Corporate governance

A comparison between the US and the EU
What is corporate governance?

- **Shareholders** (providers of capital)
- **Governing body (Board(s))**
- **Owners**
  - Elects, reports, delegates
  - Governance
  - Appoints, reports, delegates
- **Managers**
- **Other parties**

Corporate governance: a US/EU comparison – Miguel A. Mendez
Roles and prerogatives of the key players

Shareholders
- Shareholders meetings

Supervisory board

Unitary / management board
- Executive management

Governing body
- Unitary board
- Two-tier board

Other Stakeholders (employees)
Factors shaping corporate governance

• Cultural and historical factors
• Control and shareholding structures
  – Highly dispersed / fairly concentrated
    • role of shareholders
• Economic model
  – Consensus driven or market driven
  – role of financial and markets forces
• Legal model
  – Role and influence of various stakeholders
    • Primacy of shareholders’ interest
    • Primacy of the company’s interest
• External or exceptional factors
  – European integration and convergence
  – Recent scandals (Enron, WorldCom etc.)
<table>
<thead>
<tr>
<th>Influence of economic and legal models on corporate governance</th>
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</table>
| **Anglo-Saxon**  
US - UK |
| • Market oriented  
• Competition driven “winner take all”  
• More developed Financial Markets  
• Shorter term strategy  
• Greater reliance on equity  
• Shareholder primacy  
• No employee involvement  
• Dispersed shareholding structure  
• Strong managers weak owners |
| **Continental/Rhineland**  
Continental Europe |
| • Bank, network oriented  
• Consensus driven  
• Less developed Financial markets  
• Longer term strategy  
• Greater reliance on debt  
• Stakeholders/ company focus  
• Co-determination/ worker councils  
• Concentrated ownership & control  
• Strong blockholders  
weak “dispersed owners” |
Whose interests is the board looking after?

The shareholder’s interest or The Company’s interest

- Shareholders
- Customers
- Employees
- state/Community
- Creditors/Suppliers
- Senior Management

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Ownership and control patterns

% of companies having no holders with majority control

USA: 99%
UK: 98%
Sweden: 84%
Spain: 74%
Netherlands: 67%
Italy: 61%
Germany: 44%
Austria: 32%
Belgium: 34%

% of companies having no holder with at least 25%
USA: 99%
UK: 84%
Sweden: 74%
Spain: 67%
Netherlands: 61%
Italy: 36%
Germany: 44%
Austria: 32%
Belgium: 34%

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Separation of ownership and voting power

Dispersed Ownership

- US - UK
  - Management control is likely "strong managers weak owners"

Concentrated Ownership

- Continental Europe:
  - Devices overriding one share one vote
  - Other devices separating ownership and control
- US and the UK
  - Companies in countries that allow voting right restrictions (voting caps of 5%)
  - Continental Europe
    - US and the UK
One share one vote restrictions in Europe

39% comply with one share one vote
35% multiple voting rights
26% golden shares
23% ceiling on voting rights
16% non voting shares
10% ownership ceiling.

Corporate governance: a US/EU comparison – Miguel A. Mendez
The rise of institutional ownership in the US

Institutional ownership in top 1,000

Equities held by inst. In markets

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Role of the governing body

- Promotes and safeguards the interests of the shareholders /the company and balances the various interests
- Oversees and monitors of all critical functions and exerts full control over the company’s affairs
- Interacts with shareholders and senior management
- Organizes the functioning of said governing body
  - Information flow – meeting’s agendas & schedules
- It appoints, removes management and sets its compensation
- It determines the strategic direction of the company
  - capital allocation, lines of business, long range financial goals
Organizational structures

Unitary structure

<table>
<thead>
<tr>
<th>Board of directors</th>
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<tbody>
<tr>
<td>• Executive &amp; non-executive members</td>
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<tr>
<td>committees</td>
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</table>

Executive committee

Two-tier structure

<table>
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<th>Supervisory board</th>
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<td>• only non-executive members</td>
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</tbody>
</table>

Management board

• Executive members only

"Quasi Two-tier structure"

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Other board

( board of auditors )

Managing Director
Unitary governance model: variations

Shareholders

Chairman & CEO

Lead director

Board
- Executive & non-executive members

CEO + other executives

Lead director

chairman

Supervisory function

Management function

Executive committee

chairman
Two-tier structure details

**Formal two-tier**
- Management board
  - Larger
  - Meets less frequently
  - Employee represented
  - Smaller
- Supervisory board
  - No overlap in membership

**Quasi-two-tier**
- Supervisory board
  - “Management board”
  - Some overlap
Organizational framework

- **UK**: Unitary board
- **Ireland**: Unitary board
- **Portugal**: Unitary board
- **Spain**: Two tier board
- **Belgium**: Unitary board
- **Netherlands**: Exec. committee
- **Germany**: Exec. committee
- **Austria**: Unitary board
- **Denmark**: Unitary board
- **Luxembourg**: Unitary board
- **Italy**: Unitary board
- **France**: Exec. committee
- **Sweden**: Unitary (exec. Committee)
- **Finland**: Two tier board

- Separation of Chairman & CEO
Concentration of power US vs UK

**US S&P 500**
- Chairman & CEO: 79%
- Chairman is an independent director: 14%
- Chairman is outside related party: 3%
- Chairman is former executive: 3%

**UK FTSE 100**
- Chairman & CEO: 70%
- Chairman is an independent director: 24%
- Chairman is outside related party: 5%
Board representation: the actors

- Significant or controlling shareholders
- Independent directors (Representing the shareholders at large)
- Executive directors
- Employees
Board representation: the “shakers and movers”
(Weight and influence of different stakeholders on the board)

US
- Shareholders
- Employees
- Executive Directors
- Independent directors
- Chairman & CEO

United Kingdom
- Shareholders
- Employees
- Independent Directors
- Non-executive Chairmen
- Executive directors

Continental Europe
- Significant shareholders
- Employees
- Executive directors
- Independent directors

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Employee representation

USA

UK

Ireland

Portugal

Spain

France

Belgium

Lux

Austria

Denmark

Germany

Netherlands

Sweden

Finland

Italy

Greece

- Mandatory
- Advisory role, presence but no vote
- Contemplated
- No representation
Shareholders representation: who nominates directors?

• **US / UK** => board driven process
  » Non executive chairman
  » Chairman & CEO
  » Nominating committee

• **Continental Europe** => shareholders and ownership driven process
  » Shareholders committees
  » Controlling or significant shareholders

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Sources of Chairman/CEO’s power

- Knowledge of company’s affairs
- Presiding over board meeting
  - Setting the agenda
  - Deciding what information directors receive
  - Leading board discussions
- Selecting other board members
- Acting as spokesman for the company
- Interacting with shareholders
- Control of the purse
Board committees and alternative governing organs

- Audit committee
  - Board of auditors
  - Dual auditorship
  - Internal auditor
- Remuneration committee
- Supervisory
- Unitary board
- Executive committee
- Nominating committee
  - Proportional representation
  - Shareholder’s committee
  - Controlling shareholder election list

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Independence impairments

- Former executive appointed director
- CEO is also chairman of the board
- Supplier, advisor, partner of the company also director
- Represents or has ties to a shareholder
- Has served on the board more than 10 years
- Holds cross-directorships or has significant links with other directors through involvement in other companies or bodies
- Has close family ties with any of the company’s advisors, directors, or senior executives
Accountability

Shareholders

Supervision of management
And stewardship of the company

Governing body

Management of the company
& stewardship of its operations

Executive
management

Financial markets
Regulatory bodies

Other stakeholders
Employee etc

Corporate governance: a US/EU comparison – Miguel A. Mendez
Level and mix of CEO compensation 90-99
## Key differences in the governance models

<table>
<thead>
<tr>
<th>European model(s)</th>
<th>American model</th>
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<tr>
<td>• Greater emphasis on check and balances</td>
<td>• Greater emphasis on unfettered leadership</td>
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<tr>
<td>• Sharper distinction between oversight and management functions</td>
<td>• Watered down distinction and emphasis on managing the corporation</td>
</tr>
<tr>
<td>• Governing body as a check and counterweight to executive power</td>
<td>• Governing body “manages” the corporation</td>
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