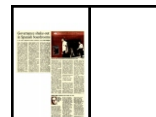

Governance shake-out in Spanish boardrooms

A new code is expected to redress imbalances, writes **Mark Mulligan**

Spain's clubby boardrooms are set for a shake-out this year as listed companies move to adopt an updated set of corporate governance guidelines, drafted by a special working group and published recently by the country's stock market watchdog.

Although presented as a voluntary code, the document will add to pressure on Spanish companies to modernise their boards, pay more attention to minority shareholders and eliminate anti-takeover mechanisms such as voting limits. From next year, listed companies will be obliged to comply or explain why they don't.

By combining and clarifying two previous sets of guidelines, and incorporating subsequent recommendations from the European Union, the so-called "Unified Code" is aimed at completing a 10-year reform of corporate practices in Spain, once renowned for cronyism in its boardrooms.

Most observers have identified a strict new definition of what constitutes an "independent director" as the most important feature of the updated governance code. Traditionally, these tended to be executives' friends who happened to be non-affiliated at the time of their nomination, rather than individuals looking out for minority interests.

"Under the new definition, 90 per cent of the so-called independents in Spanish boardrooms would not qualify," says José María Garrido, a lawyer at Cuatrecasas in Madrid and an adviser to the working group.

The code says of the maximum recommended 15 board-members, "at least one-third" should be truly independent. It also urges the inclusion of more women in Spanish boardrooms.

The tough approach to boardroom independence, coupled with strict guidelines on related party transactions and measures to encourage investor activism, are designed to redress historical imbalances in Spain's corporate sector. Open market capitalism is still immature in the country, where complex cross-shareholdings between banks and large industrial groupings often result in collegiate boardrooms dominated by political appointees, proprietary shareholders and their friends.

Manuel Conthe, chairman of Spain's stock market regulator, says compliance with the new code should result in the emergence of a new class of "professional director" and generate extra work for executive head-hunters.

However, some of the bigger companies will not need to change much to comply, he adds. "For those in the vanguard of international corporate governance standards, this code is easily attainable," he told FTfm in an interview last week.

When it comes to transparency, voting limits and information flow, some Spanish companies are already ahead of the curve. Pressure from foreign investors and regulators forced them into line well before the latest round of reforms in Spain.

Step ahead: Santander, the banking group, has already introduced governance changes — Reuters

Santander, the country's largest financial services group, eliminated voting limits and began publishing executive and board remuneration before the second round of recommendations, published in 2003.

"The Santander example was important," says Mr Garrido. "The bank decided voting limits were affecting the share price, so it got rid of them. Other big companies sat up and took notice."

According to some observers, external pressures and global shareholder activism have been just as important catalysts for change.

Market operations have also played a role; Gas Natural's hostile €22.5bn bid for Endesa has stirred Spain's largest electricity group into action. Information flow to the Spanish and US stock markets has been stepped up, and the company has promised to eliminate a 10 per cent cap on shareholder voting rights.

Spanish fund managers have also begun to force change. Gaesco, a Barcelona-based asset manager, became the first institution in the country to launch an index equity fund whose portfolio weightings are calculated according to its own corporate governance criteria, focused on ownership structure and shareholder relations, board competence and independence, remuneration and control mechanisms. Called the Corporate Governance Spain Fund, it is sponsored by Soler-Padró, a law firm with credentials in the defence of minority shareholders. Its own league table of good governance among the stock market's main Ibex-35 index puts Telecinco, the media group, at the top and Arcelor, the steel group, at the bottom.

> 'For those in the vanguard, this code is easily attainable'

"There is a compelling need for investors to avoid corporate failures such as Enron and Worldcom in the US and Adecco and Parmalat in Europe," says Jacinto Soler-Padró, founding partner of the law firm. "We believe governance is an essential tool of equity analysis and portfolio building."

José Luis Alvarez, professor at the Instituto de Empresa business school in Madrid, says the emergence of other good governance funds will provide much-needed bottom-up pressure on companies. "These will do as much – if not more – good than any guidelines handed down by a regulator," he says.

Private sector reaction to the code, which is open to submissions until the end of this month, has been mixed. There is broad opposition, for example, to the criteria on independent directors and rumblings of discontent about positive discrimination in favour of women.

Despite the grumbling, however, most of the country's top listed companies are expected to conform. "In Spain, the concept of comply or explain is replaced with comply and complain," says Mr Garrido. "But at the end of the day, we will see some important changes."

MARKET VIEW: EUROPEAN YIELD CURVE TOO FLAT

Emanuele Ravano, head of Portfolio Management, Pimco Europe

At this moment, we think the European yield curve looks too flat. It's a crucial issue because 18 months ago, a European investor could have gone from 2-year German government bonds into 10-year government bonds for 1.9 per cent more yield. At the end of last year you could only pick up 0.4 per cent.

In a normal cycle, you would expect the curve to be steep when the Central Bank starts hiking rates. Towards the end of the cycle you would expect a flat curve as the market prices are in the end of the hiking cycle and there's less of a need for the Central Bank to move.

The European yield curve has become flat quickly. If you look at the differential between Euribor [Euro Interbank Offered Rate] contracts for the first two years of expectations, or the differential between the 2 and 5-year yields, or 2 and 10-year yields, they're all flat.

For us, it provides an opportunity because it means the market has fast-forwarded this whole move. If there are surprises to the negative, it creates an opportunity.

If US growth is less than expected, if the euro appreciates more than is currently priced in, if Avian flu has more of an impact on growth, if the oil increase has an impact on growth in Europe, all those factors could result in the Central Bank doing a little bit less than expected and therefore making the curve steeper.

The first implication is that the curve is too flat and therefore there is only limited advantage to going longer to pick up that extra yield. We recommend investors focus more on the shorter maturities. The other is that European yields are on the lower end of the range for this point in the cycle. We would favour US and UK bonds.

Paradoxically, 50-year dated bonds will continue to find a lot of interest from pension funds.

To see more of this interview visit www.cantos.com