

# The road to good governance: Competence over compliance

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## **A new study maps out how the 10 largest Spanish banks comply with ownership and governance recommendations.**

The financial industry in the West is facing a period of radical change. Nowhere is this truer than in Spain, where the massive consolidation of the country's savings and retail banks, coupled with the recent failure of five of the country's 26 banking institutions to pass euro zone stress tests, has cast a spotlight on corporate governance in the country's financial sector.

In this sense, this [report](#) by IESE's [Guido Stein](#) and Manuel Gallego, together with Javier Capapé of Esade, could not be timelier.

The report focuses on the 10 largest banks in Spain in terms of market capitalization: Banco Santander, BBVA, CaixaBank, Bankia, Banco Popular Español, Banco Sabadell, Banesto, Bankinter, Banca Cívica and Banco Pastor.

How do these institutions apply good governance? In other words, what mechanisms do they implement to ensure efficient utilization of assets?

The authors' findings reveal that when it comes to compliance, a broad variety of possibilities exists.

## **Board size and composition**

Acting within the Spanish Unified Code of 2006 and E.U. recommendations, each bank's

bylaws define how it will carry out corporate governance requirements. As such, the boards studied by the authors demonstrate variety in terms of both composition and size.

For example, Santander requires the board to have between 14 and 22 members, CaixaBank 12 and 20, and BBVA anywhere between five and 15.

Of these, the proportion of executive directors to independent non-executive and proprietary directors (representing a significant shareholder) also varies. Independent directors are most common, averaging 44 percent of the total.

However, the proportion of independents varies greatly from company to company — as high as 75 percent at BBVA and as low as 29 percent at CaixaBank and Banca Cívica.

On average, proprietary directors account for 26 percent of directors within the banks. The proportion is particularly high in the banks that emerged from the recent mergers between the country's savings banks, commonly referred to as "cajas." These include CaixaBank, Bankia and Banca Cívica.

Executive directors account for 20 percent of the boards in the authors' sample, with Santander and Bankinter having the highest proportion of executive directors, at 30 percent.

Moreover, the proportion of shares owned by the chairs of Banco Santander, BBVA and Banco Pastor suggests closer executive control of those boards. Santander's Emilio Botín and BBVA's Francisco González hold 66 percent and 74 percent, respectively, while Banco Pastor's José María Arias owns more than 60 percent of total board shares.

## **Shareholder pay and CEO duality**

Banco Santander boasts the largest board of directors, with a total of 20 members. Santander also comes in with the highest total directors' remuneration, at 34 million euros, 400 percent more than the average total directors' remuneration for the Ibex 35, Spain's main stock index.

When it comes to the role of the CEO, Spanish banks tend to favor a duality system, which is when the chief executive simultaneously holds the position of chair of the board and CEO. This is certainly the case at two of the country's leading banks, Banco Santander and BBVA.

By contrast, the board of CaixaBank, the country's third largest financial institution, dictates the separation of the positions of chair of the board and company CEO.

## **Both Anglo-American and European tendencies**

The authors describe ownership structure using two variables: type of company control depending on shareholder ownership (absolute, majority, minority or internal control) and the degree of concentration of ownership (high, medium or low).

At one end of the spectrum are CaixaBank and Banesto, which are under the absolute control (over 80 percent) of just one shareholder (Caja de Ahorros y Pensiones de Barcelona in the case of CaixaBank, and Banco Santander in the case of Banesto).

At the other end of the spectrum, Santander and BBVA have internal control, with no majority shareholders. As such, in terms of degree of concentration, Santander and BBVA reflect a dispersion of ownership more typical of the U.S. and British models of corporate governance.

In contrast, most banks in the study have a high shareholder concentration. In keeping with the Spanish and dominant European model of corporate governance, 37.5 percent of the voting rights of the average Spanish bank are held by a single shareholder.

A cluster analysis of ownership structures shows Santander and BBVA in one group, and the rest of the banks in another, with the exception of CaixaBank, which is in its own category but sharing similarities with the two big banks.

A factor analysis finds that nearly 90 percent of the variability between banks can be explained by: a high free float rate, the marked presence of institutional investors and high capitalization; board size; and executive nature of the board.

## **Finding the road to good governance**

According to the authors, when it comes to achieving good governance, managerial competence is more crucial than mere compliance with the established codes of corporate governance.

They cite the case of CaixaBank, which has been led by the same management team for more than 30 years, as a model of solid professional management supported by structured corporate governance.

Clearly, since governance in banks is crucial to maintaining confidence in the financial markets and thereby creating sustainable value, it is in the interest of society at large to have stable, properly functioning banking institutions.

As this research has shown, banking institutions may achieve solid results with markedly varying business strategies and governance styles.

Nevertheless, the authors assert that the key to successful governance is appointing competent managers who really take the principles of good governance to heart.

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