
<td>Similar qualities to executive directors</td>
<td>B</td>
</tr>
<tr>
<td>Independent and able to represent the views of all shareholders</td>
<td>C</td>
</tr>
<tr>
<td>Self-confident</td>
<td>C</td>
</tr>
<tr>
<td>Integrity</td>
<td>D</td>
</tr>
<tr>
<td>Vision</td>
<td>D</td>
</tr>
</tbody>
</table>

The most important characteristics for non-executive directors to possess were the ability to question and challenge the executive directors effectively; experience which would benefit the company; independence, and integrity.

In terms of directors’ service contracts, the institutional investors usually looked for the executive directors to have service contracts of no more than twelve months, whilst for NEDs it was more usual to have a three-year term.

When asked which characteristics were deemed to be most important in an executive director, NOMAD A said that it depends on the role itself. For example:

*In the technology sector, they expect the technology director to know about the technology.*
It also depended upon the balance of the board. For big boards, they are:

...less fussy about the qualities of the individual directors. Smaller board directors are expected to have broader skills, each one has to tick the right boxes as well as stand back, liaise with all parties and be able to take a balanced overview.

NOMAD B’s emphasis was more of a personal nature:

... in no particular order, honesty, drive, presentability, brains and a willingness to take advice.

Thus, NOMAD A looked for a broader set of qualities in an executive director depending on board size, over and above those associated with personal character.

When the same question was asked in relation to a NED instead of an executive director, NOMAD A replied:

*Good track record in relation to the industry sector, know how the market works, the governance and AIM rules. The NED should have City awareness, knowledge and profile or operational experience with growing the business. Overall, if we are going to introduce him to the company, he’s got to fit that independent criteria.*

For NOMAD B, NEDs played quite a different role from that of executive directors:

*You’ve got a number of very frustrated executive directors in NEDs. People who have done it and are then advised to become NEDs. They can see the executive directors making a mess of it and want to step in rather than taking on a mentoring role which is more*
what they are there for. So it is a different skill. The old view that NEDs are retired accountants and bankers is now gone. NEDs are taken on who can add value to the business, open doors, fill in gaps in the EDs and play a mentoring role. Sometimes there is an almighty bun fight to get somebody on board because you need two independent NEDs on the board and you then can end up with rather ropey NEDs.

When asked whether independence was an important quality in NEDS, NOMAD B said that :

Institutions take a lot of store in terms of independence and whether NEDs should or should not be paid in cash and shares. It is reasonably possible for a NED to be paid £50,000 or £60,000 a year in a FTSE 100 company because there is relatively low risk in that. However, if you are on the board of a 20 million dollar AIM company where the wheels can fall off at any minute because it is moving so fast, it is a much tougher job, so that the levels of pay for NEDs you see are relatively modest and I question whether NEDs can do a proper job for that. My personal view is that independence is nice if you can get it, but actually having someone who has a minor but real stake in the business combined with honesty is important.

NOMAD A looked for different qualities depending on the type of NED recruited whereas NOMAD B preferred NEDs to play a mentoring role. When it came to whether independence was deemed an important quality, NOMAD A supported the standard independence criteria while NOMAD B implies that independence might not be compromised if NEDs were paid sufficiently well and had a small equity stake in the business to tie them into its future prosperity.
AIM companies and corporate social responsibility (CSR)

In terms of AIM companies and their approach to CSR, institutional investor A stated that the AIM company’s approach to CSR would be looked at carefully if it was an important factor for the company. For example, if it was an oil company, they would ask how the company handled political risk, corruption, and health and safety. Similarly institutional investor B stated:

*We only consider this if there is a material risk to the value of the company. For example, if the company is in the extractive industry and has problems in one of the countries in which it’s based, eg. protests are being featured by the press.*

Institutional investor D felt that this issue carried only a modest weight and that the main issue was whether a company’s share price would go up and whether the risks had been assessed. Investor C said that this area was not considered in his investment decisions as he felt that the existing legal, listing, and consumer-driven frameworks would get at these areas more effectively.

Other areas of importance when investing in AIM companies

Finally, the institutional investors were asked whether there were other areas that they thought were important to investing in AIM companies. As can be seen from Table 4.11, a number of additional areas were mentioned. Institutional investor A noted that broker quality was very important:
The quality of the individual [broker] following the company is most important and way outstrips the importance of the NOMAD.

Institutional investor A also expressed concerns about the culture of the home market of operation:

Part of the price of access to the UK market is accepting UK corporate governance standards.

Table 4.11 Other areas that are important when investing in AIM companies

<table>
<thead>
<tr>
<th>Other important areas</th>
</tr>
</thead>
<tbody>
<tr>
<td>Broker quality</td>
</tr>
<tr>
<td>Culture of home market of operation</td>
</tr>
<tr>
<td>Company size (once large enough desirable to move to main market)</td>
</tr>
<tr>
<td>Shareholder approval for transactions</td>
</tr>
<tr>
<td>Voting guidelines- need some for AIM companies</td>
</tr>
<tr>
<td>Use of non-pre-emptive capital</td>
</tr>
<tr>
<td>Most AIM companies not in a benchmark (index), so AIM companies carry extra risk</td>
</tr>
<tr>
<td>AIM valuations are low and potential for gains is high</td>
</tr>
<tr>
<td>There should be a formal process for a company to delist</td>
</tr>
</tbody>
</table>
NOMADs

Roles pre- and post- AIM listing

NOMAD A said that his role before the initial public offering was mainly:

...transaction focussed getting the company ready for the market in complying with due diligence.

NOMAD A continued that once a company was listed, the role was less transaction focussed but more to do with:

...providing advice on application of AIM rules and assistance with the announcements.

NOMAD B responded that:

The role is a chain that continues throughout. The work pre-IPO is satisfying ourselves the eligibility criteria regarding the AIM rules and also structuring the company to ensure that we can raise the money for the IPO. Afterwards, we are more in a maintenance mode because of the work we have done before. However, we continue to be actively involved with the client because they need to maintain adherence with the AIM rules. Also, this is where the NOMAD and broker roles merge. We have to keep the company in a state that investors will be happy with it and new investors who we want to introduce, consider it an appropriate investment.

Their views support the NOMAD’s objective in providing advice on due diligence and AIM rules procedures.
Factors influencing the decision to become an AIM company’s NOMAD

On the factors that influence the decision to become a NOMAD to a particular company, NOMAD A stated that:

[The] initial factor is based on a pure assessment of the company. Is the company solid and interesting with growth prospects? Secondly, the company has to be of a certain size criteria, partly because of how we think we can help and be in a position to provide funds for them. Also from a funding angle, institutions are open to certain sizes more than others. Thirdly, the likely prospects of future work on the transaction and broking side. And finally, as a NOMAD, whether we believe the company is investment grade based on the AIM rules.

NOMAD B’s view reinforces the importance of the broking service for the AIM client. He said that:

The starting position is that we are generally only happy to become a NOMAD if the company is looking to raise money. There is absolutely no point in becoming a NOMAD to a company which we can’t raise money for. We then look at the company’s management, its prospects and the market in which it sits. If we think the company is fundable, we are generally happy to act as its NOMAD. Part of a NOMAD’s role is seen as effectively being bolted on to the company rather than inherent in it, so that if the company is deficient in any way, we can effectively deal with that by putting on the frills to attract investors.

Their views suggest that the decision to become a NOMAD to their AIM clients is preceded by whether they can first act as their broker. It
implies that NOMAD cum broker companies see their broking service as far more important than being a NOMAD.

**Important issues for NOMADs**

The NOMADs were asked whether there were any other areas that they felt were important to being a NOMAD to AIM companies. NOMAD A said that:

*The issue of pre-emption rights is important from a broking perspective, but even though it has corporate governance implications, it is not a NOMAD’s concern. For example, there was a big run on an Israeli company back in 2005 due to the perception of weak corporate governance in Israel where there is no pre-emption rights and the chair/CEO can be combined. Institutional investors now see Israeli companies generally as riskier because of their weak governance.*

NOMAD B replied that how a NOMAD dealt with corporate governance issues came from experience:

*Having the ability to translate events and matters seen in one company and translating to another. The press likes to have a go at AIM and blame AIM. If the company has a problem, it’s an AIM problem. No, it is the company’s problem. It’s just because it happened to be in AIM. The risks of overseas companies are higher so quality should be higher. Spend a lot longer, more time, with overseas companies, even with the American companies. The thing that spurs us on in regard to any company is our good name. The fact that we raise money for a client and it then explodes on us can be disastrous to us as a broker. Having that hanging over our heads is more likely to make us do our job properly because broking is our daily bread rather than anything the SE can throw at us.*
Thus, the NOMADs that were being interviewed perceived their role as a broker to their AIM client companies as far more important than that of being a NOMAD. Further, their role as a NOMAD was seen in a passive capacity in offering corporate governance advice, perhaps to fulfil the obligations of their AIM client companies in having a NOMAD.

**Summary**

The interviews provide some interesting findings. Firstly, the AIM company directors indicated that their main reason for joining AIM was to better enable them to raise money for future financing of the business/acquisitions, and to gain access to institutional investors. It is perhaps then not surprising that one of the main objectives of corporate governance was identified as being to protect the interests of shareholders and other stakeholders. Good corporate governance was generally seen as something that would give investors more confidence in a company and help with the risk management aspects of the business. Equally some of the directors felt that the costs of corporate governance in terms of directors’ time were quite high and opinions as to whether corporate governance per se added value were divided.

Interestingly, and of some concern, is that a common theme from the AIM company directors, and the institutional investors, was a worry that with the rapid expansion of AIM, and with the admittance of an increasing number of overseas companies, the standards of corporate governance were sometimes not all that might be expected and a damaging financial collapse or scandal was only a matter of time.

The findings from the interviews with the NOMADs/brokers showed that they do not perceive their NOMAD role as being as important as their role as a broker to AIM companies, and the fact that they do not tend to actively give corporate governance advice is perhaps another aspect that may give added weight to concerns about the quality of corporate governance in some AIM companies.
5 ANALYSIS OF AIM COMPANIES’ ANNUAL REPORTS

Introduction

The motivation for this study to analyse the extent to which AIM companies comply with the QCA Guidelines partly stems from an absence of recent published research into the governance of companies in this market. This study examines the extent of compliance with current regulations before Rule 26 came into effect on 20th August 2007. This London Stock Exchange rule requires AIM companies to maintain corporate websites providing information on specific financial and governance matters.

This chapter has two main objectives. First, it is to investigate the level and quality of voluntary disclosure of the QCA Guidelines in a sample of 300 AIM companies. Twenty three items taken from the QCA Guidelines are organised for ease of discussion into six categories:

a) General;

b) Board;

c) Board sub-committees;

d) Non-executive directors;

e) Performance evaluation and review; and

f) Benefit of shareholders over the longer term.

Each of the 300 AIM companies’ annual reports was examined to determine the company’s disclosure practice as indicated by the level of disclosure of the various items in the QCA Guideline categories. The implications from this analysis are then discussed.
The second objective is to examine the significance of specific firm and market related characteristics as measured by a voluntary disclosure score based on 23 items analysed earlier from the QCA Guidelines. Nine questions were examined and a multiple regression model was constructed using data collected from the annual reports of the 300 sample companies. The results and findings are examined to determine the significance of these factors on the extent of corporate governance disclosure practice. Finally, a summary and conclusions are presented.

**Research design**

This section discusses the data sources that are used and how the sample companies are selected. It then discusses how the recommendations from QCA Guidelines are split into 23 items listed under six different categories. Next, it provides a brief discussion on the development of specific questions. This is followed by describing how the disclosure score is compiled together with the construction of a multiple regression model.

**Data sources and sample selection**

The sample used in this study consists of 300 companies drawn from a population of 1,118 UK incorporated companies which joined AIM before June 2006. The main criteria used for identifying the sample companies were:

- the annual report and accounts for the period ending between October 2005 and September 2006 were available by accessing Northcote, Hemscott or the company’s own websites;
- the number of companies selected for each sector were based on a representative proportion of the population contained in each
of the ten industry classification sectors adopted in the Industry Classification Benchmark (ICB); and

- the sample companies were randomly selected within each ICB industry sector.

Table 5.1 shows the total number of companies on AIM and the number in each industry sector, together with the number of companies from each industry sector in the sample. Figures 5.1 and 5.2 show that the 300 companies are a representative sample based on industry sector.

**Table 5.1 Sample companies by industry sector**

<table>
<thead>
<tr>
<th>Industry sector</th>
<th>Total No.</th>
<th>Total %</th>
<th>No. in sample</th>
<th>% in sample</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic Materials</td>
<td>114</td>
<td>10%</td>
<td>30</td>
<td>10%</td>
</tr>
<tr>
<td>Consumer Goods</td>
<td>52</td>
<td>5%</td>
<td>15</td>
<td>5%</td>
</tr>
<tr>
<td>Consumer Services</td>
<td>172</td>
<td>15%</td>
<td>46</td>
<td>15%</td>
</tr>
<tr>
<td>Financials</td>
<td>264</td>
<td>24%</td>
<td>70</td>
<td>23%</td>
</tr>
<tr>
<td>Health Care</td>
<td>72</td>
<td>6%</td>
<td>20</td>
<td>7%</td>
</tr>
<tr>
<td>Industrials</td>
<td>212</td>
<td>19%</td>
<td>56</td>
<td>19%</td>
</tr>
<tr>
<td>Oil and Gas</td>
<td>70</td>
<td>6%</td>
<td>18</td>
<td>6%</td>
</tr>
<tr>
<td>Technology</td>
<td>134</td>
<td>12%</td>
<td>38</td>
<td>13%</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>22</td>
<td>2%</td>
<td>6</td>
<td>2%</td>
</tr>
<tr>
<td>Utilities</td>
<td>6</td>
<td>1%</td>
<td>1</td>
<td>0%</td>
</tr>
<tr>
<td><strong>Total number of companies</strong></td>
<td><strong>1,118</strong></td>
<td><strong>100%</strong></td>
<td><strong>300</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>
The 23 corporate governance attributes noted below from the QCA Guidelines were recorded from the sample companies’ annual reports and a disclosure score sheet was completed by one of the researchers. A second researcher scrutinised the same annual reports and compared the results with those obtained by the first researcher to ensure consistency. Company and market related characteristics were either extracted from
the company’s annual report, a Hemscott database or downloaded from Datastream. The dates when sample companies were listed on AIM were taken from Hemscott and verified using listing data information from the London Stock Exchange.

Categorising QCA Guidelines

Table 5.2 Panels A to F document the six categories relating to features of good governance and reporting that have been distilled from the QCA Guidelines.

Table 5.2 Corporate governance practice disclosures in the annual reports of 300 AIM companies

<table>
<thead>
<tr>
<th>Panel A - General disclosures</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>%</td>
</tr>
<tr>
<td>1. Is there a corporate governance statement on how the key principles are applied?</td>
<td>272</td>
<td>90.7</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Panel B - Board disclosures</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>%</td>
</tr>
<tr>
<td>2. Are members of the board and its sub-committees identified?</td>
<td>235</td>
<td>78.3</td>
</tr>
<tr>
<td>3. Is there a statement of how the board operates?</td>
<td>267</td>
<td>89.0</td>
</tr>
<tr>
<td>4. Does the company disclose specific matters reserved for board approval?</td>
<td>49</td>
<td>16.3</td>
</tr>
<tr>
<td>5. Does the report name all the directors accompanied with biographical details?</td>
<td>232</td>
<td>77.3</td>
</tr>
<tr>
<td>6. Is the board provided with timely and appropriate information in order to discharge its duties?</td>
<td>182</td>
<td>60.7</td>
</tr>
<tr>
<td>7. Is the number of board meetings and directors’ attendance disclosed?</td>
<td>48</td>
<td>16.0</td>
</tr>
</tbody>
</table>
Table 5.2  Corporate governance practice disclosures in the annual reports of 300 AIM companies (Cont.)

<table>
<thead>
<tr>
<th>Panel C - Board sub-committees</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>%</td>
</tr>
<tr>
<td>8. Is there an audit committee?</td>
<td>250</td>
<td>83.3</td>
</tr>
<tr>
<td>9. Are there at least two members of the audit committee, who are independent NEDS?</td>
<td>118</td>
<td>39.3</td>
</tr>
<tr>
<td>10. Is there a remuneration committee?</td>
<td>253</td>
<td>84.3</td>
</tr>
<tr>
<td>11. Are there at least two members of the remuneration committee who are independent NEDS?</td>
<td>121</td>
<td>40.3</td>
</tr>
<tr>
<td>12. Is there a nomination committee?</td>
<td>113</td>
<td>37.7</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Panel D - Non-executive directors</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>%</td>
</tr>
<tr>
<td>13. Does the board describe independence?</td>
<td>97</td>
<td>32.3</td>
</tr>
<tr>
<td>14. Does the board identify the non-executive directors that it considers to be independent?</td>
<td>147</td>
<td>49.0</td>
</tr>
<tr>
<td>15. Does the board comprise of at least two independent non-executive directors?</td>
<td>131</td>
<td>43.7</td>
</tr>
</tbody>
</table>
Table 5.2  Corporate governance practice disclosures in the annual reports of 300 AIM companies (Cont.)

<table>
<thead>
<tr>
<th>Panel E - Performance evaluation and review</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>%</td>
</tr>
<tr>
<td>16. Is there disclosure that the board regularly reviews the process of internal control?</td>
<td>230</td>
<td>76.7</td>
</tr>
<tr>
<td>17. Does this disclosure cover all material controls including financial, operational and compliance controls and risk management systems.</td>
<td>210</td>
<td>70.0</td>
</tr>
<tr>
<td>18. Does the board describe how directors' performance is formally evaluated?</td>
<td>35</td>
<td>11.7</td>
</tr>
<tr>
<td>19. Are all directors submitted for re-election at regular intervals?</td>
<td>222</td>
<td>74.0</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Panel F - Benefit to shareholders</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>%</td>
</tr>
<tr>
<td>20. Is there a statement explaining directors' responsibility in respect of the accounts?</td>
<td>300</td>
<td>100.0</td>
</tr>
<tr>
<td>21. Is there a statement of the steps taken by the board to develop a dialogue with shareholders?</td>
<td>168</td>
<td>56.0</td>
</tr>
<tr>
<td>22. Are the roles of chairman and chief executive exercised by different individuals?</td>
<td>223</td>
<td>74.3</td>
</tr>
<tr>
<td>23. Where the auditor provides significant non-audit services, is there an explanation of how the auditor's objectivity and independence are safeguarded?</td>
<td>34</td>
<td>11.3</td>
</tr>
</tbody>
</table>
The first category, in Panel A, contains a question about whether an AIM company has published a corporate governance statement on its website or set out such a statement in its annual report and accounts. This statement describing how corporate governance is achieved is less onerous than that required from listed companies on the main market where Para 9.8.6 of the Listing Rules requires a listed company to describe in a statement whether it has complied throughout the accounting period with all relevant provisions set out in Section 1 of the Combined Code and, where there is non-compliance, reasons for non-compliance with any of these provisions.

The second category, in Panel B, contains six questions about the main board and how it operates. These questions range from identifying members of the board and its subcommittees to the number of board meetings and disclosure of directors’ attendance at them. Disclosures about the composition of the board sub-committees are found in the third category in Panel C. The three questions in Panel D examine the disclosure of the independence of non-executive directors, an important issue under the provisions of the Combined Code (A3.1). The penultimate category, Panel E includes three questions about the nature and frequency of internal control reviews and whether a company publicly reports on how its directors’ performance is formally reviewed. The final category, Panel F has four questions that investigate the disclosure of issues which benefit shareholders. A detailed discussion of corporate governance disclosures is given below.

Analysis of disclosure practice

The results from analysing the elements of governance practice as recommended by the QCA Guidelines are presented in Table 5.2. Examples from the sample companies’ accounting reports of corporate governance practice for each element are illustrated in appendix one.
Following Paragraph 9.8.6 of the Listing Rules, the QCA recommends that an AIM company should publish a corporate governance statement either in its annual report or on its corporate website, describing how it achieves good governance. Nine out of ten of the sample companies disclosed in their annual reports a corporate governance statement. All of them indicated that they were not required to comply with the provisions of the Combined Code but nevertheless sought to comply with its principles in so far as they deemed it appropriate to their size and business circumstances. The remaining 28 sample companies did not provide a specific corporate governance statement despite the recommendation in the QCA Guidelines. This means that just under ten percent of sample companies still view a corporate governance statement as unimportant, and hence it is not mentioned in their annual report.

On board governance characteristics, 78% of the sample companies disclosed the identity of their chairman, their chief executive officer and members of the board sub-committees. When the annual reports were scrutinised to find out how many companies issued a statement of how their board operated, 89% of the sample companies adopted this provision. This high level of compliance indicates the willingness of smaller companies to explain how their board functions.

AIM companies are expected to provide a formal schedule of specific matters reserved for board approval in their reporting to shareholders. Only one in six AIM companies disclosed this item. Many of the sample companies are clearly reticent to provide this information to their shareholders. It should be noted that 72 out of the 251 companies recorded as having non-disclosure for this item did mention that specific matters were reserved for board approval but did not identify what these specific matters were and, hence it was interpreted that they had not disclosed this item.

To encourage effective management, the QCA Guidelines recommend that the names of directors be reported together with sufficient biographical details of them. Just over three quarters of sample
companies did so, to help shareholders make informed decisions on the balance of the board.

Boards of AIM companies are encouraged to disclose how they are provided with timely and appropriate information in order to discharge their duties. Because it is subjective to decide whether information is timely and appropriate, a score of one is recorded if a sample company mentions the provision of information for the board. A reasonably high level of nearly 61% of the sample companies documented this practice.

Both QCA Guidelines and the Combined Code recommend that companies disclose the number of board meetings and their directors’ attendance for these meetings. Forty eight companies in the sample chose to do so in their annual report. Of the remaining 252 companies, 175 of them reported only the number of board meetings. Hence they were assigned a zero score because it was interpreted that they had not fully complied with the recommendation.

The QCA expects AIM companies to establish an audit committee and a remuneration committee of at least two members each, who should all be independent non-executive directors. About one in six of the sample companies had either no audit or remuneration committee, apparently due to their organisational size and stage of development. Just under half of the sample companies which had audit or remuneration committees had committee members deemed to be independent non-executive directors. Only 113 out of the 300 sample companies reported that they have established a nomination committee, a proportion much lower than that of audit or remuneration committees.

The notion of what an ‘independent’ non-executive means is described in detail under the Combined Code Paragraph A.3.1. Under this provision:

*The board should determine whether the director is independent in character and judgement and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director’s judgement.* (Para A.3.1)
Seventy one of the 300 sample AIM companies stated they followed this definition in describing their independent non-executive directors to signal their objective of having non-executive directors who were independent.

The QCA Guidelines take a less robust approach to the meaning of independence when it recommends that an AIM company should report only the reasons why it has deemed a director to ‘be independent notwithstanding variables which may appear to impair that status’ (QCA, 2005, pg 9). For example, an AIM company may wish to reward its non-executive directors with share options as an effective way to encourage their commitment, even though the Combined Code states that they should not receive such remuneration (see Paragraph B.1.3 of the Combined Code). Twenty six such companies that did not meet the Combined Code’s requirements but described why their non-executive director was considered to be independent were given a score of one too. In total, just under a third of sample AIM companies’ boards defined independence within either the context of QCA Guidelines or the Combined Code provisions.

Forty nine per cent of the sample AIM companies’ non-executive directors were identified by their boards as being independent when the sample companies annual reports were scrutinised to identify which of their non-executive directors were considered independent. As the rest of the sample AIM companies did not disclose whether their non-executive directors were independent or not, they were given a zero disclosure score for this item. This means that just slightly more than half of sample companies’ boards viewed their non-executive as being non-independent. This rather large percentage implies the ‘notion’ of ensuring their non-executives to be independent has not been adopted by them. The Combined Code and QCA Guidelines recommend that the board of a smaller quoted company should have at least two independent non-executive directors. As many AIM companies are growing young enterprises with limited resources, it is not surprising that only forty
four per cent of them reported the presence of at least two independent non-executive directors.

The QCA Guidelines state that the board should conduct a review at least once a year, of the effectiveness of the organisation’s internal control system and report this review to its shareholders. The review should include all material controls and risk management systems. Seventy seven per cent of the sample AIM companies disclosed in their annual reports that this review took place at least annually but only 70% of this group went further to describe what types of controls and risk management systems were reviewed.

The Combined Code recommends that a board states in its annual report how performance evaluation of the board and its individual directors has been carried out (Paragraph A.6.1). Guidance from the QCA is less onerous whereby a board is only expected to describe any performance evaluation procedures for its directors. The analysis of the sample AIM companies revealed poor disclosure of this item as only 35 companies described how its directors’ performances were evaluated.

The QCA also advises AIM companies to state whether all directors submit themselves for re-election at regular intervals. The disclosure rate for this was much higher with almost three out of four sample companies reporting that their directors submitted themselves for re-election at regular intervals.

One of the QCA’s disclosure guidance areas is for directors to publish a statement explaining their responsibility for preparing the annual report and accounts so that investors can confidently rely on them to make informed decisions about the company. All of the 300 sample AIM companies’ directors reported their responsibilities in the form of a separate statement.

Communications with a company’s investors, particularly major shareholders, is seen as important for the board to develop an understanding of their views about a company (Combined Code Provision D.1.2). The QCA equally endorses this principle that the
board should ensure a satisfactory dialogue takes place with shareholders. Fifty six per cent of the sample AIM companies disclosed in their annual accounts how they conducted this dialogue with their shareholders (an example can be found in appendix two). As AIM companies are not required to issue shares to the public, this high level of disclosure is encouraging.

The Combined Code makes a clear case that responsibilities for running the company’s business and running the board should be allocated to different individuals. This CEO/Chairman split, based on different roles, is also supported within the QCA Guidelines. Despite the relatively small size of boards that operate in the AIM, three out of four sample companies indicated in their annual reports that they had separate CEO and chairman roles. However, many of these companies which were given a score of one for adopting the split role did not explain in detail the division of responsibilities.

The QCA Guidelines recommend that AIM companies should explain in their annual report to their shareholders how their auditors’ objectivity and independence is safeguarded if their auditors also provide significant non-audit services. In scoring this item, auditors that only provided an audit service to AIM companies, or where non-audit services were described as insignificant, were given a score of one. There were 34 such companies. Of the remaining 266 companies, only 12 of them explained how their auditors’ objectivity and independence was safeguarded. This low compliance rate may indicate that AIM companies in general do not perceive this matter as being of such importance to them compared to the larger main market companies where non-audit services can be substantial.

Research questions

Prior research finds that certain firm and market related features are associated with the extent of company disclosures. The company
characteristics examined in this report are age, ownership by institutional
investors, company size, using a company’s gross turnover or revenue
income, gearing and board size. Two market related features unique to
AIM companies are also analysed. The first unique feature is whether an
AIM company is advised by a nominated adviser only or a nominated
adviser who also acts as its broker. The second unique feature is that
of main market companies moving down to the less regulated AIM.
The sample companies are divided into those that have shown reported
gross turnover or revenue income in their Income Statement and those
companies that have not.

No empirical studies examine the link between a company’s age
and the extent of its voluntary information disclosure. In this study,
age is measured by the number of years it has been listed on AIM as at
May 2006. This research investigates whether there is an association
between age and disclosure because the light regulatory requirements on
AIM may only work in the long term, even though newer companies are
expected to demonstrate sound corporate governance features when they
raise equity capital on admission and older AIM companies have more
resources once they are established, to improve their governance.

Thus, this study examines whether there is an association between
an AIM company’s age and the level of voluntary disclosure of corporate
governance.

Institutional shareholders, through their substantial shareholdings,
are keen to monitor the performance of their investee companies. Hence
companies have a strong incentive to disclose voluntary information to
inform these large shareholders. Both Heely et al., (1999) and Bushee’s
and Noe’s (2000) studies report a positive link between large institutional
ownership and increased corporate disclosure. Birt et al., (2006) also
find that Australian firms with high levels of share ownership by their
top 20 shareholders are more likely to disclose voluntary segmental
similarly conclude that the higher the level of institutional ownership,
the greater the disclosure of voluntary corporate practices. Further, this report examines whether the higher the total percentage of institutional shareholders’ ownership, the higher the score of voluntary disclosure of corporate governance.

Company size has been used in a number of previous studies to indicate the extent of information disclosure. Large companies are expected to disclose more information as they have more highly skilled personnel at their disposal and the cost of publicly reporting information is reduced by the need to have produced this information already for internal consumption (Camfferman and Cooke, 2002). Greater disclosure by large firms allows transparency and encourages a larger number of analysts’ to follow the companies share performance leading to a lower cost of capital (Botosan, 1997; Lang and Lundholm 2000). Chow and Wong-Boren (1987) observe however, that agency costs increase with firm size. Therefore, larger firms are encouraged to voluntarily disclose more information to reduce agency costs. McNally et al. (1982) and Cooke (1989) find that disclosure positively increases with total assets as a measure of company size. Findings from other studies using different measures of company size like turnover (Firth, 1979) or market value (Hossain et al., 1994) corroborate the increased voluntary disclosure for larger firms. Thus, this study examines whether the larger the size of a company, the higher the score of its voluntary disclosure of corporate governance.

Companies with large debt borrowings are expected to increase their level of voluntary disclosure to maintain future opportunities to raise funds. The gearing ratio can therefore be seen as a substitute for debt lenders’ claims. Empirical results for the gearing ratio as an indicator of voluntary disclosure are mixed. Camfferman and Cooke (2002) find that gearing in Dutch companies is positively associated with disclosure but gearing in UK companies is negatively associated with disclosure. A positive and significant relationship between gearing and disclosure was reported by Malone et al. (1993); Bradbury, (1992); Ahmed and
Courtis (1999) and Barako et al. (2006). However, other studies find no significant relationship (Ahmed and Nicholls, 1994; Hossain et al., 1994; Wallace and Naser, 1995). This study therefore analyses whether the higher the gearing, the higher the score of voluntary disclosure of corporate governance.

Cheng and Courtenay (2006), in examining the annual reports of Singaporean firms find that there is no association between board size and the extent of voluntary disclosure. Given there is as yet no substantial empirical evidence in this area, this research also investigates whether there is an association between the size of a company’s board and the level of voluntary disclosure of corporate governance.

An AIM company is required by the listing rules to have a nominated adviser who may also act as the company’s broker (NomadBro). Mallin and Ow-Yong (1998) posit that AIM companies which have a nominated adviser cum broker are more likely to exhibit stronger governance features than nominated adviser only (NOMAD) companies. This is probably due to the reputational effect whereby NomadBro firms have more to lose if their AIM client companies collapse. Thus, whether an AIM company advised by a nominated adviser who also acts as its broker has a higher level of voluntary corporate governance disclosure is also investigated.

The type of auditor firm, Big 4 or not Big 4, suggests that:

...the contents of annual reports and accounts are not only audited but also influenced by auditors. (Camfferman and Cooke, 2002, p.12)

This finding of positive association is also corroborated by DeAngelo (1981) and Wallace et al. (1994) who argue that companies audited by larger audit firms disclose more. Thus, companies audited by a Big 4 audit firm may have a higher score of voluntary disclosure of good corporate governance.
A unique feature of AIM is the possibility for main market companies to move down to list on AIM which requires less compliance and regulatory costs. As these ex-main market firms may already possess corporate governance structures required by the Combined Code, it is expected that they will continue to maintain the governance structures subject to resource constraints. Differences in the level of voluntary disclosure of corporate governance features between ex-main market AIM companies and other AIM companies is not predicted prior to our analysis as there are no previous published studies on this aspect.

Due to the lighter regulation on the AIM, companies listing there do not require a previous trading or financial history on admission. Thus, a number of companies have reported expenditure without showing any gross turnover or revenue in their annual reports. Consequently, there may be an association in the level of voluntary disclosure of corporate governance between AIM companies with or without gross turnover or revenue.

**Construction of corporate governance disclosure score**

This study uses the self-constructed disclosure score already discussed to capture the cross-sectional variation in disclosure levels based on elements of good governance recommended in the QCA Guidelines for AIM companies. The disclosure items sheet is shown in appendix one.

An important and contentious issue often discussed in the empirical literature is whether to assign some form of weighting to items such as these. Both weighted and unweighted scores have been criticised for the subjectivity in weighting. In this study a non-weighted aggregate score is adopted as it is deemed too subjective to assign different weights on aspects of governance. A dichotomous variable was employed whereby a company is given a score of one if the item is disclosed, otherwise zero is recorded. The maximum score that could be achieved is thus 23. The disclosure score for the company is then used as the dependent variable or factor in a multi-variable regression model discussed next.
Regression model

The technique employed to examine the relationship between the voluntary disclosure score and the independent variables uses a regression model that investigate whether the voluntary disclosure score is affected by:

\[ X_1 = \text{AIMAge} = \text{number of years company is listed on AIM}; \]
\[ X_2 = \%\text{Institut} = \text{percentage of equity ownership by institutional investors with 3\% equity or more}; \]
\[ X_3 = \log \text{of total assets}; \]
\[ X_4 = \text{Gearing} = \text{book value of long term debt as a percentage of the book value of long term debt and shareholder funds}; \]
\[ X_5 = \text{BSize} = \text{total number of directors on the board}; \]
\[ X_6 = \text{BroNom} = 1 \text{ if the company’s NOMAD is also its broker, 0 if otherwise}; \]
\[ X_7 = \text{Big4Firm} = 1 \text{ if the company’s auditor is a Big 4 Firm, 0 if otherwise}; \]
\[ X_8 = \text{ExMain} = \text{if the company joined AIM from the main market, 0 if otherwise; and} \]
\[ X_9 = \text{Turndum} = 1 \text{ if the company has a gross turnover or revenue; 0 if otherwise.} \]

The regression model allows the measurement of how significant or otherwise any of these variables are on the disclosure score.
Regression results and analysis

Table 5.4 presents summary results of the disclosure score and the factors that may affect it.

Table 5.4  Descriptive statistics

<table>
<thead>
<tr>
<th>Panel A: Disclosure score variable</th>
<th>Label</th>
<th>Mean</th>
<th>Median</th>
<th>Min</th>
<th>Max</th>
<th>Standard Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Disclosure score</td>
<td>DScore</td>
<td>13.05</td>
<td>13</td>
<td>2</td>
<td>23</td>
<td>5.09</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Panel B: Explanatory Factors</th>
<th>Label</th>
<th>Mean</th>
<th>Median</th>
<th>Min</th>
<th>Max</th>
<th>Standard Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of years listed on AIM</td>
<td>AIMAge</td>
<td>3.87</td>
<td>3.00</td>
<td>1.00</td>
<td>11.00</td>
<td>2.59</td>
</tr>
<tr>
<td>% of total institutional investors shareholding</td>
<td>%Institut</td>
<td>29.58</td>
<td>28.47</td>
<td>0.00</td>
<td>98.30</td>
<td>24.44</td>
</tr>
<tr>
<td>Total assets</td>
<td>LogAssets</td>
<td>9.58</td>
<td>9.58</td>
<td>4.64</td>
<td>14.15</td>
<td>1.45</td>
</tr>
<tr>
<td>Long term debt/total capital</td>
<td>Gearing</td>
<td>0.15</td>
<td>0.01</td>
<td>0.00</td>
<td>0.99</td>
<td>0.26</td>
</tr>
<tr>
<td>Board size</td>
<td>BSize</td>
<td>5.63</td>
<td>6.00</td>
<td>2.00</td>
<td>10.00</td>
<td>1.61</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Panel C: Other Factors</th>
<th>Label</th>
<th>No. of companies without these factors</th>
<th>No. of companies with these factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Broker cum Nomad/Nomad</td>
<td>BroNom</td>
<td>85 companies</td>
<td>215 companies</td>
</tr>
<tr>
<td>Audit firm</td>
<td>Big 4 Firm</td>
<td>202 companies</td>
<td>98 companies</td>
</tr>
<tr>
<td>Main to AIM</td>
<td>ExMain</td>
<td>275 companies</td>
<td>25 companies</td>
</tr>
<tr>
<td>Turnover or trading activity</td>
<td>Turndum</td>
<td>43 companies</td>
<td>257 companies</td>
</tr>
</tbody>
</table>
Table 5.4 shows that there is a wide range in the disclosure score, from just two items disclosed to all 23 items disclosed, with a mean of 13.05. The regression analysis was carried out using the normalised disclosure scores employing the van Der Waerden technique.

The average mean age of the sample AIM companies is 3.87 years which suggests that relatively more companies were admitted in recent years than eleven years ago when AIM was launched. Institutional investors, on the whole, owned an average of nearly 30% of the total issued shares. The distribution of the total assets book value was normalised using a log transformation. As 132 out of the 300 companies did not have any long-term debt, the gearing level is quite low. The low gearing level indicates there is still surplus equity capital that was raised by these companies on admission to AIM.

The number of directors on the boards ranges from two to ten with an average mean of 5.63 directors. Further analysis, not shown here, reveals that only two out of three of the sample AIM companies have at least three executive directors on their boards, while 48% have at least three non-executive directors resulting in relatively smaller boards when compared with the larger main market listed companies.

Two hundred and fifteen AIM companies were advised by nominated advisers who also acted as their brokers, the remaining companies had separate nominated advisers and brokers. Nearly a third of AIM companies are audited by one of the Big 4 audit firms with the remaining companies audited by smaller audit practices.

There were 25 companies that had previously been listed on the main market with the remaining 275 companies listing for the first time on AIM. Although the proportion of ex-main market companies is low in this sample, it nevertheless indicates that there is a small migration of main market companies onto the lightly regulated AIM with its lower fees.
Finally, there are 43 AIM companies where the annual reports reveal no trading activity or revenue. Thirty-six of these 43 companies disclosed that they had yet to borrow any long-term debt.

Table 5.5 shows that larger firms tend to have bigger boards and are audited by Big 4 audit firms.

Table 5.6 presents the regression model that has an adjusted R² of 25.6% which shows that these factors explain 25.6% of the disclosure score. The AIMAge variable is statistically significant (p < 0.05) but has a negative coefficient indicating that younger companies disclose more corporate governance. This implies that younger companies with little or no trading history demonstrate a higher commitment to good governance practice to investors upon listing on AIM.

The percentage of institutional shareholders does not appear to impart better corporate governance disclosure. Company size as measured by total assets is highly significant (p < 0.01) and positively associated with disclosure. This finding is consistent with the argument that size is significant on companies’ reporting practices confirming that larger companies tend to have more voluntary disclosure of information.

**Table 5.5  Pearson correlations among explanatory and categorical factors**

<table>
<thead>
<tr>
<th>Label</th>
<th>AIMYear</th>
<th>%Institut</th>
<th>LogAssets</th>
<th>Gearing</th>
<th>BSize</th>
<th>BroNom</th>
<th>Big4 Firm</th>
<th>Ex-Main</th>
</tr>
</thead>
<tbody>
<tr>
<td>%Institut</td>
<td>-0.050</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>LogAssets</td>
<td>0.006</td>
<td>0.135**</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gearing</td>
<td>0.064</td>
<td>-0.065</td>
<td>0.018</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BSize</td>
<td>-0.008</td>
<td>0.065</td>
<td>0.252***</td>
<td>-0.100</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BroNom</td>
<td>-0.051</td>
<td>0.001</td>
<td>0.080</td>
<td>-0.121**</td>
<td>0.093</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Big4Firm</td>
<td>0.111</td>
<td>0.028</td>
<td>0.269***</td>
<td>-0.035</td>
<td>0.219***</td>
<td>-0.004</td>
<td></td>
<td></td>
</tr>
<tr>
<td>ExMain</td>
<td>-0.144</td>
<td>-0.094</td>
<td>0.068</td>
<td>0.031</td>
<td>-0.042</td>
<td>-0.025</td>
<td>0.099</td>
<td></td>
</tr>
<tr>
<td>Turnover</td>
<td>0.194***</td>
<td>-0.109</td>
<td>0.066</td>
<td>0.140**</td>
<td>0.029</td>
<td>0.017</td>
<td>0.082</td>
<td>0.123**</td>
</tr>
</tbody>
</table>

**Note:**  
** Correlation is significant at the 5% level  
*** Correlation is significant at the 1% level
Table 5.6  Regression estimates: (Dependent variable\(^1\): Unweighted QCA Guidelines Disclosure Score)

<table>
<thead>
<tr>
<th>Explanatory factors(^2)</th>
<th>Predicted sign(^3)</th>
<th>Estimated co-efficient(^4)</th>
<th>T-statistic(^5)</th>
<th>P-value(^6)</th>
</tr>
</thead>
<tbody>
<tr>
<td>AIMAge</td>
<td></td>
<td>-0.060</td>
<td>-3.06</td>
<td>0.002</td>
</tr>
<tr>
<td>%Institut</td>
<td>+</td>
<td>0.004</td>
<td>1.72</td>
<td>0.086</td>
</tr>
<tr>
<td>LogAssets</td>
<td>+</td>
<td>0.112</td>
<td>3.10</td>
<td>0.002</td>
</tr>
<tr>
<td>Gearing</td>
<td>+</td>
<td>-0.459</td>
<td>-2.34</td>
<td>0.020</td>
</tr>
<tr>
<td>BSize</td>
<td></td>
<td>0.182</td>
<td>5.68</td>
<td>0.000</td>
</tr>
<tr>
<td>Categorical Factors</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BroNom</td>
<td>+</td>
<td>-0.050</td>
<td>-0.44</td>
<td>0.659</td>
</tr>
<tr>
<td>Big4Firm</td>
<td>+</td>
<td>0.178</td>
<td>1.61</td>
<td>0.108</td>
</tr>
<tr>
<td>ExMain</td>
<td></td>
<td>0.416</td>
<td>2.28</td>
<td>0.023</td>
</tr>
<tr>
<td>Turndum</td>
<td></td>
<td>0.516</td>
<td>3.55</td>
<td>0.000</td>
</tr>
<tr>
<td>Constant</td>
<td></td>
<td>-2.4</td>
<td>-6.49</td>
<td>0.000</td>
</tr>
</tbody>
</table>

Notes:

1. The dependent variable is a variable that depends upon the values of other variables and constants in some relationship.
2. Explanatory factors are those factors that are examined to observe their effects on the value of the dependent variable.
3. The predicted positive sign means there is a predicted positive relationship between an explanatory factor and the dependent variable.
4. The estimated co-efficient represents the rate of change of the dependent variable as a function of changes in an explanatory factor.
5. T-statistic is used to evaluate the significance of an explanatory factor.
6. P-value is the probability that a calculated T-statistic occurred by chance alone.
7. R-Square (adjusted) measures the extent to which the explanatory factors account for the variation in the disclosure score (dependent variable) after taking into account the sample size and number of explanatory factors used in this model. R-Square (adjusted) = 25.6%.
8. F-Stat measures the overall significance of the explanatory factors as a group. F-Stat = 12.46.
It is expected that companies with high gearing levels would have more voluntary corporate governance disclosure in their annual reports. Our findings show gearing is significant \( p < 0.05 \) but it has a negative coefficient. This result suggests that companies with lower gearing voluntarily disclose more than those with higher gearing levels. This inconsistency with our expectations may be explained by the fact that a large number of the sample AIM companies (44\%) do not have long term debt borrowings at all. Many of them are young companies which have raised substantial equity capital on admission to AIM. Thus their equity investors may expect to see good governance structures, such as strong boards and independent NEDs, in place, to protect their claims especially if these companies have limited, or no, financial history.

The size of an AIM company’s board is found to be highly significant \( p < 0.01 \) and positively associated with the extent of disclosure. A possible reason for this positive association is that as AIM boards are typically smaller than main market boards, the larger the board size, the more likely an AIM company has the capacity to comply with good governance practice.

The results also show that whether an AIM company is advised by a nominated adviser cum broker or nominated adviser only is not statistically significant \( p > 0.05 \) and the coefficient is negative. A possible explanation for this finding is that nominated advisers whether acting on their own for these AIM companies or as their brokers too, are licensed by the London Stock Exchange. Hence, they would encourage their client companies to comply with good disclosure reporting in their capacity as nominated advisers if only to protect their reputation and continued good relationship with the London Stock Exchange.

The external audit firm variable also lacks statistical significance \( p > 0.05 \) although its positive coefficient indicates that AIM companies with Big 4 Firm auditors tend to have higher disclosure levels than those with non-Big 4 Firm auditors. A possible reason is that all AIM
companies, whether audited by a Big 4 firm or not, would be advised by their nominated advisers to comply with good governance practice.

The ex-main market variable has a significant ($p < 0.05$) and positive association with the extent of voluntary disclosure. This result is expected because main market firms moving down to a junior market like AIM should have had the necessary governance structures in place in response to the Combined Code requirements and are expected to continue and maintain their governance status where feasible.

Finally, the turnover variable is highly significant ($p < 0.01$) and its positive coefficient means the level of disclosure by an AIM company that has turnover or revenue is higher than one without. It is interesting to note that 35 out of the 43 companies in the ‘no turnover’ variable group, come from the basic materials and oil and gas sector industries. This result appears to suggest that highly risky extractive industry sector companies which operate mainly outside the UK, have lower levels of reported corporate governance as recommended under QCA Guidelines. As a group collectively, their low disclosure levels are likely to be of some concern to the regulatory authorities.

**Summary**

This chapter extends previous studies on the voluntary disclosure of company information in three ways. First, AIM companies’ compliance with the recommendations of good governance practice by QCA is analysed through the annual reports of 300 companies. Second, the impact of various firm and market related features on the degree of voluntary corporate governance disclosure by these AIM companies is analysed through a multi-linear regression model. Thirdly, the sample is of AIM companies which are under-researched so this study makes a significant contribution to that area of research.

This chapter finds that the basic elements of good governance practice such as including a corporate governance statement, the presence
of board sub-committees, identifying who the directors are and their responsibilities, and splitting the role of chairman and CEO are disclosed by the majority of the sample AIM companies. The QCA Guidelines on what independence means and having at least two independent non-executive directors are moderately adopted. The level of disclosure is low for aspects of governance that reveal more personal matters like evaluating directors’ performance and their attendance at board meetings.

The findings from the tabular analysis conducted in this study can be broadly compared with some of the findings in the Grant Thornton (2005) survey although its sample is much smaller, based only on AIM companies located in the South West region and analyses compliance with the Combined Code (2003) rather than the QCA Guidelines. Overall, this study indicates an increase in disclosure levels when compared with the Grant Thornton (2005) survey. For example, 89% of the sample AIM companies issued a statement on how the board operates compared with 49% in Grant Thornton’s survey. Increased disclosure on a more modest level is also found in the disclosure of the identity of board and subcommittee members, a description of independence, identifying independent NEDs and a review of the internal control processes.

Overall, the sample AIM companies disclose less on corporate governance practice than expected from the recommendations stated in the QCA Guidelines. This indicates that AIM companies can, and should, increase their disclosure levels especially in the areas that influence investors’ decisions on NEDs’ independence and reporting on the formal evaluation of directors’ performance.

The regression of the firm and market related factors on the disclosure score produced some interesting results. First, young AIM companies are likely to disclose a higher level of governance practice. Second, the finding on the influence of company size on disclosure levels is consistent with previous studies. However, the presence of institutional investors does not affect disclosure levels. Third, equity investors in AIM companies which have no long term-debt borrowings still expect good governance structures to protect their claims.
The reporting of the adoption of good governance increases with board size and shows that wide adoption of the QCA Guidelines may be impaired by companies with small boards. The type of nominated adviser and audit firm are found not to be influential in determining the disclosure level. Ex-main market companies are found to have higher disclosure scores indicating that they generally continue to maintain the governance structures and disclosures that they had when they were listed on the main market. The low reported level of disclosure by the majority of companies in the highly risky basic materials and oil and gas sector industries may indicate weaknesses in their corporate governance and hence these companies may be more vulnerable to financial problems. In summary, the findings suggest that the internal dynamics of AIM companies like company size and board size exert a greater influence on voluntary corporate governance disclosures than market related factors such as the type of external advisor or auditor.
As identified at the start of the report, AIM is a fast-growing and important market in the UK. A prominent financial scandal or collapse in that market has the potential to shake confidence not just in AIM itself but also more widely. In order to determine the current state of corporate governance in AIM companies, this report has followed a two pronged approach of carrying out interviews with AIM company directors, institutional investors and NOMADs/brokers and carrying out a detailed analysis of the corporate governance statement in the annual report and accounts of 300 AIM companies.

The interviewees provided a rich source of their perceptions and experiences of AIM. Similarly the detailed analysis of the annual report and accounts of 300 AIM companies enabled an empirical interpretation of key aspects of corporate governance. This chapter summarises the main conclusions and implications for AIM participants and for policy makers arising from the foregoing analyses of current practice in AIM companies and the AIM market generally.

**Adoption of best practice corporate governance**

The analysis of the interviews with directors of AIM companies provided some useful insights. In the sample of 19 companies interviewed, 13 of the 19 had either two or three non-executive directors. All the companies visited had adopted audit committees and remuneration committees but only a minority had adopted nominations committees. It is to be expected that the adoption of nominations committees would be less given the relatively small size of AIM companies. The majority of directors confirmed that there was a split of the roles of Chair and CEO in their companies.
When appointing non-executive directors, the AIM company directors rank objectivity and integrity very highly followed by relevant business skills and experience. Institutional investors view the most important characteristics of non-executive directors as being independence; integrity; the ability to question and challenge the executive directors effectively; and experience which will benefit the company.

However, when remunerating their non-executive directors, some companies use stock options as a means of payment as the salaries they are able to offer are quite low and so attracting appropriate non-executive directors can be difficult.

The institutional investors see the most important factors in an AIM company’s corporate governance structure as being the presence of independent NEDs, the presence of an audit committee, and disclosure and transparency in reporting. They are not keen on stock options for NEDs but recognise that this may occur where companies have a negative or low cash flow and need to conserve their cash.

Overall, the signs are encouraging as AIM companies seem to be adopting many of the features of corporate governance best practice as embodied in the QCA Guidelines, which are based on the Combined Code.

**Relationship with institutional investors**

The vast majority of the companies schedule meetings with their institutional investors although the frequency of such meetings may vary. Corporate governance is important to institutional investors.
Role of NOMADs

NOMADs are viewed in a mixed light by the AIM company directors. Some find their NOMADs good at advising them, and keeping them up-to-date, on corporate governance and regulatory issues. Others have a less positive experience.

When deciding whether to invest in an AIM company, the institutional investors do not generally view an AIM company’s NOMAD as being a significant factor in their investment decisions. However if they had had a previous bad experience with a particular NOMAD in the past, then they would look more carefully at the AIM company being advised by them before making a decision to invest in that company.

Reputation of AIM

One of the most worrying aspects of the interviews with the AIM company directors was their concerns about the quality of some of the companies that have been admitted in recent years. The institutional investors also expressed some doubts, particularly in relation to some of the overseas companies. Moreover their concerns are echoed by influential outside parties such as Andrew Hill, writing in the Financial Times (15th January 2008):

As the regulator [Financial Services Authority] points out, most of the recent growth in the UK’s share of the global market for initial public offerings has come from the less regulated GDR and AIM categories. Overseas, and particularly emerging market, issuers make up a significant proportion. What if one of those companies were to implode?
Corporate governance disclosures in the annual report

The QCA Guidelines were used to benchmark the extent of voluntary corporate governance practice disclosed in the annual reports of 300 sample AIM companies. This study found that the basic elements of good governance practice were disclosed by the majority of the sample companies. However, on average, the sample companies disclosed 13 items out of a possible 23 corporate governance items. As the QCA Guidelines are considered to be the minimum level of governance, it suggests AIM companies should disclose much more than they are currently doing. AIM’s rule 26 which came into effect in August 2007 is a step in the right direction to encourage more transparency of good governance practice.

Nine firm and market-related factors were chosen to indicate the extent of their compliance with the 23 corporate governance items. Findings from this analysis suggest that the number of directors on the board influences the level of disclosure of good governance practice. AIM companies should try to increase their board size subject to practicability/resource constraints to improve their corporate governance.

The proportion of institutional investors in a company appears not to affect the level of disclosure. This is possibly because they would have ensured adherence to basic corporate governance practice before investing in these AIM companies.

Similarly, the type of NOMAD firm is unimportant in determining the disclosure level by AIM companies. It indicates the reputation effect of brokers who also act as NOMADs to their client AIM companies now lacks the potent force to encourage high quality governance which they hitherto had, based on a previous study by Mallin and Ow-Yong (1998).

AIM companies with no trading activity have lower reported disclosure levels compared to those which have revenue income. It could
be argued that as these companies have not generated revenue, they should not incur substantial costs in trying to adopt good governance practice. However, these companies run a higher risk that ineffectual corporate governance may make them more susceptible to the improper use of funds raised.

**Policy implications**

The policy implications from the foregoing analysis of current corporate governance practices in AIM companies are as follows:

- The role of the NOMAD, in relation to corporate governance practices and disclosure, could usefully be re-examined as they play a significant role, both for companies coming to AIM and for those already on AIM. Given the rapid growth in AIM, it may be that appropriate mechanisms need to be put in place to try to ensure that the NOMADs carry out their role more effectively, show better due diligence, and have a more beneficial relationship with their AIM clients.

- The admission of overseas companies to AIM should be more closely scrutinised, especially when the company’s home country has much weaker corporate governance than in the UK.

- The regulatory authorities should monitor more closely the governance of AIM companies which have not yet started trading so that the monies raised during Admission are not being misused.

- AIM companies with small boards should consider increasing the number of directors on their board, subject to resource constraints/practicability.

- The voluntary adoption of the QCA guidelines should be maintained.
Avenues for future research

This research provides an up-to-date and comprehensive analysis of corporate governance in AIM companies, and the attitudes towards, and perceptions of, corporate governance by a range of AIM participants. However, an avenue for future research would be comparative studies with similar markets in the US and continental Europe to provide insights into the corporate governance practices of companies on their smaller company markets, and to see if there are any lessons to be learnt – both about what is successful and what is not – that might be transferable to the UK.


APPENDIX 1

QCA Guidelines - items on voluntary disclosure score

1. Is there a corporate governance statement on how the key principles are applied?
2. Are members of the board and its subcommittees identified?
3. Is there a statement of how the board operates?
4. Does the company disclose specific matters reserved for board approval?
5. Does the report name all the directors accompanied with biographical details?
6. Is the board provided with timely and appropriate information in order to discharge its duties?
7. Is the number of board meetings and directors’ attendance disclosed?
8. Is there an audit committee?
9. Are there at least two members of the audit committee, and are they all independent NEDs?
10. Is there a remuneration committee?
11. Are there at least two members in the remuneration committee, and are they all independent NEDs?
12. Is there a nomination committee?
13. Does the board describe the consideration of independence?
14. Does the board identify the non-executive directors that it considers to be independent?

15. Does the board comprise of at least two independent non-executive directors?

16. Is there disclosure that the board regularly reviews the process of internal control?

17. Does this review cover all material controls including financial, operational and compliance controls and risk management systems.

18. Does the board describe how directors’ performance is formally evaluated?

19. Are all directors submitted for re-election at regular intervals?

20. Is there a statement explaining directors’ responsibility in respect of the accounts?

21. Is there a statement of the steps taken by the board to develop a dialogue with shareholders?

22. Are the roles of chairman and chief executive exercised by different individuals?

23. Where the auditor provides significant non-audit services, is there an explanation of how the auditor’s objectivity and independence are safeguarded?

Source: QCA Corporate Governance Guidelines for AIM companies.
# Appendix 2

## The scoring of corporate governance practice disclosures in the annual report based on QCA Guidelines

<table>
<thead>
<tr>
<th>Scoring (1 if disclosed, 0 otherwise)</th>
<th>Illustrative disclosure (examples of disclosures coded 1)</th>
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<tbody>
<tr>
<td>1. Is there a corporate governance statement on how the key principles are applied?</td>
<td>The Company is committed to good standards of corporate governance and historically has, as far as is practical, voluntarily complied with the relevant Guidelines that are applicable to fully listed companies. During the year, the Company has reviewed its corporate governance procedures in light of the revised Code (the ‘2003 FRC Code’) that became effective for accounting periods beginning on or after 1 November 2003. The Company has complied with the 2003 FRC Code as described below. (Armour Group Annual Report, 2005, pg 18)</td>
</tr>
<tr>
<td>2. Are members of the board and its subcommittees identified?</td>
<td>William Z. Fox (64) is the chairman and John Allbrook (44) its Chief Executive Officer (GolIndustry Annual Report, 2005, pg 6) The Audit Committee is comprised of David Bailey, William Fox, Kamal Advani and David MacNamara, and is chaired by David Bailey. The Remuneration Committee consists of David Bailey, William Fox, Kamal Advani and David MacNamara and is chaired by William Fox. (GolIndustry Annual Report, 2005, pg 8).</td>
</tr>
<tr>
<td>Scoring (1 if disclosed, 0 otherwise)</td>
<td>Illustrative disclosure (examples of disclosures coded 1)</td>
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<tr>
<td>3. Is there a statement of how the board operates?</td>
<td>The board comprises three executive directors, including the Chairman, and three non-executive directors. The board usually meets monthly to discuss a formal scheduled agenda covering the key areas of the Company’s affairs, including the monthly management accounts which include an analysis of comparisons of actual versus budget. (European Nickel, Annual Report, 2005 pg 12)</td>
</tr>
<tr>
<td>4. Does the company disclose specific matters reserved for board approval?</td>
<td>The board, which meets every month, exercises overall control of the Group’s affairs by reference to a schedule of matters reserved for its decision. These matters include: • major acquisitions and disposals • the approval of Financial Statements and assessment of financial performance • authority levels of expenditure, with detailed appraisals and reviews • treasury policies and review of financial planning; and • risk management policies. (Autologic, Annual Report 2005, pg 18)</td>
</tr>
<tr>
<td>5. Does the report name all the directors accompanied with biographical details?</td>
<td><strong>William C. Currie, aged 44 – Non-executive Director</strong>  Bill manages his own investment fund, which has strategic stakes in a number of high growth companies. Formerly, he was Founder and Chairman of The Fragrance Shop, which he sold to The Peacock Group in 2004. Prior to that Bill was Joint Managing Director of Charterhouse Securities, one of the UK’s leading Stockbrokers. Whilst with BZW and Hoare Govett he was the City’s No.1 ranked Food Retailing analyst. During his career Bill has been either Stockbroker or Advisor to most of the UK’s major food retail groups and a number of leading non-food retailers. (Coffeeheaven International, Annual Report 2005, pg 22)</td>
</tr>
<tr>
<td>Scoring (1 if disclosed, 0 otherwise)</td>
<td>Illustrative disclosure (examples of disclosures coded 1)</td>
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<td>-------------------------------------</td>
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<tr>
<td>6. Is the board provided with timely and appropriate information in order to discharge its duties?</td>
<td>The board holds monthly formal board meetings (meeting 12 times in the financial period to 4 March 2006) supplemented from time to time with ad hoc face to face or telephone board meetings to consider specific or urgent issues. Prior to each board meeting, every member of the board is supplied with a detailed information package including minutes of previous meetings, a full set of management accounts, a detailed report on the trading and operational performance, a rolling update on the new business pipeline, and background on any contract or capital expenditure approvals. The board papers also include other documents which relate to matters included in the agenda, as appropriate, in order to ensure that members of the board are given the fullest opportunity for consideration of matters to be discussed at meetings. (Blueheath Holdings (Annual Report, pg 11)</td>
</tr>
<tr>
<td>7. Is the number of board meetings and directors’ attendance disclosed?</td>
<td>The table below shows the number of committee meetings during the financial year and member’s attendance. (Cobra Bio Manufacturing, Annual Report 2006, pg 17)</td>
</tr>
<tr>
<td>8. Is there an audit committee?</td>
<td>The audit committee comprises two of the non-executive directors (G R Norfolk and P H Keane), and is chaired by G R Norfolk. (Business Direct Group, Annual Report 2005, pg 11)</td>
</tr>
<tr>
<td>9. Are there at least two members of the audit committee, and are they all independent NEDS?</td>
<td>The Audit Committee comprises the two non-executive directors and is chaired by P Kennedy (Nautical Petroleum, Annual Report 2005, pg 25)</td>
</tr>
<tr>
<td>Scoring (1 if disclosed, 0 otherwise)</td>
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<tr>
<td><strong>10. Is there a remuneration committee?</strong></td>
<td>The Remuneration Committee comprises three Non-Executive Directors, Robert Alcock, Caroline Price and Tim Ross, who acts as its Chairman. (Connaught, Annual Report 2006, pg 29)</td>
</tr>
</tbody>
</table>
| **11. Are there at least two members in the remuneration committee, and are they all independent NEDS?** | **Independent non-executive directors**  
*J B Diggines (53) – senior non-executive director*  
Mr Diggines is chief executive of Enterprise Ventures Limited. He was appointed to the board of Nichols plc in July 1995.  
*J D Bee (64)*  
Mr Bee has held a number of non-executive directorships with both public and private companies and is currently vice-chairman of the Manchester Building Society. He was appointed to the board of Nichols plc in January 2002. Both of the above are members of the audit and remuneration committees of the board. (Nichols, Annual Report 2005, pg 16) |
<p>| <strong>12. Is there a nomination committee?</strong> | The Nomination Committee is comprised entirely of non-executive directors, being John Standen as Chairman and Ian Smith. The committee oversees the structure and balance of the board generally and is responsible for screening and proposing candidates for appointment to the board. (Z Group plc, Annual Report 2006, pg 14) |</p>
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| 13. Does the board describe the consideration of independence? | Mr Rowbotham has been a Director with the Company since 1995. The board continues to consider Mr Rowbotham as independent despite provision A.3.1. of the Combined Code regarding board service of more than nine years. The board considers that during this period, Mr Rowbotham has maintained his objectivity and continues to remain robustly independent in both character and judgement. There are no circumstances or relationships that would require the board to alter his classification as independent.  
(Advent Capital plc, Annual Report 2005, pg 28) |
| 14. Does the board identify the non-executive directors that it considers to be independent? | During the year, the board comprised five Executive Directors and four Non-Executive Directors. Neil Johnson joined the board as Senior Independent Non-Executive Director on 23 January 2006.  
(Autologic Holdings, Annual Report 2005, pg 9) |
| 15. Does the board comprise of at least two independent non-executive directors? | The board comprises a non-executive Chairman, the Chief Executive, the Managing Director, the Finance Director and two non-executive Directors. The board considers the non-executive Directors to be independent and feels that their diverse experiences and backgrounds bring a depth of debate and alternative viewpoint to the board.  
(Davenham Group, Annual Report 2006, pg 16) |
| 16. Is there disclosure that board regularly reviews the process of internal control? | The board is ultimately responsible for the Group’s system of internal control and for reviewing its effectiveness. A comprehensive business plan and budget is in place and actual results will be compared to this plan and reported to the board on a monthly basis.  
(Earthport, Annual Report 2006, pg 9) |
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<tr>
<td>17. Does this review cover all material controls including financial, operational and compliance controls and risk management systems.</td>
<td>Reports on operational, compliance and risk management are also reviewed by the board. (Capcon Holdings, Annual Report 2005, pg 6)</td>
</tr>
<tr>
<td>18. Does the board describe how directors’ performance is formally evaluated?</td>
<td>The level of remuneration awarded to Directors reflects consideration of comparable market compensation packages, the achievement of targets the board sets for the Group and the individual performance of each Director, together with the Group’s profitability and its position within its development cycle. (Panmure Gordon, Annual Report 2005, pg 9)</td>
</tr>
<tr>
<td>19. Are all directors submitted for re-election at regular intervals?</td>
<td>Directors who are appointed in the period are required to be elected by shareholders at the next Annual General Meeting, as is one third of the remainder of the board who are required to retire by rotation. Details of the Director’s offering themselves for election or re-election are given in the Directors’ Report. (Accident Exchange, Annual Report 2006, pg 29)</td>
</tr>
</tbody>
</table>
| 20. Is there a statement explaining directors’ responsibility in respect of the accounts? | Statement of directors’ responsibilities for the financial statements  
Company law in the United Kingdom requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and the group and of the profit or loss of the group for that period. (Augean Plc, Annual Report 2005, pg 17) |
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<tr>
<td>21. Is there a statement of the steps taken by the board to develop a dialogue with shareholders?</td>
<td>Relations with Shareholders The board attaches great importance to maintaining good relations with its shareholders. Extensive information about the Company’s activities is included in the Annual Report and Accounts and Interim Reports, which are sent to all shareholders. Market sensitive information is regularly released to all shareholders concurrently in accordance with stock exchange rules. The Company welcomes communication from both its private and institutional shareholders. (Alexander Mining, Annual Report, pg 17)</td>
</tr>
<tr>
<td>22. Are the roles of chairman and chief executive exercised by different individuals?</td>
<td>Whilst there is a clear division of responsibilities between the Chairman and the Chief Executive Officer, Stephen Gutteridge plays a role in the strategic development of the Group, and is not considered independent for the purposes of the Combined Code. (Star Energy, Annual Report 2005, pg 27)</td>
</tr>
<tr>
<td>23. Where the auditor provides significant non-audit services, is there an explanation of how the auditor’s objectivity and independence are maintained?</td>
<td>• a review of non-audit services provided to the Group and related fees; • discussion with the auditors of a written report detailing all relationships with the Company and any other parties that could affect independence or the perception of independence; • a review of the auditors’ own procedures for ensuring the independence of the audit firm and partners and staff involved in the audit, including the regular rotation of the audit partner; • obtaining written confirmation from the auditors that, in their professional judgment, they are independent. (City Lofts, Annual Report 2005, pg 22)</td>
</tr>
</tbody>
</table>
Nominated adviser responsibilities

The responsibilities set out in this appendix consist of numbered principles as specified by the London Stock Exchange (LSE) in its AIM Rules for Nominated Advisors (February 2007). The numbered principles must be satisfied in all cases. The LSE also specify a list of non-exhaustive actions, which have not been reproduced in this appendix (see LSE 2007), that the LSE would usually expect a nominated adviser to fulfil in satisfying that principle.

Admission responsibilities

These apply to a nominated adviser that is acting for an applicant (including in relation to a reverse takeover coming within rule 14 of the AIM Rules for Companies and also including, as applicable, a quoted applicant) in respect of its admission to AIM.

The applicant and its securities

AR1 - In assessing the appropriateness of an applicant and its securities for AIM, a nominated adviser should achieve a sound understanding of the applicant and its business.

Directors and board

AR2 – In assessing the appropriateness of an applicant and its securities for AIM, a nominated adviser should (i) investigate and consider the suitability of each director and proposed director of the applicant; and (ii)
consider the efficacy of the board as a whole for the company’s needs, in each case having in mind that the company will be admitted to trading on a UK public market.

**Due diligence**

AR3 – The nominated adviser should oversee the due diligence process, satisfying itself that it is appropriate to the applicant and transaction and that any material issues arising from it are dealt with or otherwise do not affect the appropriateness of the applicant for AIM.

**Admission document**

AR4 – The nominated adviser should oversee and be actively involved in the preparation of the admission document, satisfying itself (in order to be able to give the nominated adviser’s declaration) that it has been prepared in compliance with the AIM Rules for Companies with due verification having been undertaken.

**AIM rule compliance**

AR5 – The nominated adviser should satisfy itself that the applicant has in place sufficient systems, procedures and controls in order to comply with the AIM Rules for Companies and should satisfy itself that the applicant understands its obligations under the AIM Rules for Companies.
Ongoing responsibilities

These apply on a continuing basis in respect of any nominated adviser who acts for an AIM company.

Regular contact between company and nominated adviser

OR1 – The nominated adviser should maintain regular contact with an AIM company for which it acts, in particular so that it can assess whether (i) the nominated adviser is being kept up-to-date with developments at the AIM company and (ii) the AIM company continues to understand its obligations under the AIM Rules for Companies.

Review of notifications

OR2 – The nominated adviser should undertake a prior review of relevant notifications made by an AIM company with a view to ensuring compliance with the AIM Rules for Companies.

Monitor trading

OR3 – The nominated adviser should monitor (or have in place procedures with third parties for monitoring) the trading activity in securities of an AIM company for which it acts, especially when there is unpublished price sensitive information in relation to the AIM company.
Advise the AIM company on any changes to the board of directors

OR4 – The nominated adviser should advise the AIM company on any changes to the board of directors the AIM company proposes to make, including (i) investigating and considering the suitability of proposed new directors and (ii) considering the effect any changes have on the efficacy of the board as a whole for the company’s needs, in each case having in mind that the company is admitted to trading on a UK public market.

Engagement responsibilities

These apply when a nominated adviser is being engaged as a nominated adviser to an existing AIM company.

In satisfying these responsibilities, a nominated adviser should in addition refer to AR1 (in relation to ER1 below), AR2 (in relation to ER2) and AR5 (in relation to ER3) and consider what actions may be appropriate. The actions to be taken will depend on, for example, the circumstances surrounding the change of nominated adviser or the changes that have taken place in the company since admission. For example, it is unlikely that the due diligence reports usually obtained in preparation for admission as mentioned in part of AR1 would be required on engagement pursuant to ER1 or ER3 below.

The AIM company and its securities

ER1 - In assessing the appropriateness of an AIM company and its securities for AIM when taking on an existing AIM company, a nominated adviser should achieve a sound understanding of the AIM company and its business.
Directors and board

ER2 – In assessing the appropriateness of an existing AIM company and its securities for AIM, a nominated adviser should (i) investigate and consider the suitability of each director and proposed director of the AIM company and (ii) consider the efficacy of the board as a whole for the company’s needs, in each case having in mind that the company is admitted to a trading on a UK public market.

AIM rule compliance

ER3 – The nominated adviser should satisfy itself that the AIM company has in place sufficient systems, procedures and controls in order to comply with the AIM Rules for Companies and should satisfy itself that the AIM company and its directors understand their obligations under the AIM Rules for Companies.
Chris Mallin is Professor of Corporate Governance & Finance, and Director of the Centre for Corporate Governance Research, Birmingham Business School, University of Birmingham. She is a member of the International Corporate Governance Network (ICGN) Cross-Border Voting Practices Committee, and a member of the UK’s Shareholder Voting Working Group chaired by Paul Myners.

She was a Director (2000-2006), and Chair of the Audit and Risk Management Committee (2004-2006), of the Aston Reinvestment Trust (chaired by Sir Adrian Cadbury) which was launched in 1997 as a pioneer of social investment and has become the leading local community finance initiative in the UK.

She was the Editor of ‘Corporate Governance: An International Review’ from 2000-2007. She has published widely on corporate governance issues in both academic and professional journals. The second edition of her book ‘Corporate Governance’ was published by Oxford University Press in 2007.

Kean Ow-Yong is Lecturer in Finance, and Associate of the Centre for Corporate Governance Research, Birmingham Business School, University of Birmingham. Prior to his current post, he held a similar academic post at Nottingham Trent University.

He has published in a number of refereed journals including the European Journal of Finance and Corporate Governance: An International Review. His research interests include corporate governance, risk management and developments in financial markets.
Corporate Governance in Alternative Investment Market (AIM) Companies

AIM is the world’s leading market for smaller, growing companies from all over the world. Since its launch in 1995, over 2,500 companies have chosen to join AIM, creating a unique community of innovative and entrepreneurial companies. One of AIM’s key features is its simplified regulatory environment specifically designed for the needs of smaller companies. This means that AIM companies are not obliged to abide by the UK’s Combined Code. However, it is considered best practice for AIM companies to comply with good corporate governance practice as far as possible and to this end the Quoted Companies Alliance (QCA) has produced Guidelines on Corporate Governance for AIM Companies, based on the UK’s Combined Code.

This report elicits the views of AIM company directors, AIM investors and AIM nominated advisors (NOMADs) on corporate governance issues. The study includes a detailed analysis of corporate governance statements in the annual reports of 300 AIM companies to assess the overall compliance with the Quoted Companies Alliance guidelines and to determine which areas may prove problematic for these smaller companies.

The study identifies that the ‘lighter touch’ on corporate governance for AIM companies seems to be working quite well with institutional investors recognising that full compliance with the Combined Code is not always appropriate for AIM companies. The report however does highlight a concern that a damaging financial collapse or scandal is only a matter of time. This concern suggests that although the current framework seems to be working the sector should not be complacent. The authors conclude with important and potentially far reaching policy implications for the sector.

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