

Corporate Role and Reform in Scandinavia and Europe

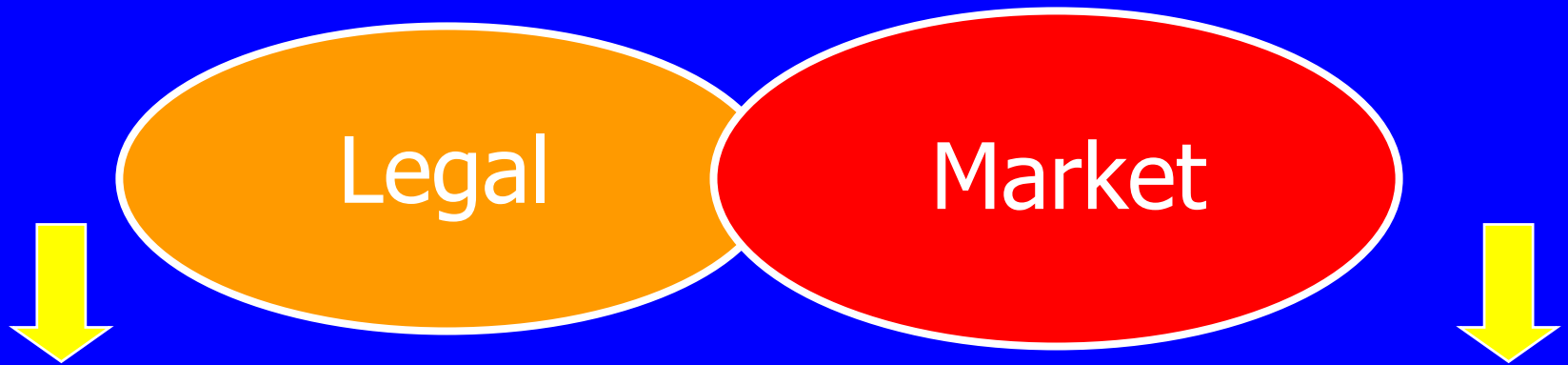
Professor Karin S. Thorburn

Center for Corporate Governance

Tuck School at Dartmouth

September 27, 2002

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

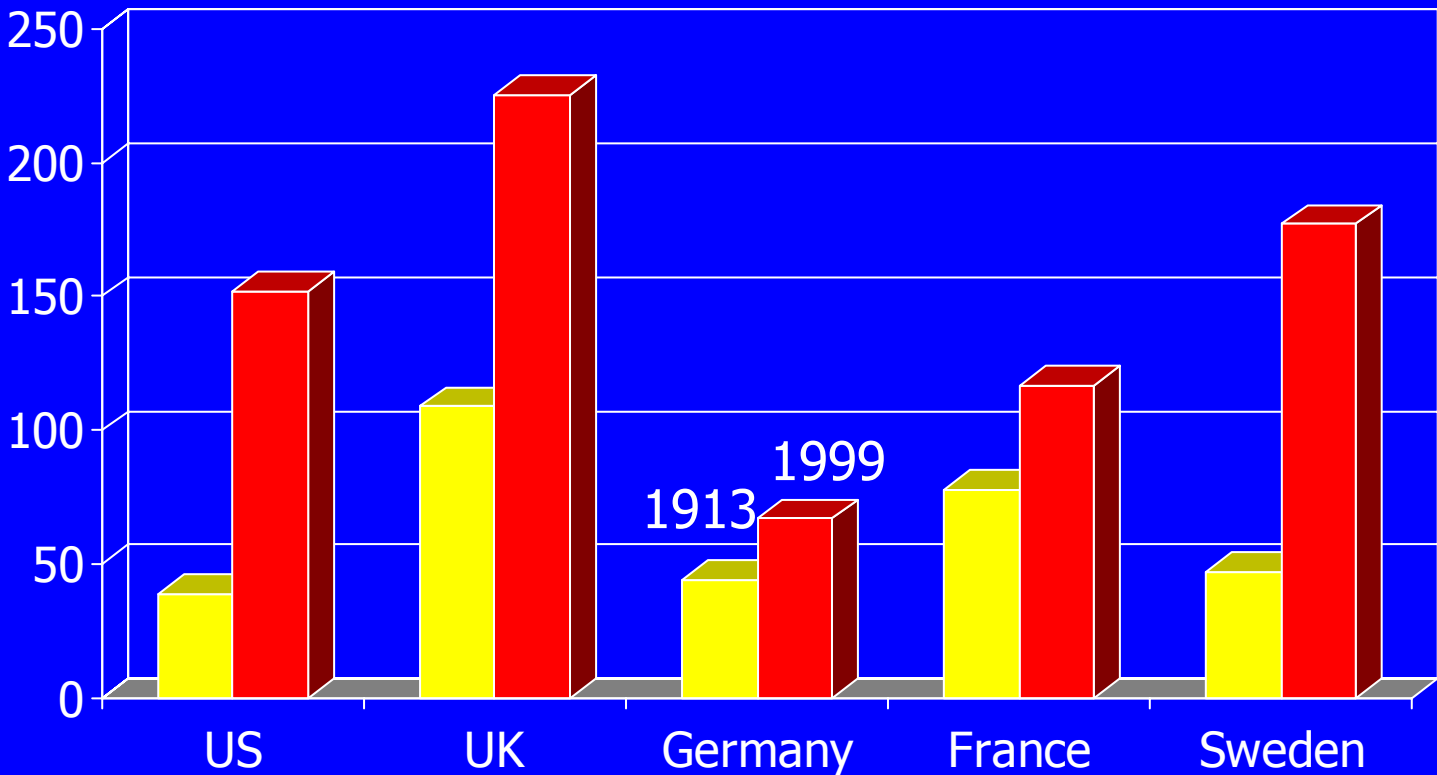
Governance and economic growth

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

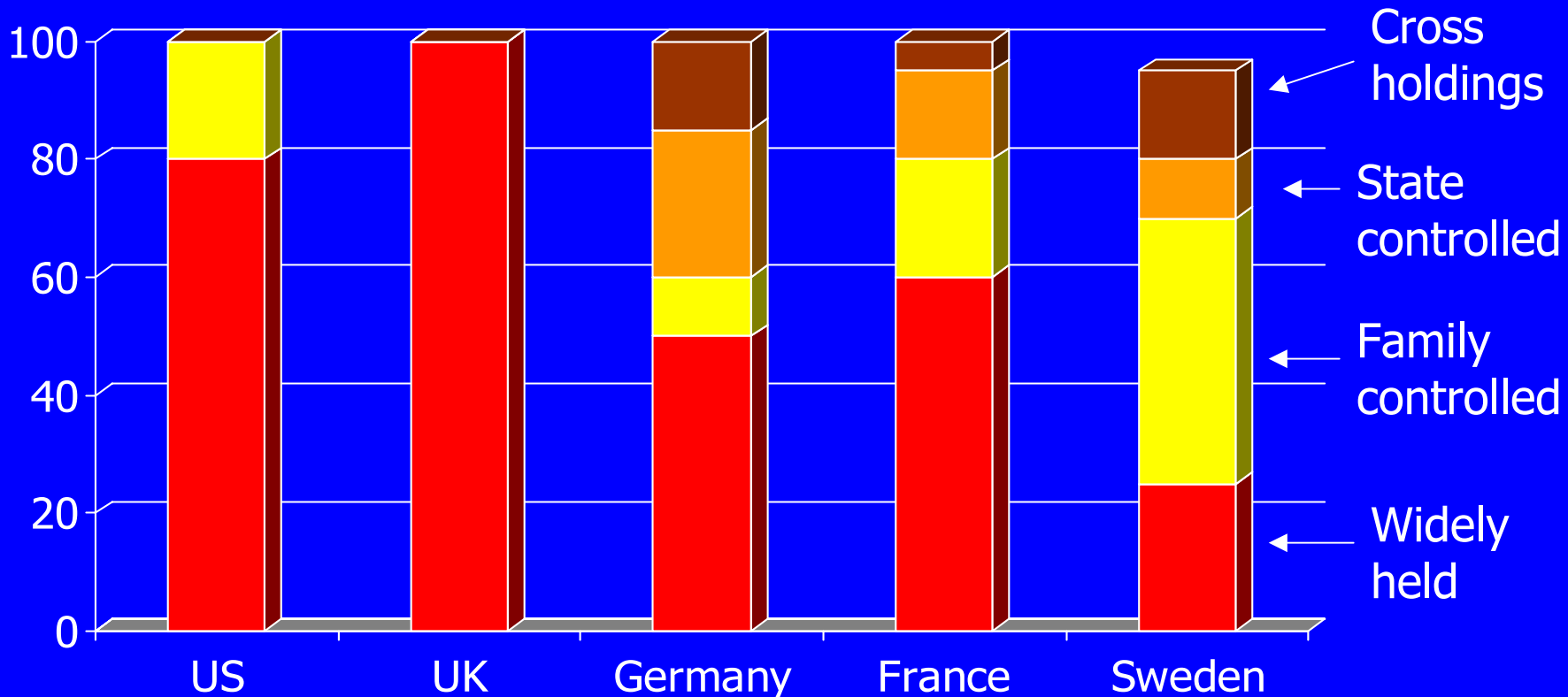
- Poor board oversight
- Management entrenchment
- Excessive executive compensation
- Uncritical analysts
- Lack of auditor independence
- Opportunistic bank behavior

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

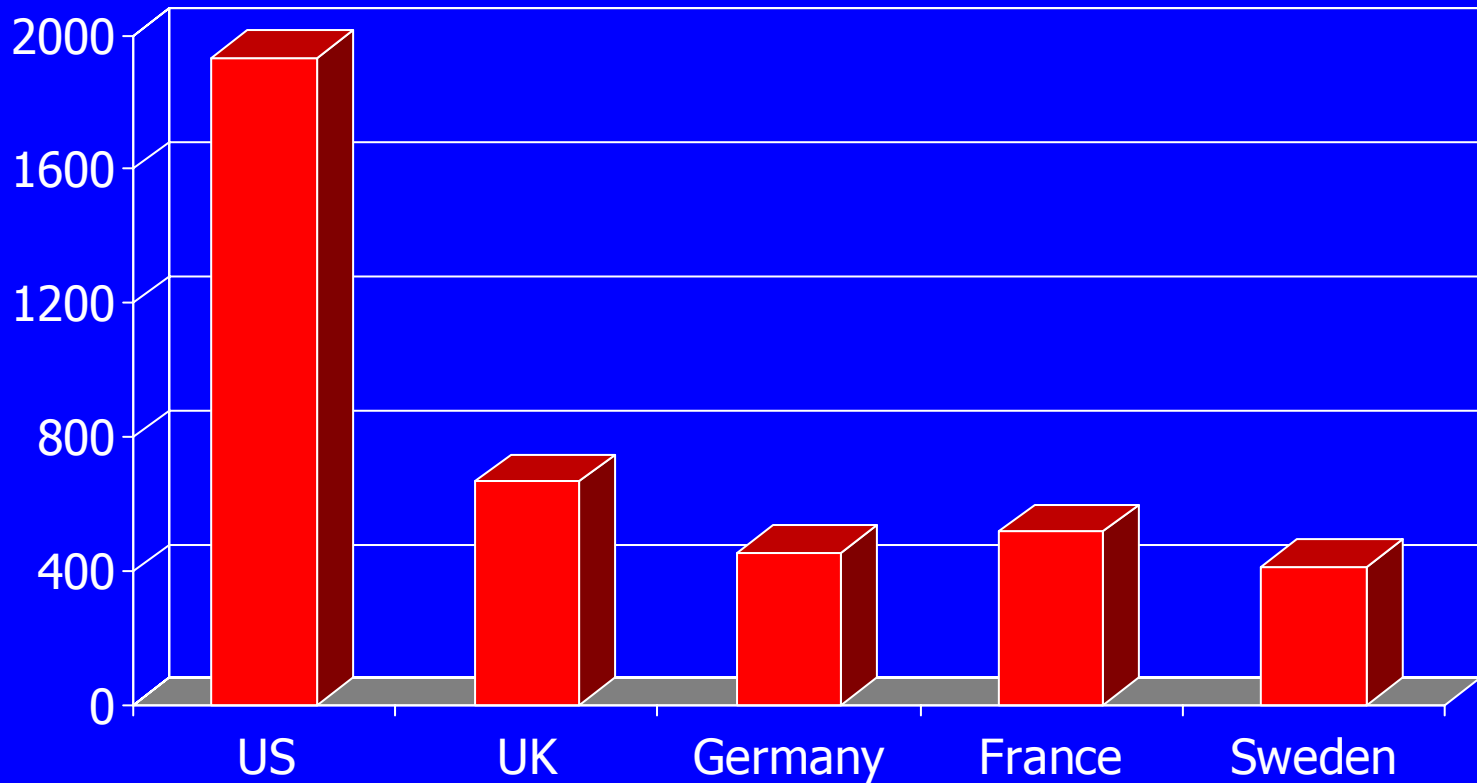
% of firms. Control is defined as 20% ownership stake or more



Source: La Porta, Lopez-de-Silanes and Shleifer (1999)

CEO total compensation 2001

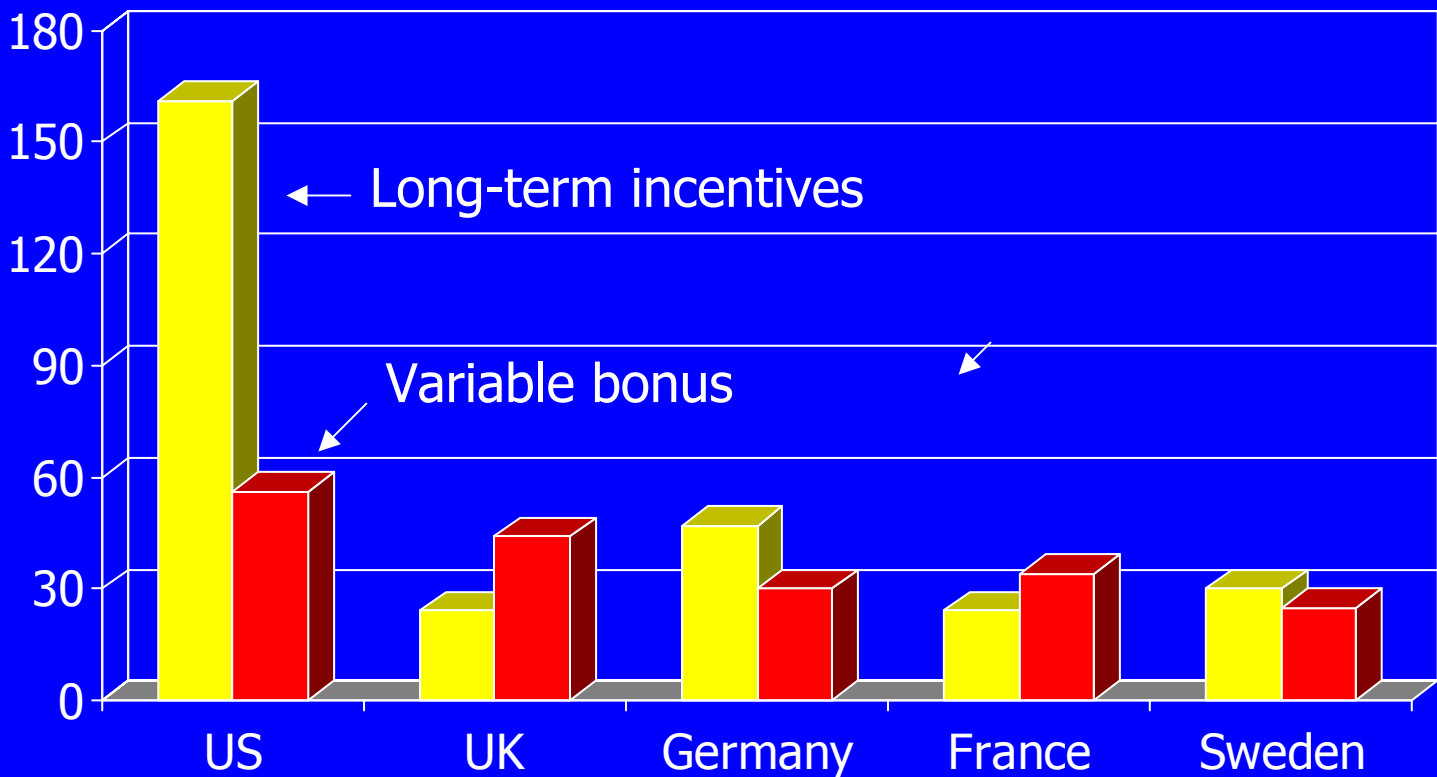
\$ thousand



Source: Towers Perrin

CEO variable pay 2001

% of annual basic compensation



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