Corporate Role and Reform in Scandinavia and Europe

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Governance Forces

- Investor rights
- Director responsibility
- Disclosure rules
- Enforcement

- Capital market
- Product market
- Labor market
- Internal controls
Governance systems

Market-based system
- Contractarian culture
- Common law tradition
- Outsider-controlled
- Dispersed ownership
- Banks play minor role
- US, UK, Canada

Bank-based system
- Communitarian culture
- Civil law tradition
- Insider-controlled
- Concentrated ownership
- Banks play major role
- Germany, Scandinavia
Corporate objective, Germany

• Defined in corporation law (1965):
  “The managing board is, on its own responsibility, to manage the company for the good of the enterprise and its constituencies (Gefolgschaft), the community (Volk) and the country (Reich).”

• Labor representation on the board
Corporate governance in the UK

Highest governance standards in Europe

- 1992 Cadbury Committee Report
- Separation of Chairman and CEO
- Executives with prior violations to corporate law banned from boards
- Tight executive trading disclosure rules
- Principle-based approach to auditing
Governance and economic growth

Higher economic growth in countries with

- High accounting standards
- Developed and concentrated banking system
- High stock market activity
Stock market evolution

Market capitalization in % of GDP, 1913 and 1999

Source: Rajan and Zingales (2001)
System failure in the US

- Poor board oversight
- Management entrenchment
- Excessive executive compensation
- Uncritical analysts
- Lack of auditor independence
- Opportunistic bank behavior
Could this happen in Europe?

- Strong owners
- Bank financing
- Independent boards
- Lower levels of executive compensation and smaller option awards
- International GAAP requires disclosure of off-balance sheet transactions
Control of large public firms

% of firms. Control is defined as 20% ownership stake or more

Source: La Porta, Lopez-de-Silanes and Shleifer (1999)
CEO total compensation 2001

Source: Towers Perrin
CEO variable pay 2001

% of annual basic compensation

- Long-term incentives
- Variable bonus

Source: Towers Perrin
Key reform areas

• Accounting:
  – Adoption of IAS before 2005

• Takeover guidelines
  – Equal voting rights

• Auditor independence
  – Disclosure of non-audit fee
  – Partner rotation
Key reform areas, cont.

- Analysts guidelines
  - Conflict-of-interest disclosure
  - Ban of deal-related pay
- Credit rating agency independence
- Executive compensation
  - Shareholder vote on executive pay
  - IAS requires options to be expensed
  - Improved disclosure of executive pay
Key reform areas, cont.

• Board of directors
  – Statement of directors’ duties
  – Duration of director’s contracts
  – Disclosure of training and qualifications

• Harmonization is difficult and will take long time