



**The board's  
role in  
designing  
an effective  
framework  
of corporate  
governance**



**Joint survey across  
11 EU countries**

**ecoda**  
The European Voice of Directors

**M**  **MAZARS**

**MARCH 2018**

A photograph of a man with glasses and a beard, wearing a white shirt, looking at a laptop screen. He is in a meeting with other people, some of whom are wearing pink shirts. The background is slightly blurred, focusing on the man in the foreground.

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# CORPORATE GOVERNANCE FROM THE BOARD'S PERSPECTIVE

## Mazars and ecoDa highlight key challenges facing European corporate governance systems

A quarter of a century since the world's first corporate governance code, Mazars and ecoDa report the headline findings from a survey of 130 listed companies across 11 EU countries and set out the key issues that need to be considered by boards, shareholders and regulators.



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*The principles of Corporate Governance are of great importance. Their application needs though to be subject to evaluation of the particular company's circumstances.*



## INTRODUCTION

- Boards should be able to apply their national codes of corporate governance in a manner appropriate to the size and shareholding structure of their companies
- National codes should cater sufficiently for the specific characteristics of the different kinds of companies represented in the capital markets in their countries
- Provisions protecting the rights of minority shareholders should be included in the corporate governance codes of all countries
- There is a risk of proxy agencies forcing a standard approach and thereby unduly influencing the corporate governance landscape

### governance landscape

- **In addition to focusing on compliance with corporate governance codes there needs to be a stronger emphasis on whether a well-functioning board is in place**
- **There would be merit in proactive shareholder engagement across a wide range of issues whereas at present it seems to be narrowly focused on issues such as remuneration**
- **In looking at corporate governance it is important that there is a clear focus on entrepreneurship as well as on accountability.**

Using the 'Comply or Explain' approach is widespread amongst listed companies in the EU. Influenced by the Cadbury Report, first published 25 years ago, and the 2014 recommendation of the European Commission, the approach is now embedded in national corporate governance codes.

There are significant differences in the structure of equity markets across Europe, giving rise to a number of challenges:

- The extent of the application of national corporate governance codes
- The appropriateness of approach
- The quality of compliance and monitoring





DISCUSSION POINTS

To stimulate conversation around the subject, ecoDa and Mazars have undertaken a joint project, which is being delivered in phases, and looks at the 'Comply or Explain' concept from three different perspectives:

- (I) corporate Governance Codes and Monitoring Systems across European Union ('EU') Member States;
- (II) the board's role in designing an effective framework of corporate governance;
- (III) what stakeholders think of the evolution of the 'Comply or Explain' approach.

This report follows on from the desktop research and [report](#) which provided an overview of the mechanisms in place to monitor the level and quality of compliance with governance codes. Phase II of the study focuses on the practical implications of complying with corporate governance codes from the board's perspective.

The nature of the survey does not allow the extrapolation of the observations and conclusions across the EU. The purpose of the report is to highlight awareness, raise questions and promote a

discussion around the approach to reporting on corporate governance.

We have included quotes from corporate respondents to the electronic survey throughout the report. Many of them support the overall observations made. They have been used in their original form and are within quotation marks.

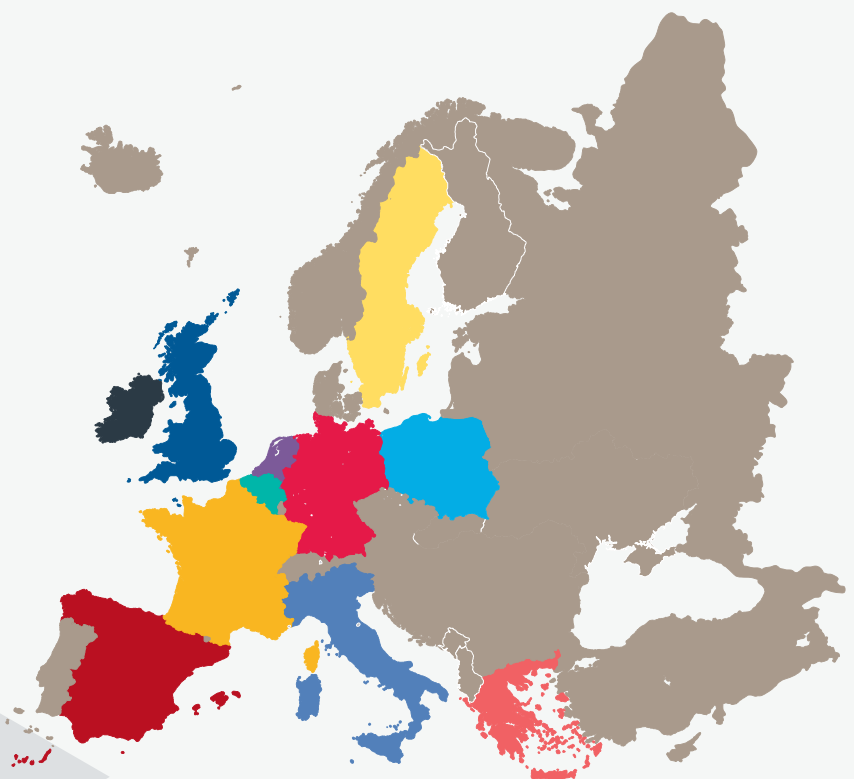
ecoDa and Mazars extend their thanks to the European Corporate Governance Codes Network (ECGN) for having joined forces with them on this project, providing significant input to all aspects of the study.

**130**  
listed companies

across

- COUNTRIES INCLUDED:
- Belgium
  - France
  - Germany
  - Greece
  - Ireland
  - Italy
  - The Netherlands
  - Poland
  - Spain
  - Sweden
  - UK

**11**  
EU countries, including amongst others:  
- subsidiaries of foreign companies  
- those listed on more than one stock exchange  
- financial institutions



**7%**  
are subsidiaries of foreign companies

**15%**  
are financial institutions

**35%**  
are listed on more than one stock exchange

Secondary listing is mostly on US or UK stock exchanges



## TYPE OF COMPANIES

OWNERSHIP	
FAMILY	39%
MANAGEMENT	6%
STATE	8%
INDUSTRIAL	6%
INSTITUTIONAL	32%
INDIVIDUAL	2%
OTHER	7%
	100%

The majority of family owned businesses in our sample are in Mediterranean countries, such as Spain, Greece and Italy. In countries like France and Belgium ownership is more equally split between family and institutional investors. Most of the companies where institutional investors owned the majority of shares were in the UK, Ireland and the Netherlands.

COUNTRY	Average shareholding % of the largest shareholder	Average % of free float
GERMANY	54.50%	37.00%
ITALY	52.07%	40.21%
SPAIN	45.16%	59.29%
GREECE	39.00%	41.32%
BELGIUM	28.83%	60.43%
POLAND	27.67%	57.56%
SWEDEN	27.59%	46.25%
FRANCE	23.17%	51.2%
THE NETHERLANDS	21.27%	78.15%
UK	19.84%	79.44%
IRELAND	17.44%	82.07%

In Mediterranean countries, the largest shareholder tends to own almost half of the shares, whereas in the UK and Ireland the largest shareholders in the survey own no more than 20% of total shares.



# OVERALL OBSERVATIONS

## THE IMPACT OF DOMINANT SHAREHOLDERS ON GOOD CORPORATE GOVERNANCE

As noted in the Phase I report, not only is the relative weight of listing quite different, but the type of shareholding also varies significantly across EU Member States. The 'classical' example of a stock exchange, with widely dispersed shareholding and a high degree of free float, is found especially in the UK and Ireland. On the other hand, listed companies in continental European countries tend to have a much more stable and concentrated shareholding structure and, consequently, a free float that is much more limited.

Moreover, a number of countries in the EU have a model that can be classified as a 'controlling' shareholder model, with the largest shareholder holding percentages of 20% or more. Together with other major shareholders, they hold a significant 'controlling' stake in the company.

This survey tentatively suggests that the approach to corporate governance by listed companies differs across the EU according to the different shareholder models in place.

This situation would explain the low involvement of shareholders in the process of developing companies'

corporate governance frameworks, with the exception of some countries where there are dominant shareholders on the board. It raises the question of whether minority shareholders have sufficient opportunities to express their views, where dominant shareholders approve matters at board level or in other ways outside of shareholders' meetings.



### At shareholders' meetings, do minority shareholders have sufficient opportunities to express their views?

The existence of different shareholder models across the EU would suggest that it is important for individual jurisdictions to have codes relevant to their particular circumstances, and that these should take account of the risks associated with each model that may exist in their capital markets, having regard to the impact of globalisation. The risks may be linked to either:

- dominant shareholders seeking to advance their interests at the expense of the minority shareholders; or
- a large group of shareholders - with none holding a significant proportion of the shares - not taking an active interest in governance and leaving such matters very much to the board, potentially reducing the expected checks and balances in the system.

National codes should therefore be sufficiently tailored to reflect the varying circumstances of their countries' different legal systems, national cultures and business practices.

In addition, from a company perspective, when choosing to implement the corporate governance code in the country of their primary listing, do they sufficiently consider the shareholder structure of their particular entity and ensure that the best interests of the shareholders as a whole are promoted?





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*Investors range from highly active to passive. Understanding the investors' preferred engagement style is crucial.*

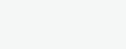
## OUTSIDE SHAREHOLDERS DO NOT SEEM TO HAVE A STRONG FOCUS ON CORPORATE GOVERNANCE

Although more than 75% of respondents say that corporate governance is an area of interest to their investors, the analysis of the detailed results would indicate that investor engagement by outside shareholders is not proactive. This is true both in countries without dominant shareholders as much as in those with them.

Most of the changes made to a particular company's corporate governance code are the result of changes in legislation or the reference corporate governance framework, with a few instances of other changes being made at the behest of the board, and a smaller number as a consequence of requests from shareholders.

The topics of discussion with investors on corporate governance seem to centre around remuneration and the nomination of directors, with issues being raised at various points such as prior to the General Assembly, at the General Assembly, at ad hoc meetings and during road shows.

It could be argued that corporate governance, and, consequently, sustainable business performance, would be likely to improve in overall terms if investors took a greater interest in a broader range of issues, including purpose, corporate culture, strategy, risk management and succession-planning.



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*There needs to be a higher principle, and the explanation needs to explain why failing to comply with a point of detail does not undermine the higher principle.*

## USE OF THE FLEXIBILITY PROVIDED BY THE 'COMPLY OR EXPLAIN' APPROACH

Around 60% of the companies surveyed made use of the flexibility provided by the 'Comply or Explain' approach in corporate governance codes.

Where explanations were given, rather than the board complying with the relevant provision of the reference code, companies report that these seem to have been accepted by the shareholders with a relatively low degree of challenge. This raises questions concerning whether institutional investors are sufficiently engaged, and whether their engagement on matters of exception is an indication of a primarily reactive rather than pro-active approach to their governance responsibilities.

## PERCEPTION THAT GIVING AN EXPLANATION DOES NOT REFLECT GOOD CORPORATE GOVERNANCE

There seems to be concern amongst, at least some companies, that deciding to 'explain' rather than to 'comply' with certain corporate governance provisions would be seen as not demonstrating the application of high corporate governance standards.



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The proxy agents tend to ignore the 'Comply or Explain' flexibility and vote 'no' on principle if there is non-compliance

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## ARE PROXY AGENTS INFLUENCING THE APPLICATION OF THE 'COMPLY OR EXPLAIN' APPROACH?

Interestingly, there is a preference to make use of the 'Comply or Explain' approach amongst family, management and state-owned companies. This is in comparison to institutional investor and industrial-owned companies preferring to mostly comply with the code.

In a number of instances, proxy investors may act on behalf of holders of a significant proportion of total shares. This raises the question whether they, in effect, are the equivalent of a dominant shareholder on governance issues exerting substantial hidden influence, with limited accountability.

A question to explore is whether proxy agencies, hired by institutional investors in many instances to assess the corporate governance of investee companies on their behalf, are tending to want companies to 'comply' rather than 'explain' regardless of the circumstances. The standard global approach of proxy agencies makes their monitoring role more straightforward.



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*Corporate governance for small quoted companies is due more work. More clarity on the code as it applies to small companies would be helpful. An engaged shareholder group is essential for successful governance reform.*

## MONITORING BODIES AND THEIR INFLUENCE IN THE CHOICE OF 'COMPLY OR EXPLAIN'

On average, companies mostly comply with all or nearly all of the provisions in codes. This could also suggest that this approach, makes the task of identifying and analysing exceptions more manageable for regulators and shareholders. It would be much more difficult if more companies reported multiple departures from the normal expectations of the code. This is contrary to the often heard view that the use of explanations would enable boards to tailor the application of the relevant code more closely to the specific circumstances of their companies, including its shareholder model.

## CONSIDERATION OF THE SIZE OF THE COMPANY WHEN DEFINING THE COMPLIANCE EXPECTATIONS

Respondents also alluded to the fact that the size of the company should also be considered and that expectations of compliance with the full code, in the same way as for their larger counterparts, place onerous expectations on smaller listed companies. This is particularly of interest in countries where there are a large number of smaller listed companies on the main market in addition to those quoted on the secondary alternative markets.



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*The company has an intrinsic motivation to maintain sound corporate governance. The code is not the main driver to develop the governance framework, though seen as valuable guidance.*

## FOCUSING ON GOVERNANCE IN PRACTICE AND NOT JUST A DESKTOP REVIEW OF CODE APPLICATION

In analysing how codes are applied in different companies and jurisdictions, it is important to bear in mind that a key determinant of effective corporate governance is the collective quality of the people on the board, both executive and non-executive, and of others with leadership roles in the business. The principal factors impacting this are the board members' individual skills, experience and personalities, and how well they work as a team. This in turn will be influenced by the culture in the boardroom, and whether it provides both strong challenge and strong support to the executive team. Many major governance failures, turn out to be linked to the existence of a dominant individual, whose behaviour went unchecked. No desktop review of how a code has been applied can provide deep insights into such issues.

The above raises the question of whether investors should devote more attention and resources to how well their boards are operating in practice. It also highlights the merits of boards reporting more openly on the outcomes of independent board evaluations.



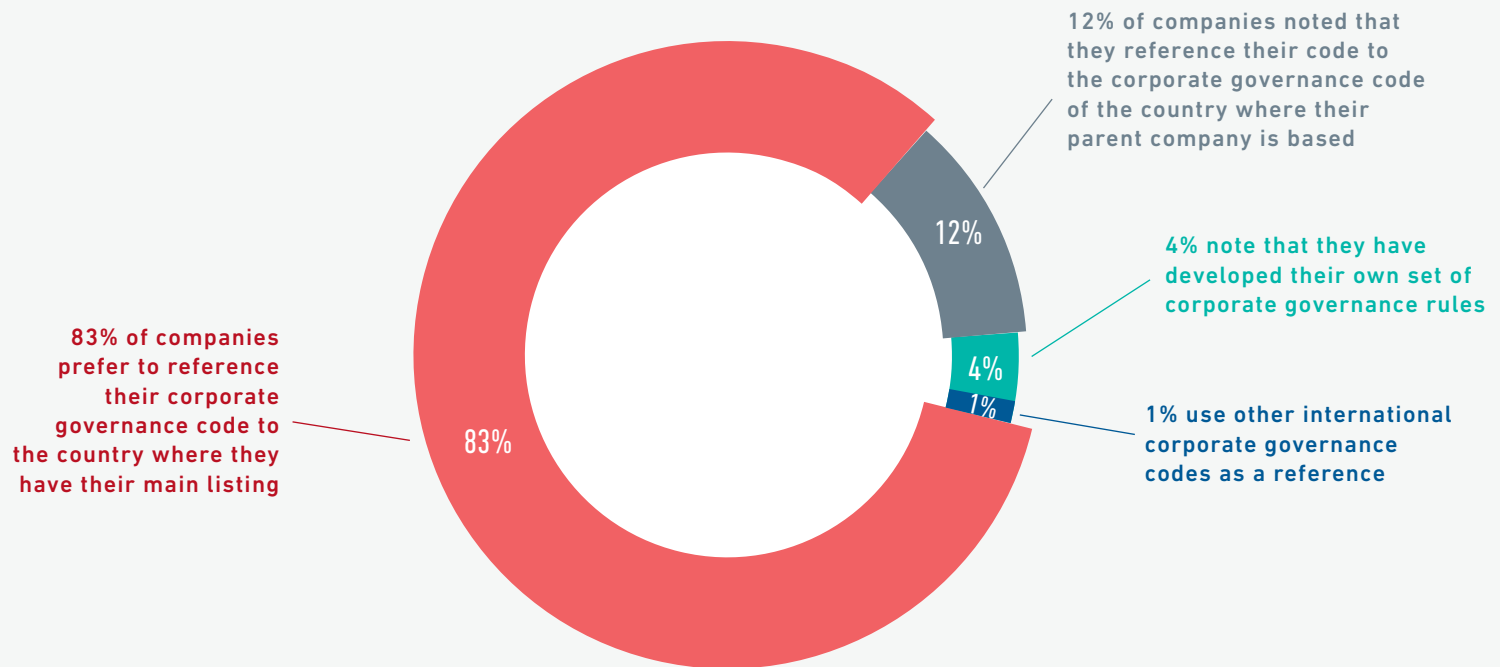
## Good corporate governance can drive company reputation and sustainable success

But the codes are just the tip of the corporate governance iceberg. They should be used to drive better governance by encouraging a longer term view of business performance, leading to sustainable behaviours which create value for companies, their stakeholders and wider society.

# HIGHLIGHTS FROM SURVEY RESPONSES

## REFERENCE CODE USED

- Most companies apply the corporate governance code of the country where they have their main listing.



- The majority of companies noted that 'discussions' with shareholders did not result in amendments to the corporate governance framework. Any amendments that did arise were mostly minor. A number of companies also reported major adjustments being made following a discussion with the board.



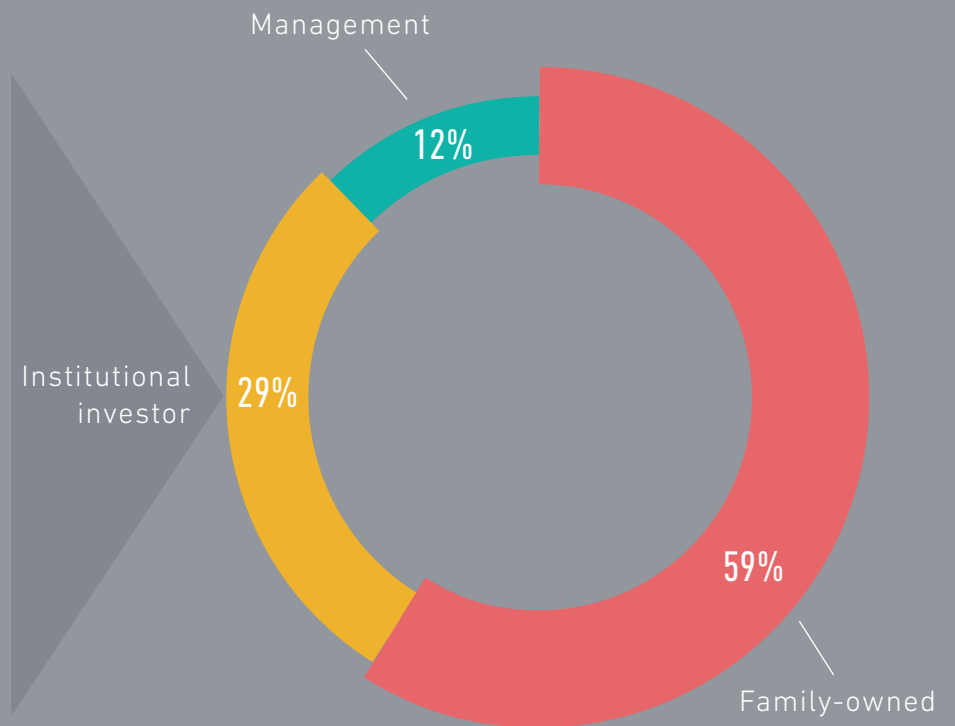
## MOTIVES OF COMPANIES CHANGING THEIR CORPORATE GOVERNANCE FRAMEWORK

Company profile	Changes in national/ European law	Changes in the reference corporate governance code	At the request of the main shareholders	Investors comments or negative voting	At the request of the board of directors	At the request of management
Subsidiaries	3	3	3	0	2	0
Parent company	43	49	6	7	39	19
Companies listed on more than one stock exchange	12	17	4	2	15	4
Companies listed on a single stock exchange	33	34	6	5	25	14
Family-owned	12	17	2	0	9	5
Management	3	4	1	1	2	1
State-owned	4	2	1	0	3	2
Industrial owner	4	4	2	0	2	0
Institutional investor	17	17	3	1	14	7
Individual investor	1	1	0	1	2	0
Bank	0	0	0	0	1	0
Financial institutions	7	7	1	1	7	3
Other sector	39	45	8	6	34	16

## MOTIVES OF COMPANIES CHANGING THEIR CORPORATE GOVERNANCE FRAMEWORK

- Most companies noted that they revised their corporate governance model in the last year and that the main reasons behind the revisions were changes in the reference corporate governance code or in national/European law. In the majority of cases the revision was requested by the board of directors and/or management.

17% OF COMPANIES REPORTED THEY HAD REVISED THEIR CORPORATE GOVERNANCE FRAMEWORK IN THE LAST YEAR. THE MAJORITY OF COMPANIES IN THIS CATEGORY WERE FAMILY OWNED COMPANIES:





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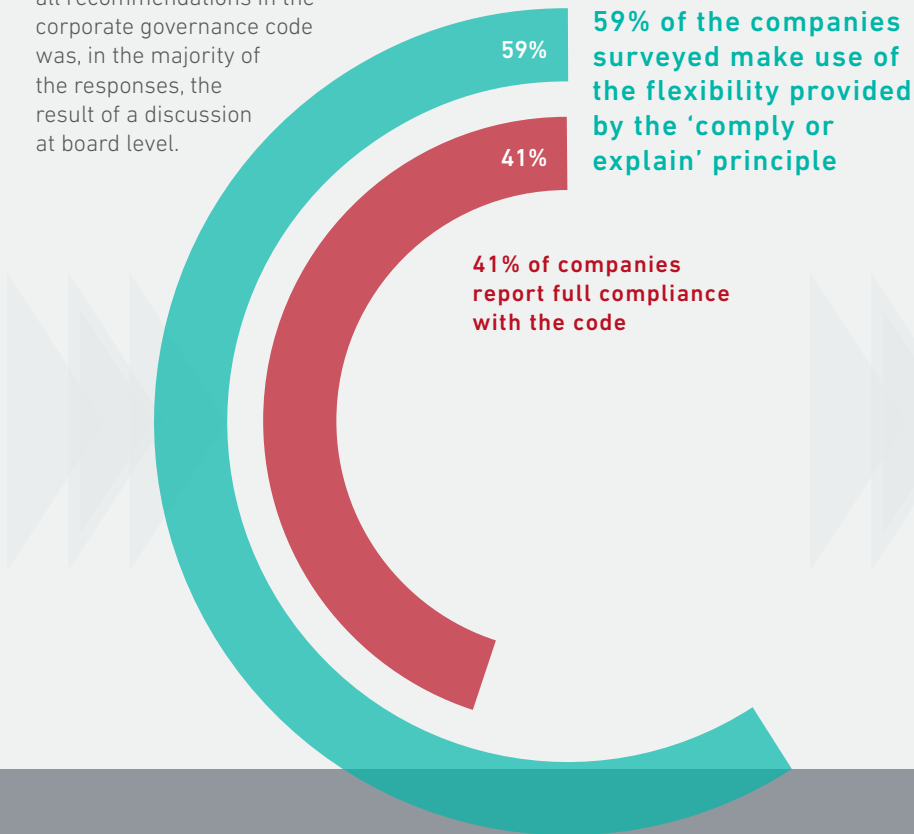
## The ‘explain’ element is not taken up by the outside world as being valid

Compared to a ‘comply’, on the contrary, it is always referred to as ‘not compliant, not respecting the code’ while the intention was to allow deviation if justified.

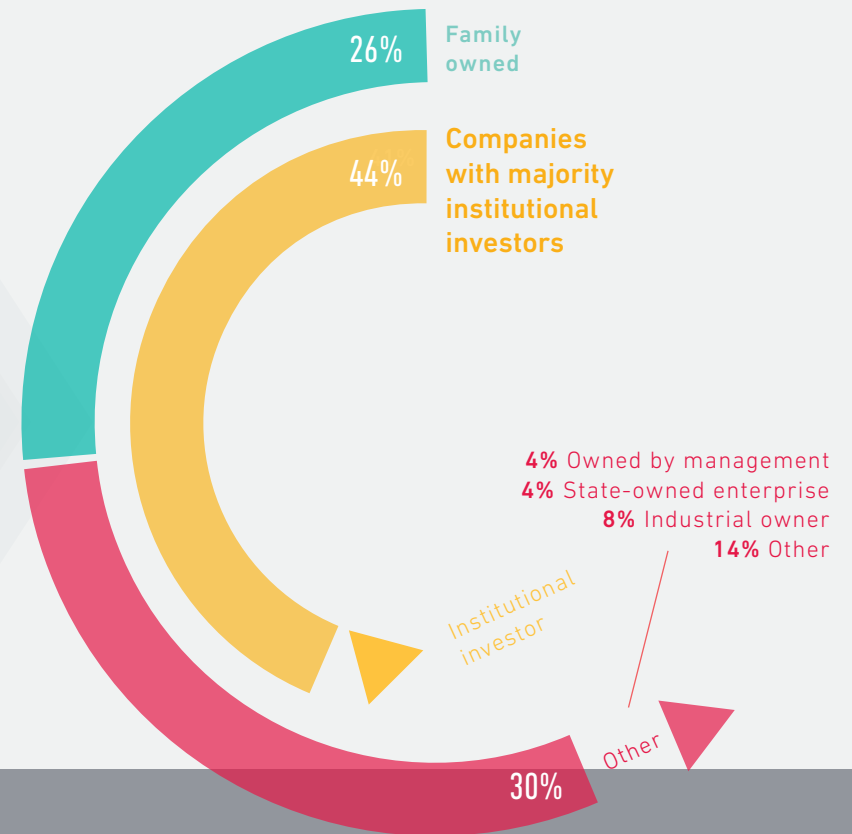


## USE OF THE 'COMPLY OR EXPLAIN' OPTION BY COMPANIES

- The drafting of the annual corporate governance statement is mainly the responsibility of the company secretary or legal counsel.
- In the majority of cases the explanations were used to explain the length of service of NEDs or representation on board committees (number of members, age, etc).
- The decision not to comply with all recommendations in the corporate governance code was, in the majority of the responses, the result of a discussion at board level.



## OF THOSE NOT TAKING ADVANTAGE OF THE FLEXIBILITY OF THE 'COMPLY OR EXPLAIN' OPTION

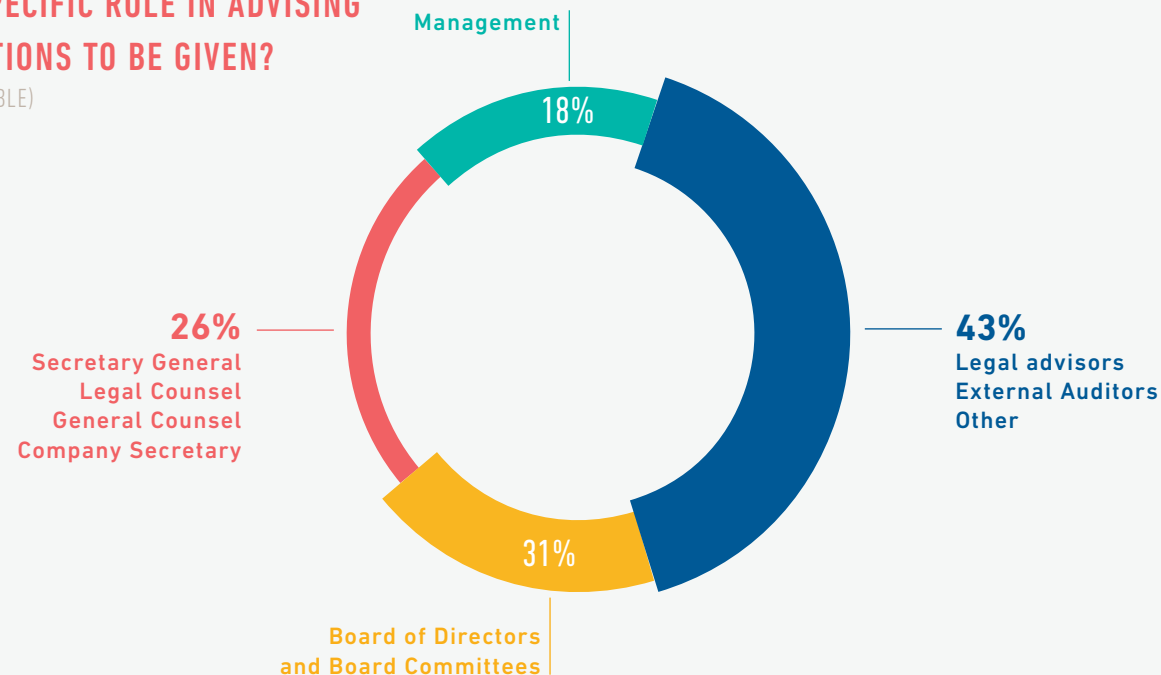


## 'COMPLY OR EXPLAIN' – WHAT BOARDS THINK...

- 70% of the companies note that they use the guidance in the national corporate governance code to develop explanations.
- 52% of companies surveyed did not believe that additional guidance on the application of the 'Comply or Explain' principle (in addition to the current EU Recommendation/ national guidance) is required. Whereas the remaining 48% of the companies stated that additional guidance would be helpful to:
  - learn about best practices
  - get clearer guidelines
  - promote high quality explanations

### WHO PLAYED A SPECIFIC ROLE IN ADVISING ON THE EXPLANATIONS TO BE GIVEN?

(MULTIPLE ANSWERS POSSIBLE)





- From the responses, the 'Comply or Explain' approach appears to work well. Interestingly some companies note:

“A growing number of obligations lead to an ‘explosion of information’ and ‘dilution of the essential information’;”

“The ‘**explain**’ element is not taken up by the outside world as being valid, compared to a ‘comply’, on the contrary, it is always referred to as ‘**not compliant, not respecting the code**’ while the intention was to allow deviation if justified”;

“Companies should not be jeopardized in case of ‘explain’”.

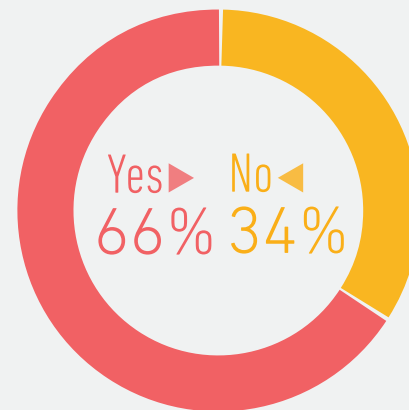
# WHAT COMPANIES THINK OF INVESTORS' APPROACH TO 'COMPLY OR EXPLAIN'

76% of the companies surveyed, agreed that corporate governance is an area of interest to their investors.

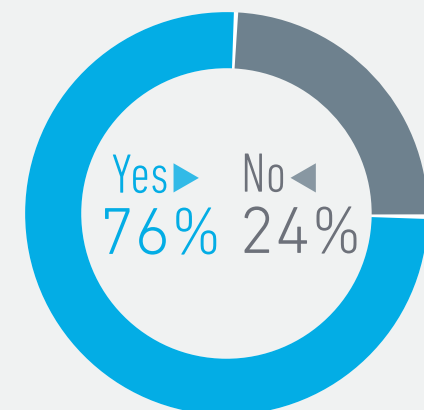
66% of the companies agree that their investors value the use of the 'comply or explain' principle.

- The main topics discussed with investors are **executive remuneration and nomination of board members**. Most issues are not only raised prior to or during the General Assembly but additionally discussed during investor meetings or at road shows.

## IS THE 'COMPLY OR EXPLAIN' PRINCIPLE VALUED BY INVESTORS?



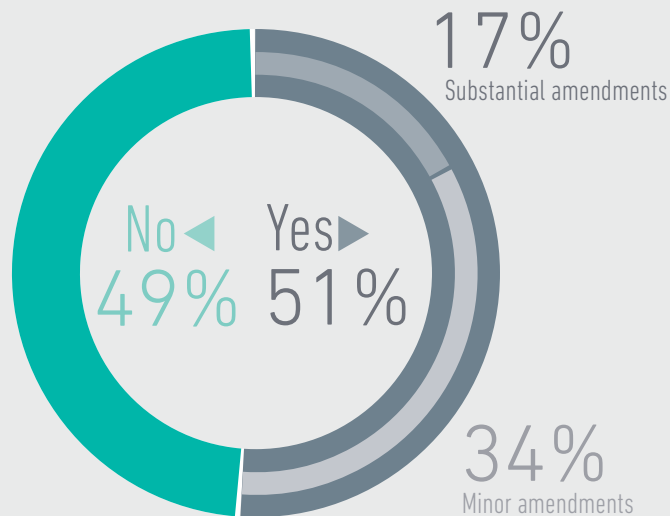
## IS CORPORATE GOVERNANCE AN AREA OF ATTENTION FOR INVESTORS?



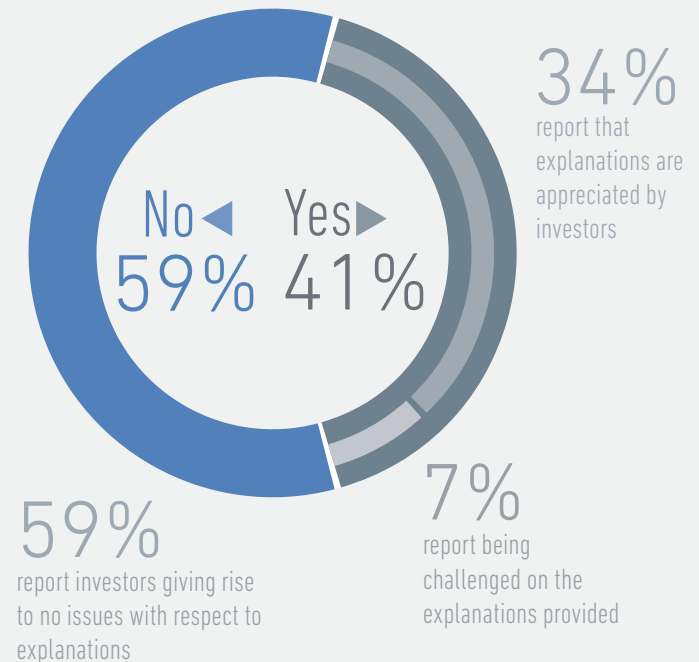
# WHAT COMPANIES THINK OF INVESTORS' APPROACH TO 'COMPLY OR EXPLAIN'

The majority of discussions with investors do not give rise to major issues and many go on to suggest that investors appreciate the explanations given where the flexibility of 'Comply or Explain' is made use of, challenging the companies on this in very few cases.

## DO DISCUSSIONS WITH INVESTORS LEAD TO AMENDMENTS IN THE COMPANY'S CORPORATE GOVERNANCE FRAMEWORK?



## IS NON-COMPLIANCE AND THE PROVISION OF EXPLANATIONS CHALLENGED BY INVESTORS?







## **‘Comply or Explain’ can contribute to sustainable success if three conditions are fulfilled**

- boards should be willing to depart from a particular part of their code, when necessary;
- national codes must be focused on encouraging businesses to achieve long-term sustainable success; and
- boards and the investors in their business must be committed to the benefits of striving for sustainable success.



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