

Comparative Corporate Governance

2015

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Corporat Corporate Finance Central Europe

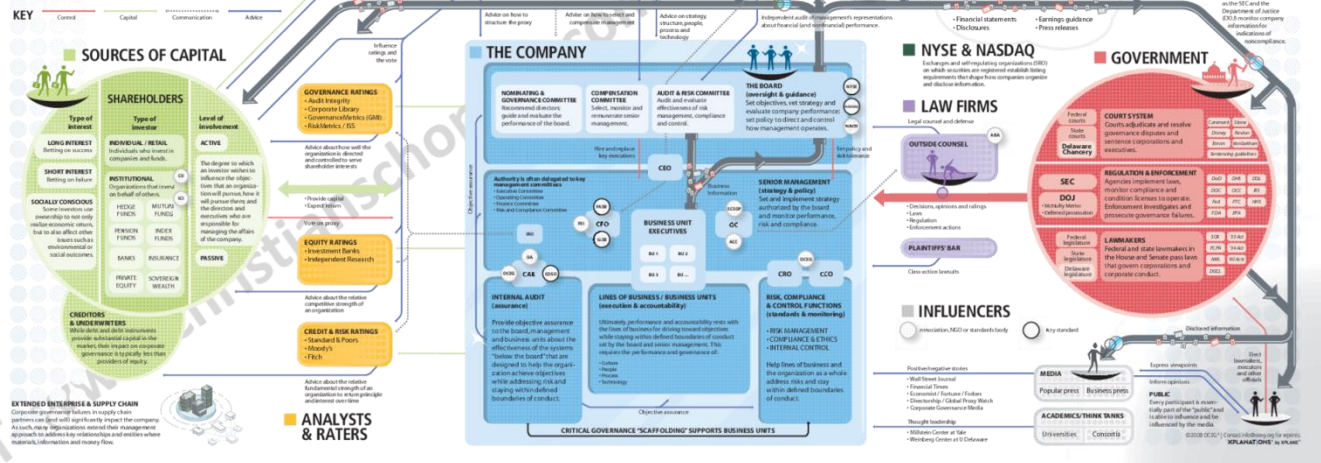
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Corporate Governance in a Complex World

Corporate Governance Ecosystem

Corporate Governance enhances value and performance through balanced relationships and improved decision-making. There are many participants in the Corporate Governance Ecosystem. Each one plays an important role in directing and controlling an organization so that long-term value is generated. Contact sven@christianschopper.com for comments / feedback on this illustration.



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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

Separation of Ownership and Control

Ownership and Control

- A corporation has an inherent corporate power that is associated to the **tactical and strategic decision-makings**
- The modern concept of corporate power holds that the **rights of the participants** as well as the **conduct of the enterprise** must be the **subjects to managerial discretions**
- This has been the basis for the modern theory of the firm

Agency Theory of the Firm

- The Agency Theory is based principally on the agency relationship between **managers** (the agents) and **shareholders** (the principals)
- More specifically, pure agency relationship arises from the contract nature between the two parties

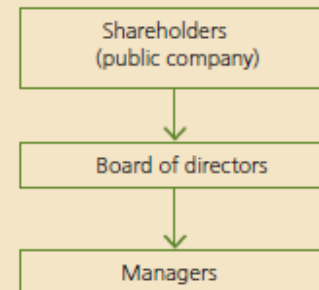
Corporate Governance Perspectives

Corporate Governance Perspectives

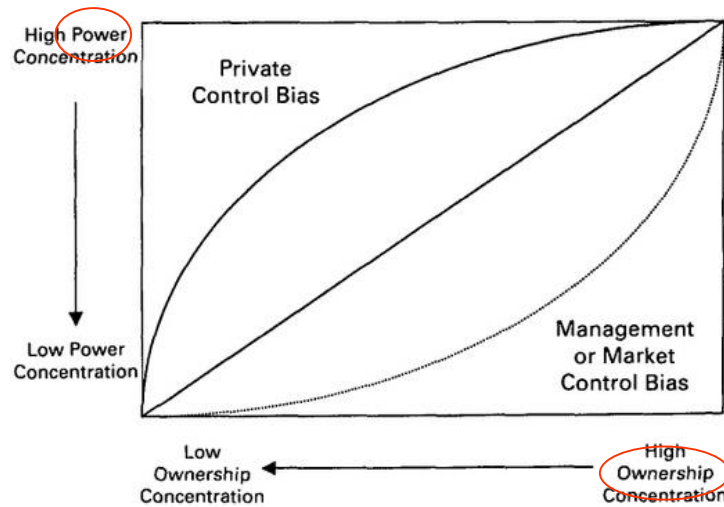
There are a number of predominant theoretical perspectives on corporate governance:

- **Agency theory**—align the interests of internal agents (executives/managers) who display strong self-interest with those of the shareholders (owners). In effect this represents a double agency dilemma (see figure)
- **Transaction cost theory**—reduce costs of transactional hazards through internal corporate governance mechanisms, which cannot be handled by external market mechanisms
- **Stewardship theory**—general human motives of achievement, altruism and meaningfulness should be managed and guided in the most opportune manner
- **Resource dependence theory**—highlights corporate dependence on external relations and sees governance as a vehicle to ensure continued access to essential resources

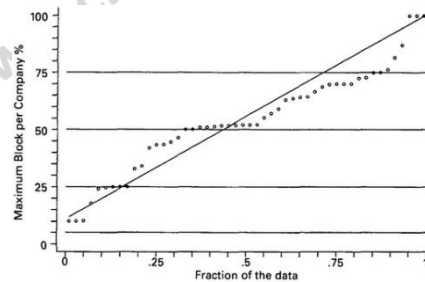
- **Stakeholder theory**—acknowledges agreements with multiple stakeholders that can create incremental value and/or lead to subsequent risk events if neglected or abused



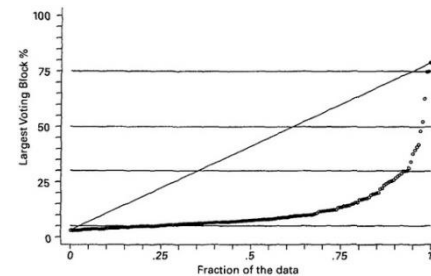
Corporate Control Structures



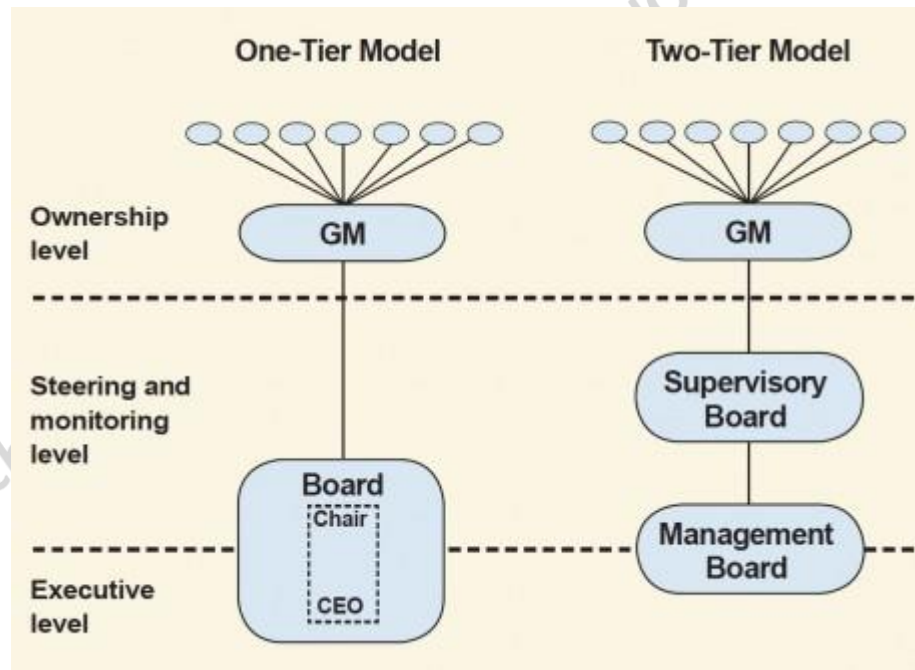
Austria



United Kingdom



One-Tier Model vs Two-Tier Model



One-Tier Model vs Two-Tier Model (cont'd)

Anglo-Saxon

US / UK

- Market oriented
- Competition driven “winner take all”
 - Active ‘market for corporate control
- More developed Financial Markets
- Shorter term strategy
- Greater reliance on equity
- Shareholder primacy
 - Primacy of shareholder rights over that of stakeholders
- No employee involvement
- Dispersed shareholding structure
- Strong managers weak owners
- Relationships between management and shareholders being fluid and arms-length

Continental / Rhineland

Continental Europe

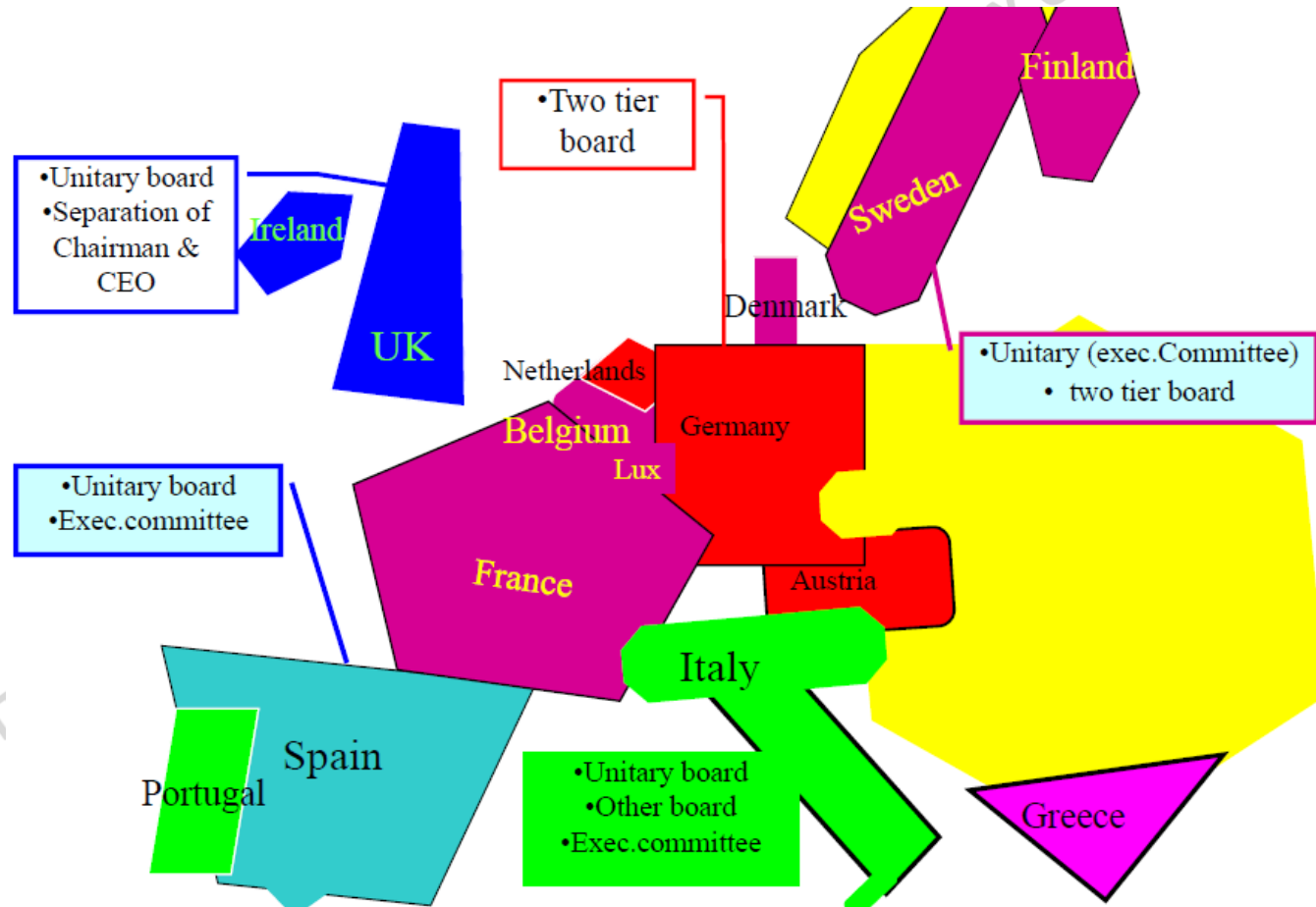
- Bank, network oriented
- Consensus driven
- Less developed Financial markets
- Longer term strategy
- Greater reliance on debt
- Stakeholders/ company focus
 - Stable and close relationships between management and shareholders
- Co-determination/ worker councils
- Concentrated ownership & control
- Strong blockholders
 - Weak “dispersed owners”
- “Insider system”
 - Owners of firms tend to have an enduring interest in the company and often hold positions on the board of directors or other senior managerial positions

One-Tier Model vs Two-Tier Model (cont'd)

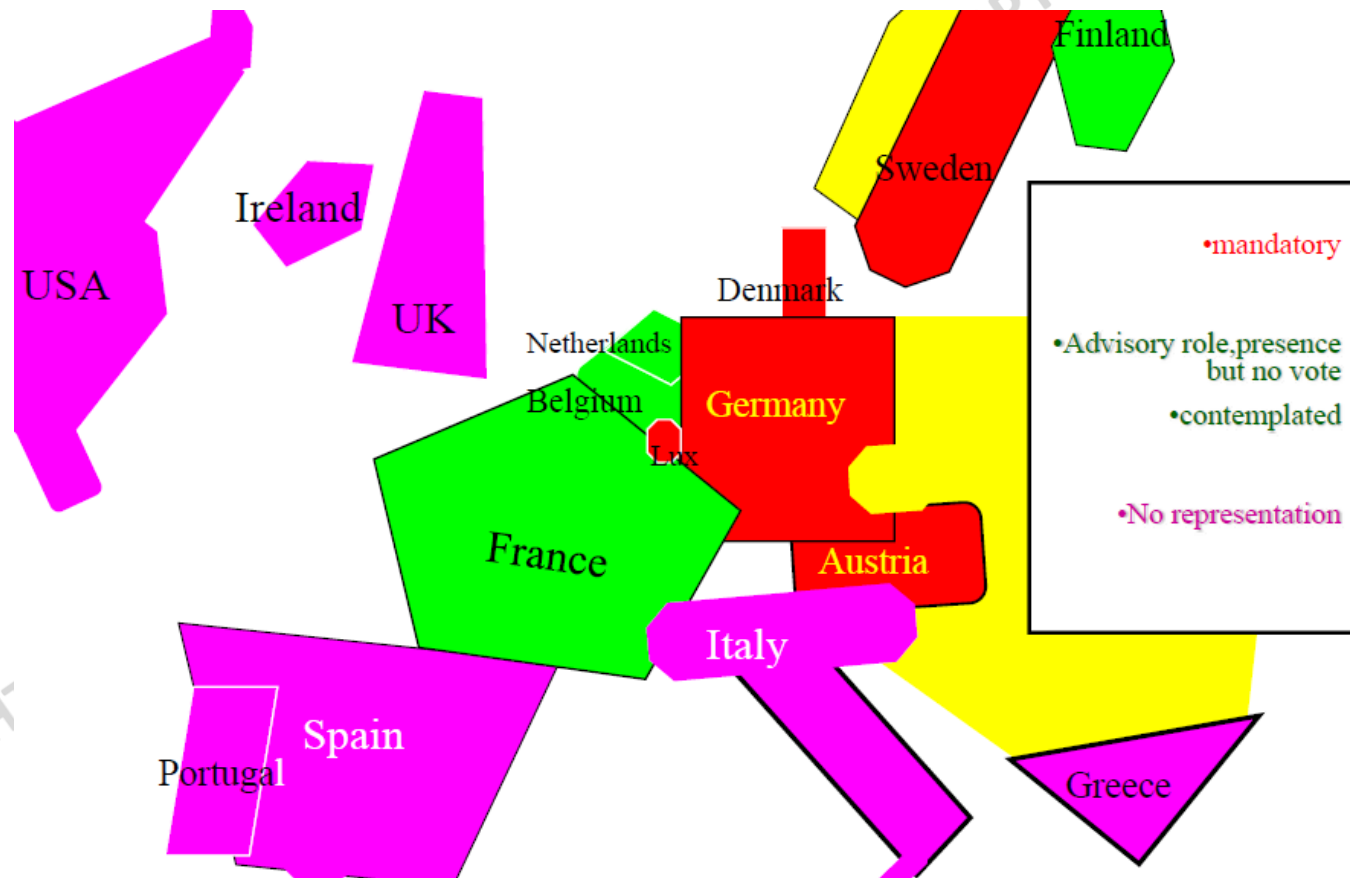
	Anglo-American Systems	Non-Anglo-American Systems
Legal Origin	Common Law	Roman (Civil) Law
Security Law	Strict	Liberal
Capital markets	Liquid capital markets	Illiquid capital markets
Ownership Concentration	Low level of ownership concentration	Higher level of ownership concentration
Business Objectives	Shareholder orientations	Stakeholder orientations
Crossholdings	Low level of crossholdings	High level of inter-corporate crossholdings
M&As	Active market for corporate control	Inactive market for corporate control

Source: Constructed from Brendt (2002).

One-Tier Model vs Two-Tier Model (cont'd)

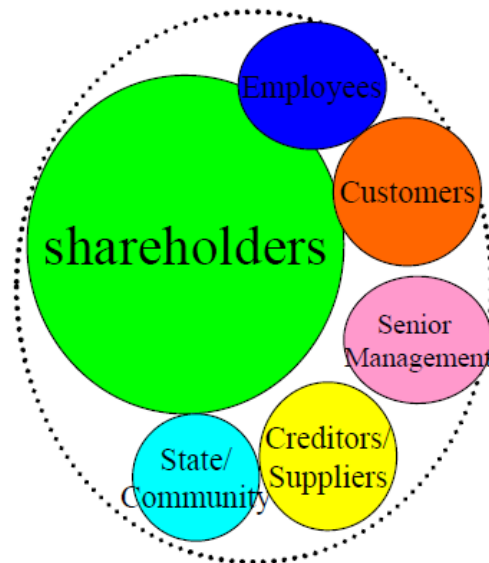


Employee Representation

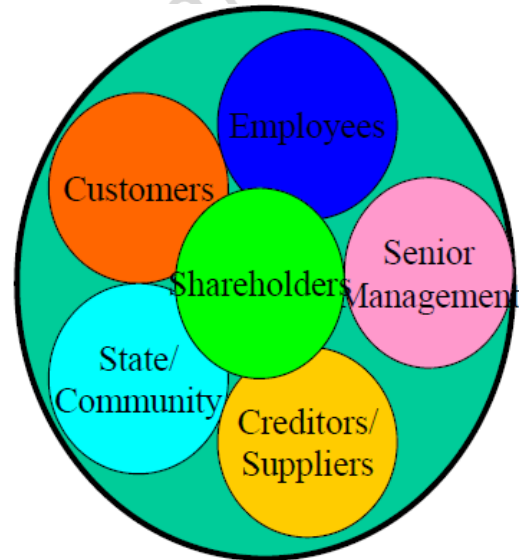


Whose Interests is the Board Looking After

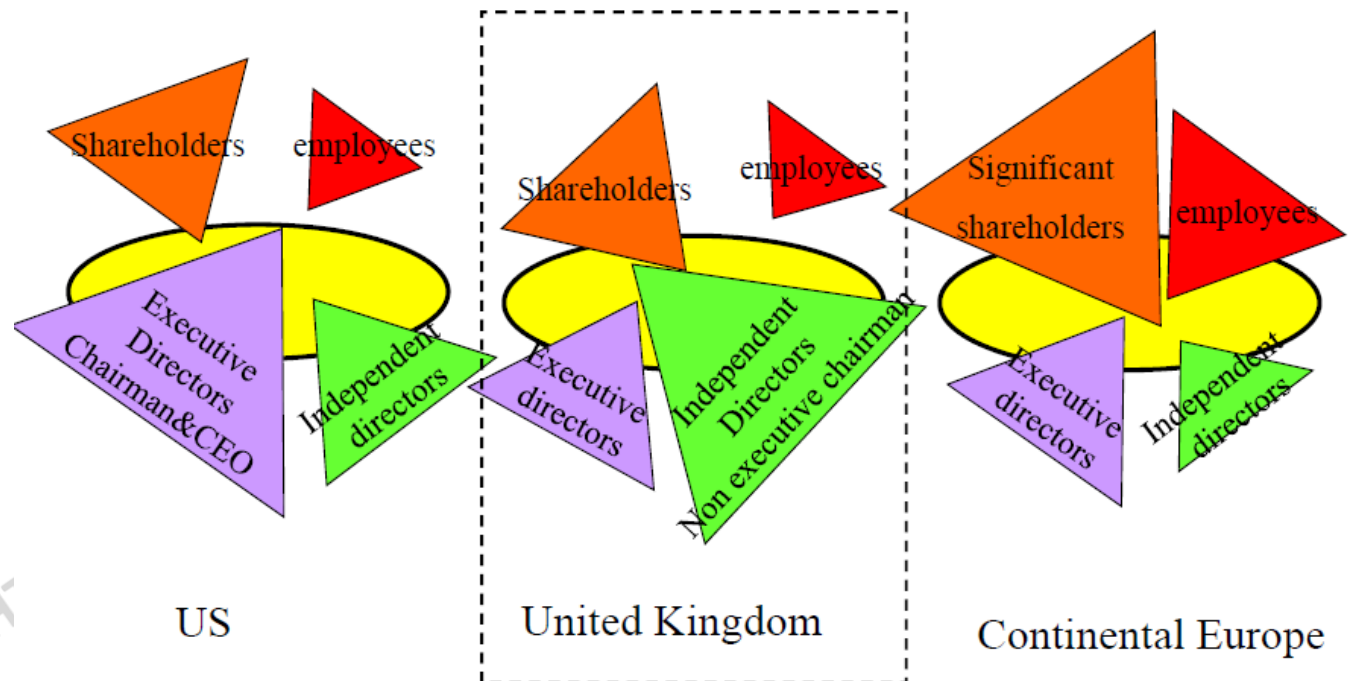
The Shareholder's Interest



The Company's Interest



Weight and Influence of Stakeholders



Key Differences in the Governance Models

American Model

- Greater emphasis on **unfettered leadership**
- Watered down distinction and **emphasis on managing the corporation**
- Governing body “manages” the corporation

European Model(s)

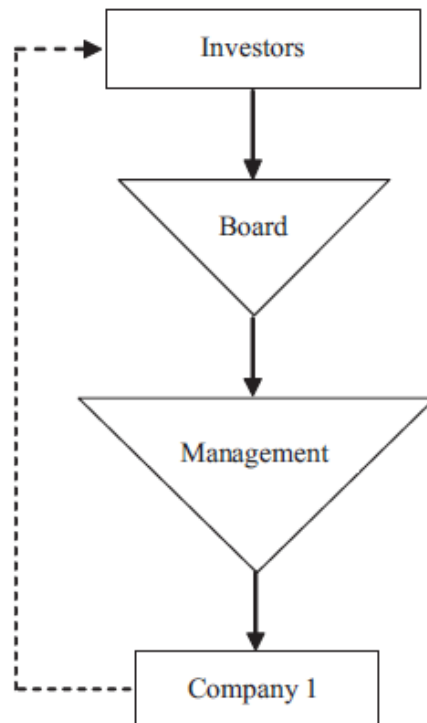
- Greater emphasis on **check and balances**
- Sharper **distinction between oversight and management** functions
- Governing body as a check and counterweight to executive power

Preliminary Assessment of the Governance Models

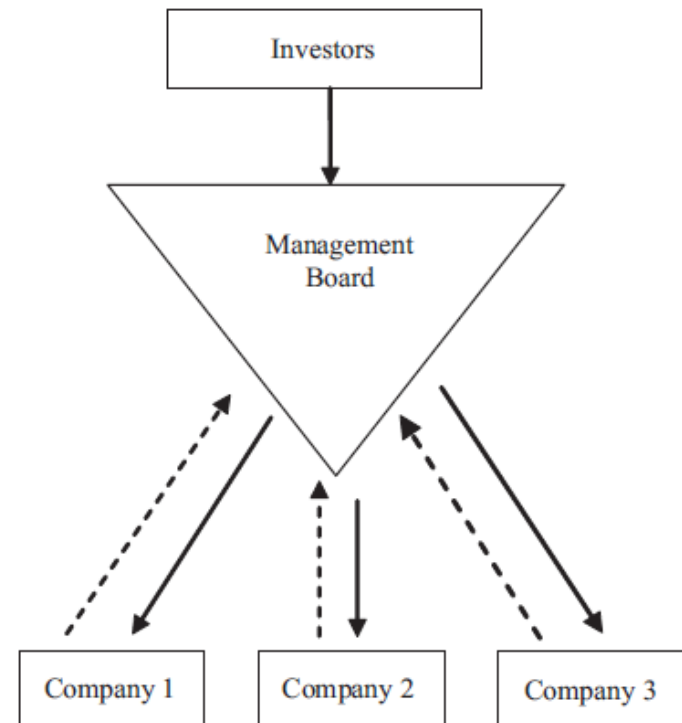
	Board of directors (unitary board)	Supervisory board (dual board)
Advantages	<p>Capability to represent shareholders interests</p> <p>Flexible and relatively inexpensive form</p> <p>Direct contact between executives and non-executives that enables sound monitoring and counselling</p> <p>Efficient information flow and non-executives' access to corporate data</p>	<p>Capability to represent shareholders interests</p> <p>All members are non-executives</p> <p>Balancing the power of CEO and board Chairman</p> <p>Higher objectivity and independence, particularly in the process of management evaluation, compensation policy</p> <p>No personal connections enable sound monitoring and counselling</p>
Disadvantages	<p>Powerful position of CEO who holds Chairman function</p> <p>Dependence on CEO policy, lack of objectivity</p> <p>Risk of building a coalition between CEO and outside directors (evaluation of board work, resisting to takeovers)</p>	<p>Higher costs of board functioning</p> <p>Poorer information flow and non-executives' access to corporate data</p> <p>Lack of direct contact between executives and non-executives</p> <p>Risk of dominating the board by majority shareholder</p>

Structure Amendment as Complexity Rises ...

„Old“



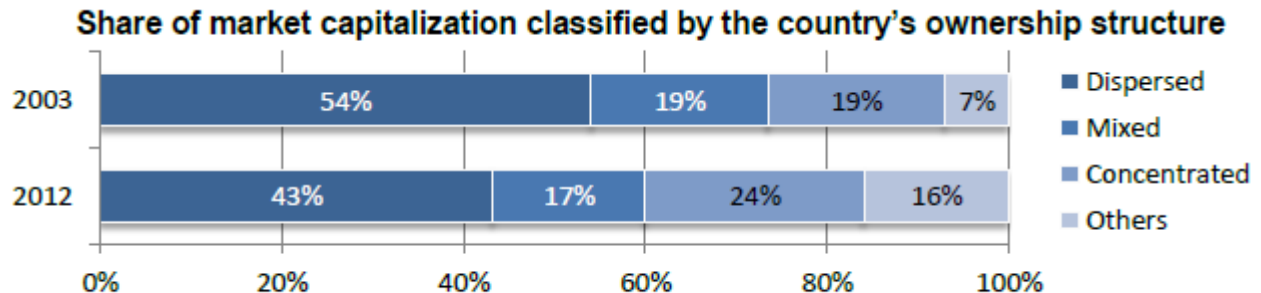
„New“



Empirical Comparison of Corporate Governance

The Ownership Structure of Listed Companies

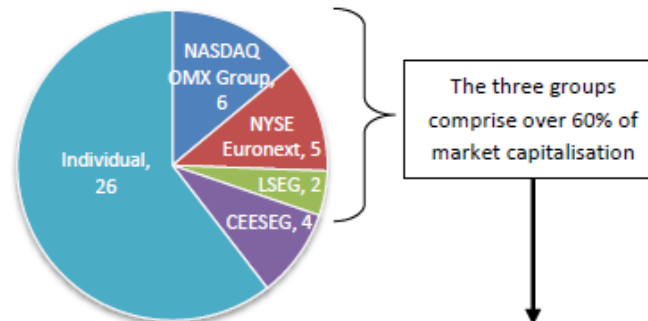
- Three countries (**Australia**, the **UK** and the **United States**) are generally characterised as having a predominantly “**dispersed**” ownership structure
 - The global aggregate market capital share of these countries has decreased from 54% to 43% over the last decade
- In **most OECD** and non-member countries, a majority of listed companies have a **controlling shareholder**
 - The presence of these countries with “**concentrated**” ownership structure has increased from 19% to 24% in terms of aggregate market capital share
 - In those companies with a concentrated ownership structure, “horizontal” agency problems (between controlling and minority shareholders) are abundant, while “vertical” agency problems (between managers and shareholders) may be mitigated
- Five countries (**Canada**, **Germany**, **Netherlands**, **Japan** and **Switzerland**) do not fall into either of these two categories, but are instead characterised as having a “**mixed**” ownership structure



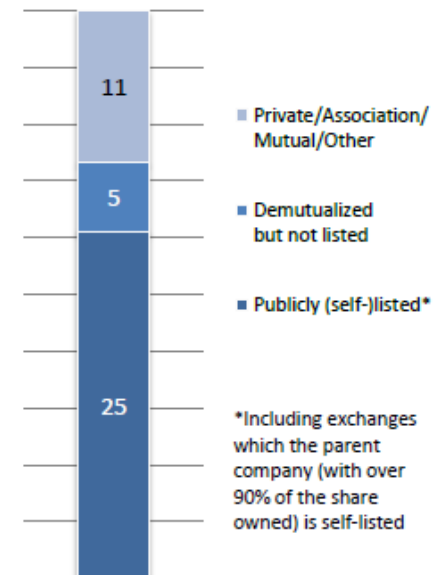
Source: OECD calculation on the basis of data from the World Bank.

Stock Exchanges by Legal Origin

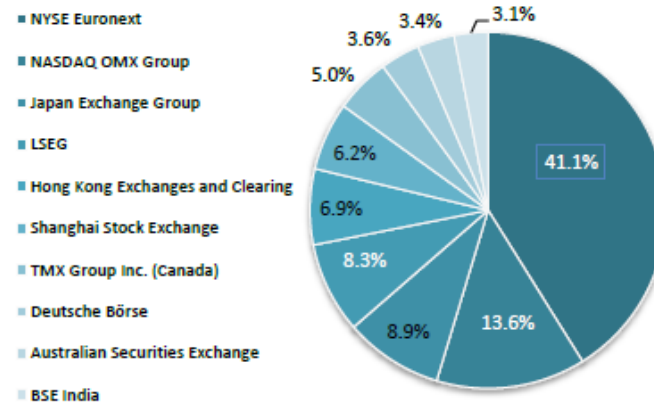
Largest stock exchanges in each jurisdiction: Member of a group or individual?



Legal Origin of Major Stock Exchanges



Top 10 domestic listed equities market capitalisation



As of year-end 2012

Source: World Federation of Exchanges "Cost & Revenue Survey 2012"

Source: Website of each stock exchange

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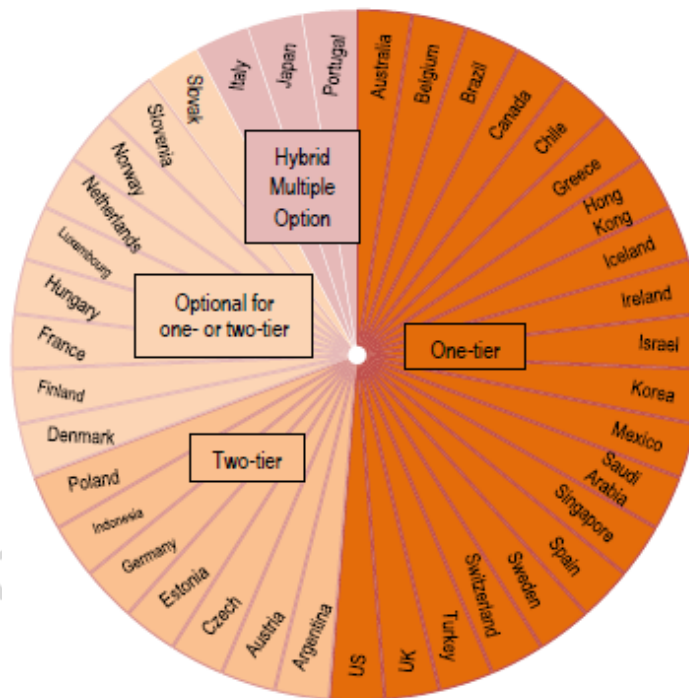
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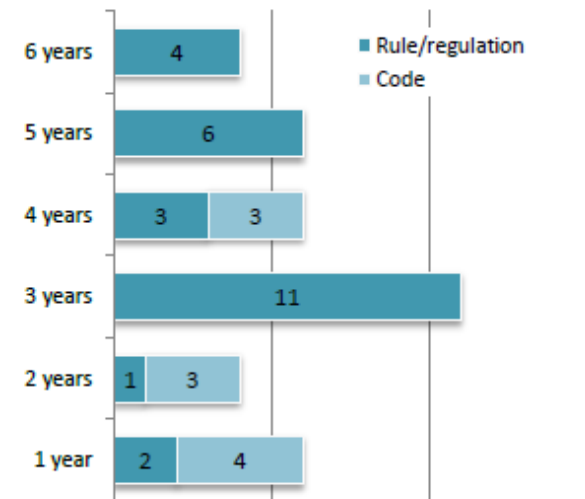
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Basic Board Structure and Board Independence

One-tier, Two-tier, Optional or Hybrid?³³



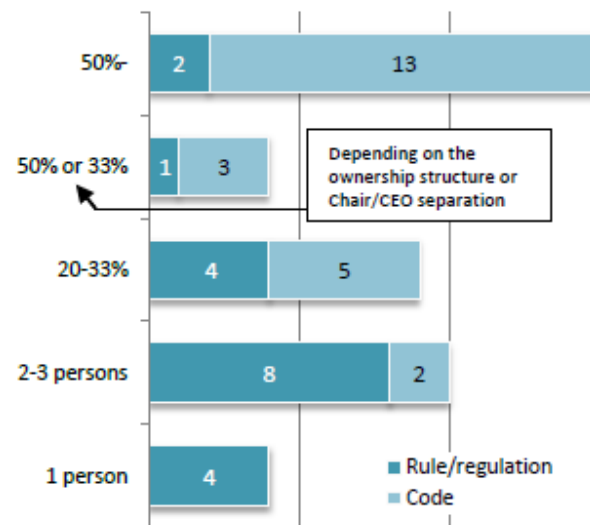
Maximum term of years for the (supervisory) board members (N° of jurisdictions)



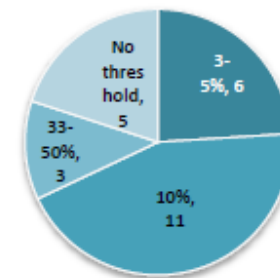
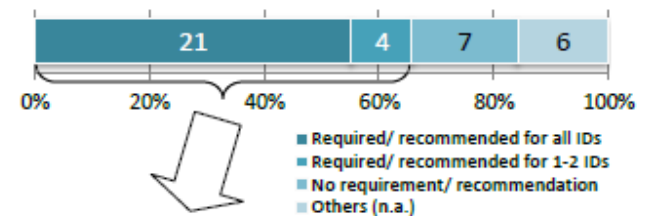
Note: The jurisdictions with two different frameworks are counted twice. "Rule/regulation" includes the requirement by the listing rule.

Basic Board Structure and Board Independence (cont'd)

Minimum number or ratio of independent directors (N° of jurisdictions)



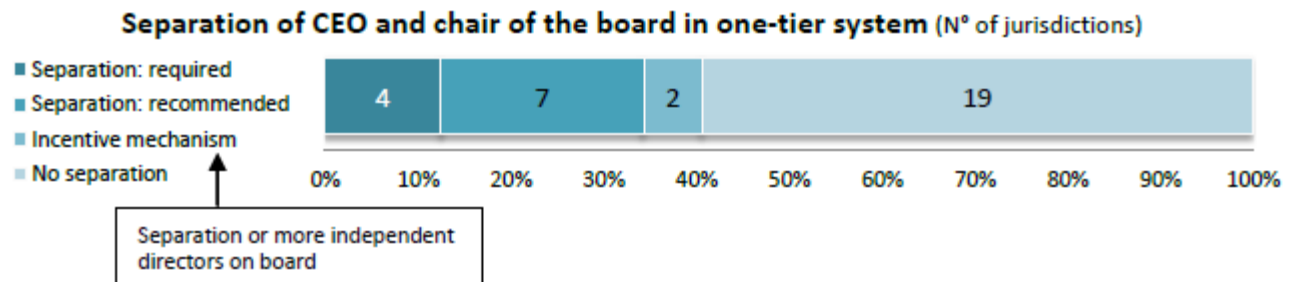
Definition of "independence":
Independence of substantial shareholders (N° of jurisdictions)



Shareholding threshold of substantial shareholders for assessing independence (N° of jurisdictions)

Note: The jurisdictions with two different frameworks are counted twice. "Rule/regulation" includes the requirement by the listing rule.

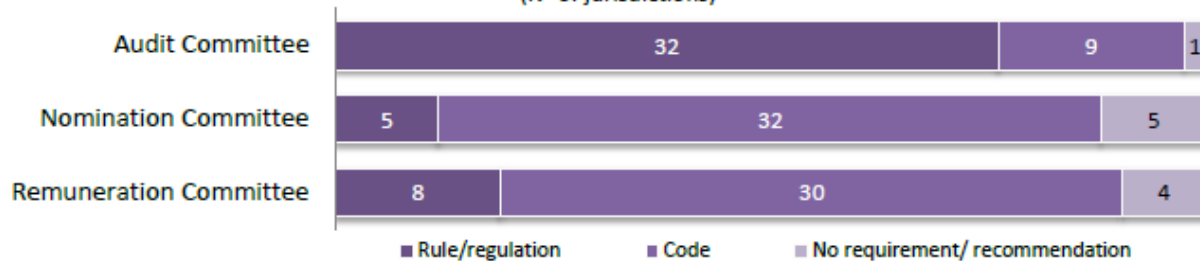
Basic Board Structure and Board Independence (cont'd)



Board-level Committees

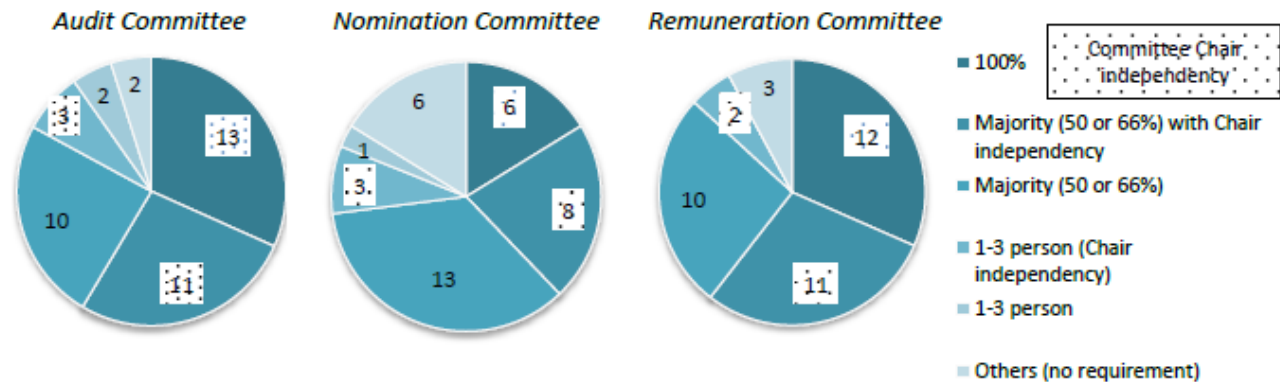
Establishment of board-level committees

(N° of jurisdictions)



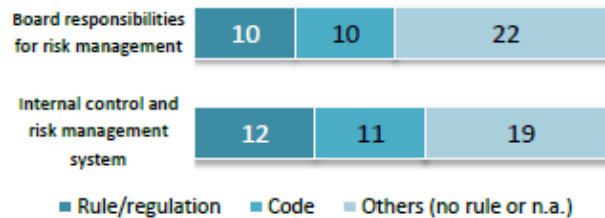
Minimum number or ratio of independent members

(N° of jurisdictions)

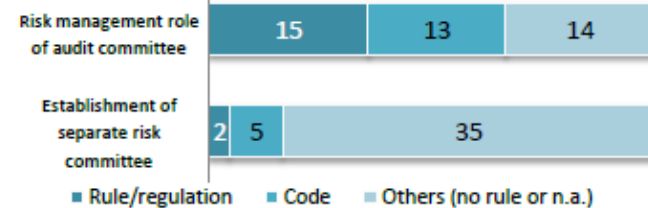


Board-level Committees (cont'd)

Governance of internal control and risk management (N° of jurisdictions)

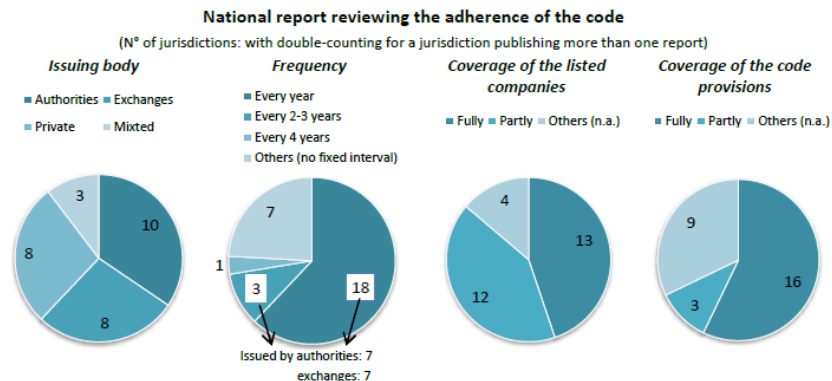
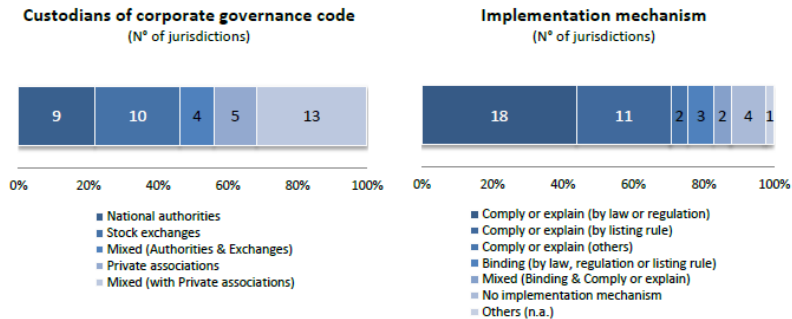


Board-level committee for risk management (N° of jurisdictions)



Regulatory Framework of Corporate Governance

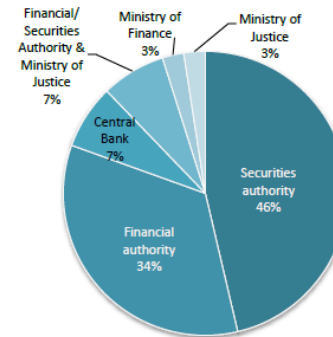
- In dealing with corporate governance issues, countries have used a varying combination of legal and regulatory instruments on the one hand, and codes and principles on the other.



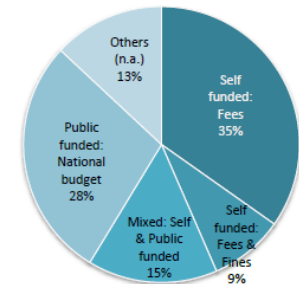
The Main Public Regulators of Corporate Governance

- Public regulators have the capacity to supervise and enforce the corporate governance practices of listed companies in all surveyed jurisdictions

Who is the regulator of corporate governance?
(% share based on the number of jurisdictions)

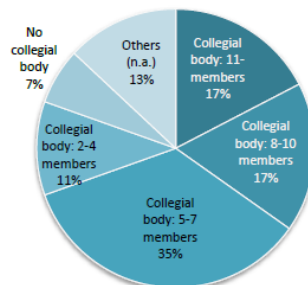


How is the regulator funded?
(% share based on the number of jurisdictions)



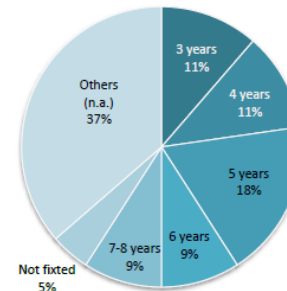
Note: The jurisdictions with two main regulators are counted twice.

How is the ruling body of the regulator organised?
(% share based on the number of jurisdictions)



Note: The jurisdictions with two main regulators are counted twice.

Term of members of the ruling body
(% share based on the number of jurisdictions)



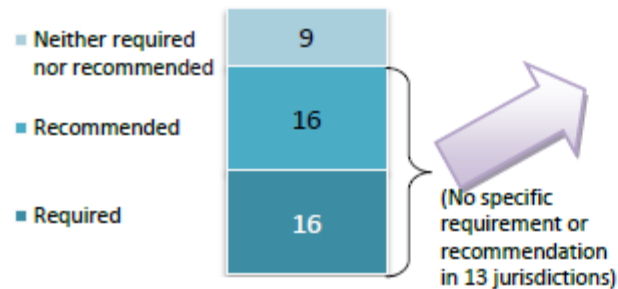
Note: The jurisdictions with two main regulators are counted twice.

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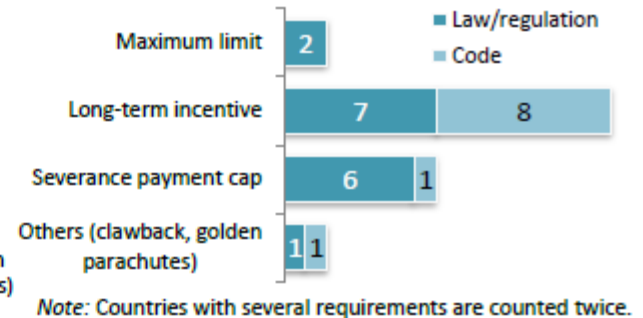
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Governance of Board and Key Executive Remuneration

Criteria for board and key executive remuneration (N° of jurisdictions)



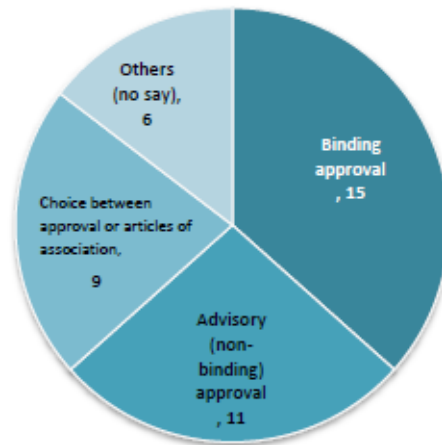
Specific requirement or recommendation (N° of jurisdictions)



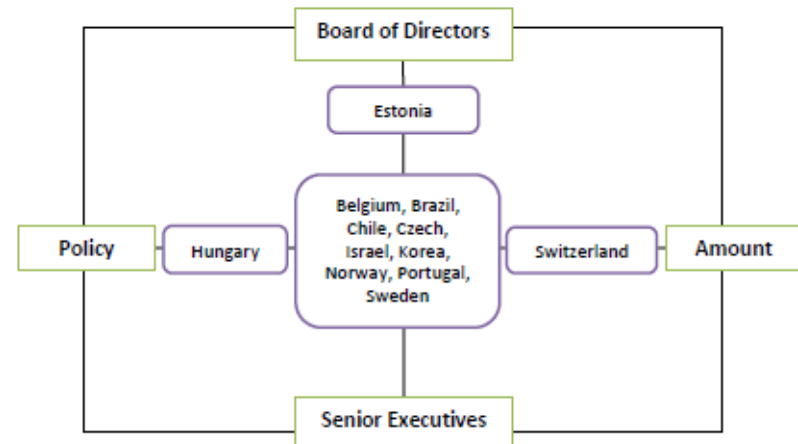
Governance of Board and Key Executive Remuneration (cont'd)

- Say on pay is a term used for a rule in corporate law whereby a firm's shareholders have the right to vote on the remuneration of executives

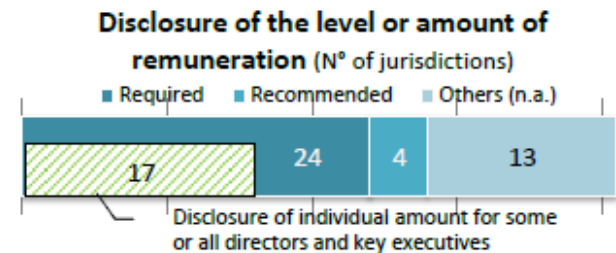
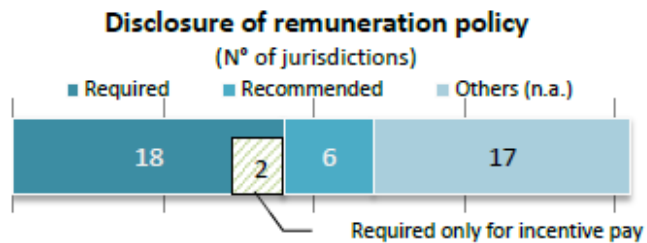
Requirement or recommendation for "say on pay" (N° of jurisdictions)



Coverage of the "say on pay" (Binding approval)

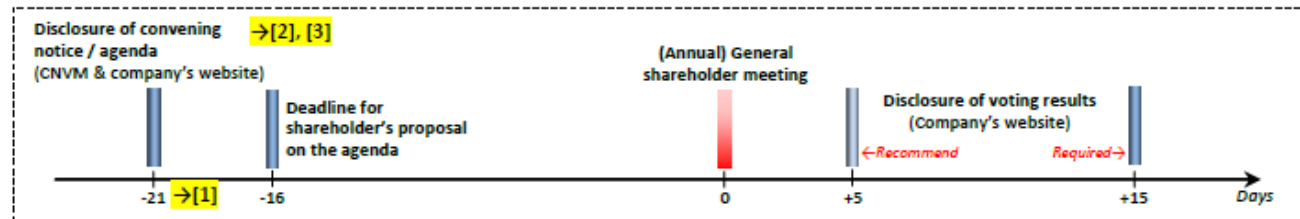


Governance of Board and Key Executive Remuneration (cont'd)

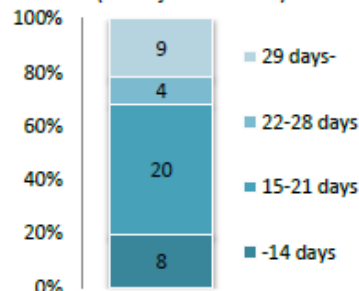


Notification of General Meetings & Information Provided

Timetable for convening general shareholder meetings: An Example of Portugal

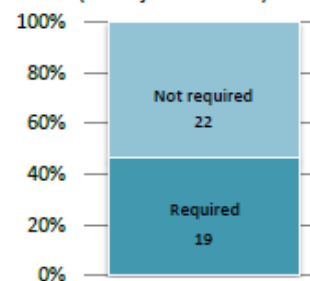


[1] Minimum period of time before the meeting
(N° of jurisdictions)

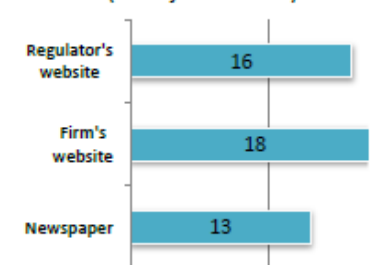


Notification of general meetings

[2] Requirement for sending notification to all shareholders
(N° of jurisdictions)



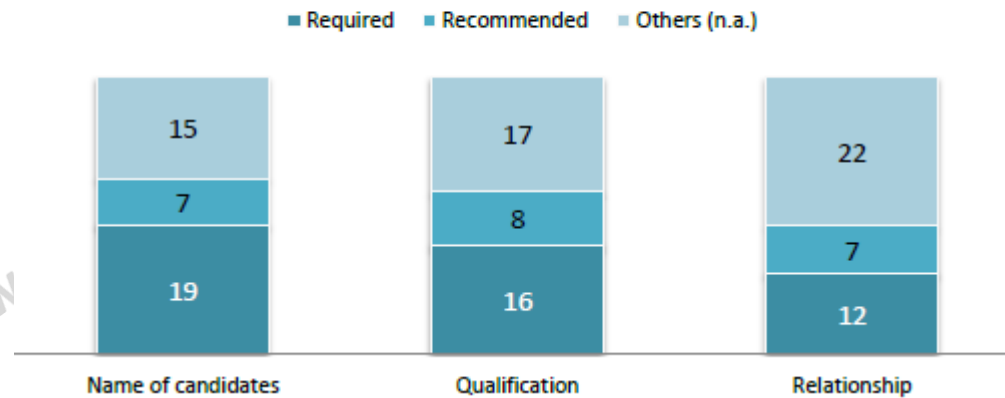
[3] Required media for publishing the notification
(N° of jurisdictions)



Note: Countries with several requirements are counted twice.

Notification of General Meetg's & Information Provided (cont'd)

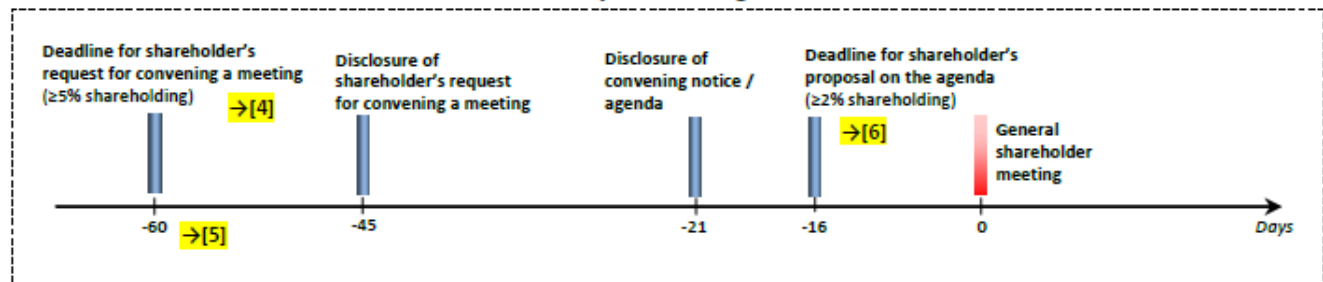
Information provided to shareholders regarding the candidates of board election
(N° of jurisdictions)



Shareholder's Rights

Timetable for Shareholder's request for convening a shareholder meeting and placing items on the agenda:

An Example of Portugal



Shareholder's request for convening a shareholder meeting

[4] Minimum shareholding requirement (N° of jurisdictions)

3%	5%	10%	20%
3	22	15	1



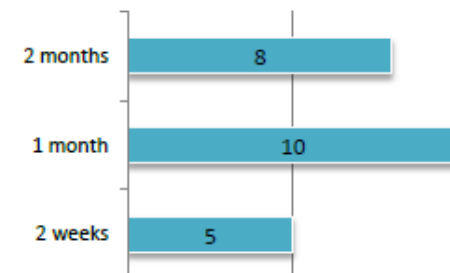
Same threshold in 14 jurisdictions
Lower threshold in 23 jurisdictions

Shareholder's request for placing items on the agenda

[6] Minimum shareholding requirement (N° of jurisdictions)

No threshold	0-3%	3%	5%	10%	Others (n.a.)
6	8	4	5	6	6

[5] Deadline for holding a meeting after the request (N° of jurisdictions)



Shareholder Voting

- A cumulative voting election permits voters in an election for more than one seat to put more than one vote on a preferred candidate
- When voters in the minority concentrate their votes in this way, it increase their chances for obtaining representation in a legislative body
- This is different from bloc voting, where a voter may not vote more than once for any candidate, and 51% of voters can control 100% of representation

Voting practice for board election

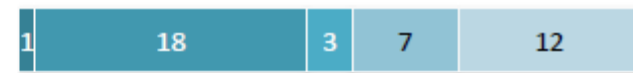
Majority requirement (N° of jurisdictions)

■ Required ■ Not required ■ Others (n.a.)



Cumulative voting (N° of jurisdictions)

■ Required ■ Allowed ■ Allowed with limit
■ Not allowed ■ Others (n.a.)



Issuing shares with limited voting rights (N° of jurisdictions)

■ Allowed ■ Allowed with limit (max 25%-50%) ■ Not allowed ■ Others (n.a.)

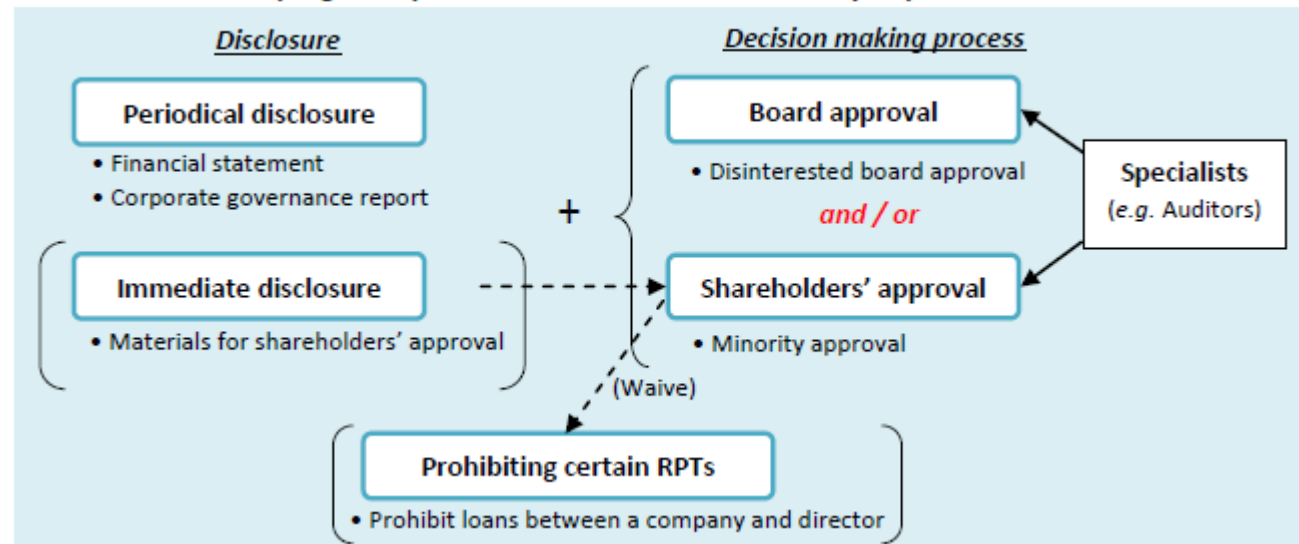


Issuing shares with non-voting rights (N° of jurisdictions)

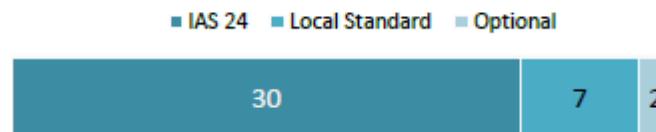


Related Party Transactions

Key regulatory framework to address the related party transactions



Disclosure of related party transactions in financial statements (N° of jurisdictions)



Related Party Transactions (cont'd)

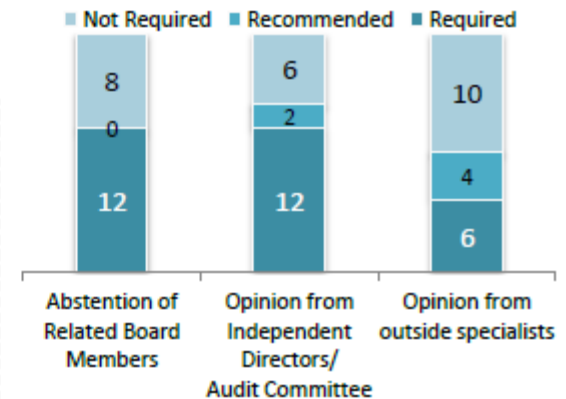
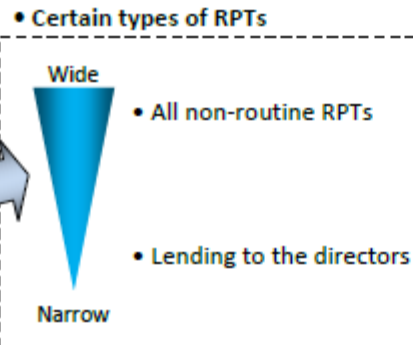
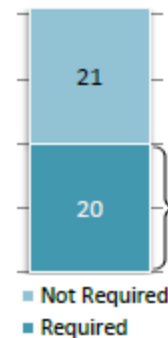
Related party transactions: Board approval for individual transaction

(N° of jurisdictions)

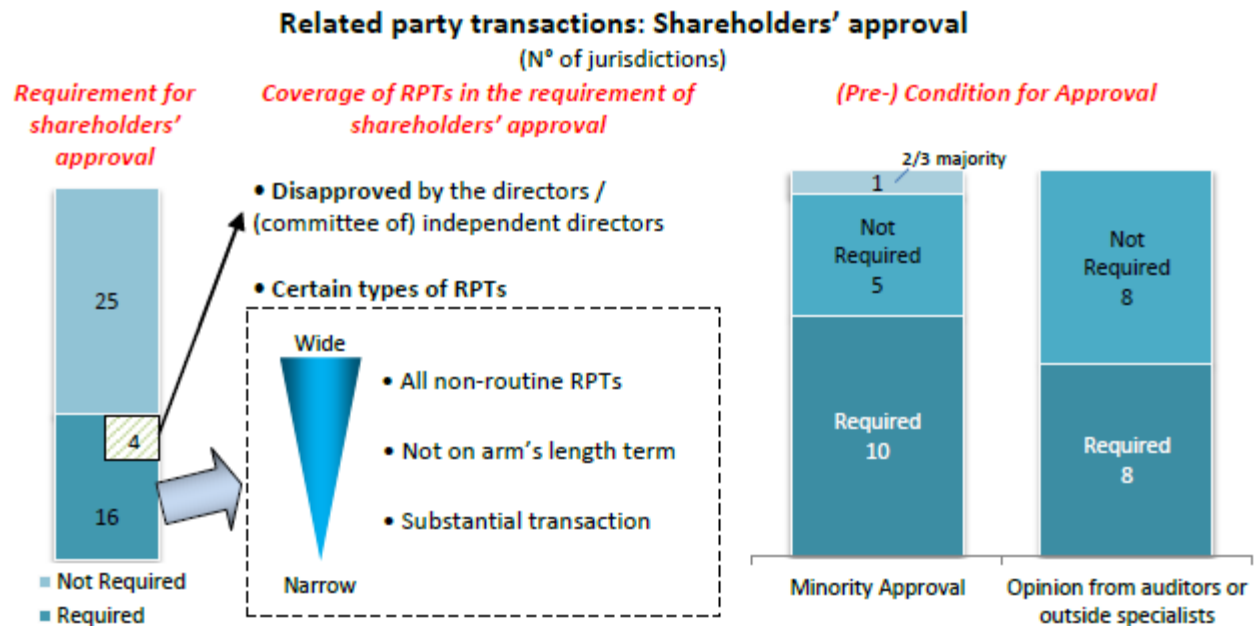
*Requirement for
board approval*

*Coverage of RPTs in the requirement
of board approval*

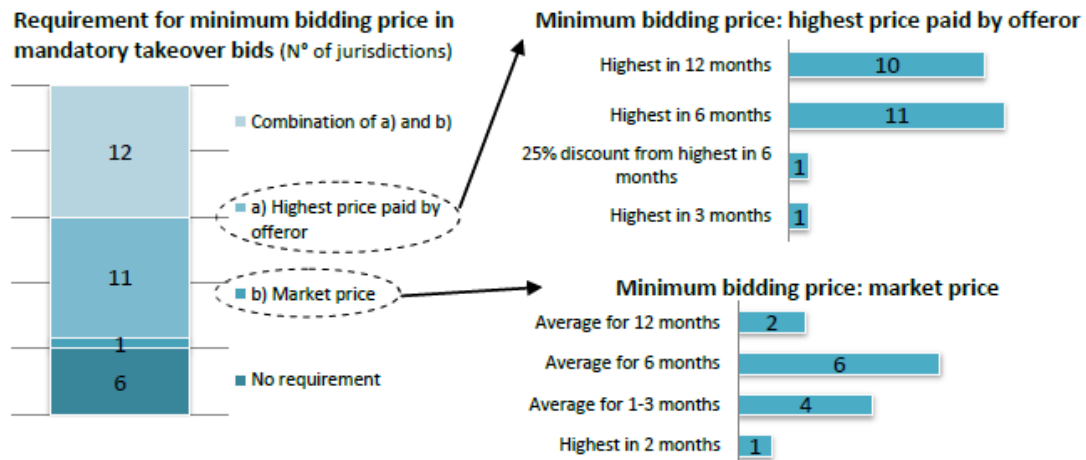
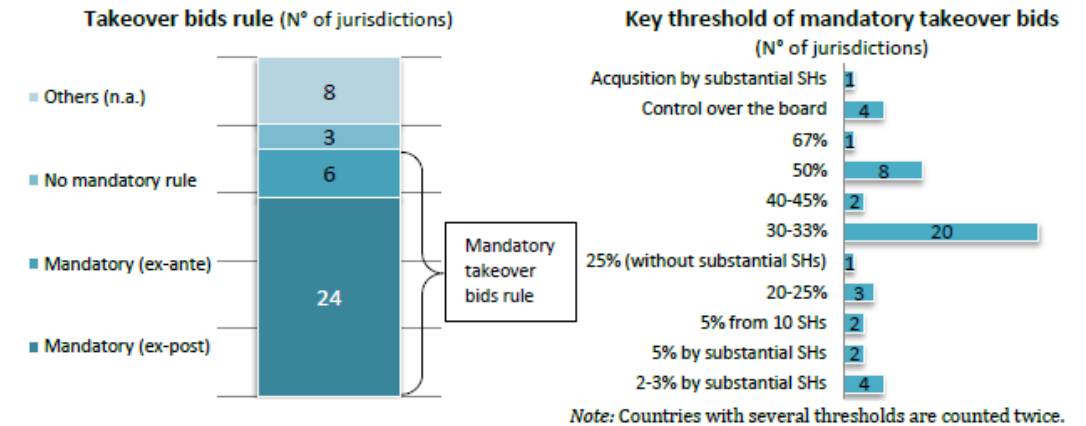
(Pre-) Condition for Approval



Related Party Transactions (cont'd)



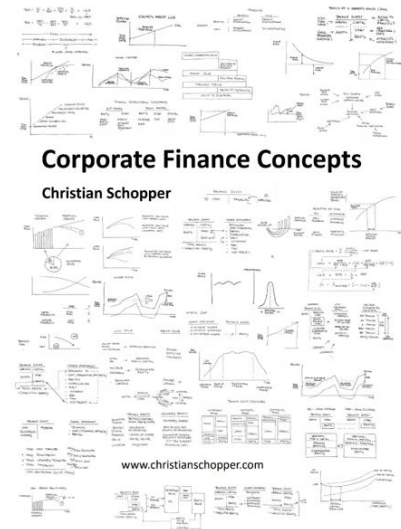
Takeover Bid Rules



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