DISCLOSURE OF BOARD REMUNERATION IN LARGE EUROPEAN BANKS

Hans-Peter Burghof[*] and Christian Hofmann[†‡*]

Abstract

In our paper, we analyze the remuneration of board members of large European banks as presented in the annual reports. We find that remuneration differs greatly between European countries both with respect to its total amount and components. Furthermore, the degree of disclosure about remuneration ranges from very detailed reports in some countries to perfect obscurity in others. We construct a disclosure index to characterize the transparency of board remuneration in the different countries. Under agency perspectives, our results encourage the introduction of stricter disclosure rules for executive compensation on a European level.

Keywords: remuneration, banks, transparency, executives

1. Introduction

In the common European market, banks will compete with other banks from different countries both for customers and for equity capital. Thereby, equity is of crucial importance not only as major element of a sensible finance mix to optimize capital structure, but also to adhere to the regulatory rules of capital adequacy as prescribed by the Basle Committee on Banking Regulation. Thus, in the evolving competition of European banks, the ability to attract equity capital on capital markets might be decisive.[1] One factor of significant influence on the willingness of potential investors to supply banks with the needed capital is the compensation for bank top executives. Obviously, excessive compensation reduces shareholder value. Furthermore, the compensation scheme should align managers' interests with the interests of the shareholders and thereby increase shareholder value.[2] Instruments to implement such compensation schemes are performance-related payments and employee stock options (ESO). Their general characteristic is that they lead to an increase in the proportion of performance related wealth transfer to the manager.

However, the investor's knowledge regarding the compensation schemes influences the value of performance related compensation. If the compensation's details are not disclosed, investors can only make mere estimates about the resulting degree of coherence of interest. The estimation risk is

[*] Chair of Banking and Finance, University of Hohenheim, Schloß Hohenheim, 70577 Stuttgart, Germany, Tel.: +49/711/459-2900, Fax +49/711/459-3448, burghof@uni-hohenheim.de.
[†] Chair of Managerial Accounting, University of Hannover, Königsworther Platz 1, 30167 Hannover, Germany Tel.: +49/511/762-8112, Fax: +049/511/762-8153, hofmann@controlling.uni-hannover.de.
[‡] corresponding author

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[1] Note that the definition of regulatory capital according to the Basle Committee comprises categories of capital issued on capital markets that are available to all banks irrespective of their legal status. Thus, at least on the margin, even state owned banks rely on external investors.

[2] See DeFusco/Johnson/Zorn 1990.

expected to increase the cost of equity capital.[3] Furthermore, managers in conjunction with members of the compensation committee might use the shelter of nondisclosure to implement excessive remuneration. And, in the context of the actual debate on corporate governance, they might even be tempted to abuse seemingly performance related instruments for a simple pay rise. Thus, the degree of disclosure on compensation schemes should influence strongly the willingness of external investors to supply banks with the needed equity.

The purpose of this paper is to describe what is published about the composition and amount of board remuneration in the annual reports of large European banks and to evaluate the degree of disclosure achieved thereby. Note that the latter is constrained through a minimum level defined by the different legal disclosure regimes in the European countries. Therefore, we will also compare the degree of homogeneity of disclosure on a country level to answer the question if market forces might compel some banks in a country to voluntarily disclose more information than others.

One major problem of our study is the limited data available for European firms. Unlike Compustat and Forbes for US firms, there is no comparable institution that collects and distributes disclosed data on executive's compensation for European firms. The data provided by the European Independents Remuneration Network and used by Conyon and Schwalbach (1999) is "survey data assembled by important compensation consulting companies throughout Europe."[4] However, we prefer to restrict our analysis to disclosed data which should be available to financiers. Therefore, we analyze the annual financial reports and collect the disclosed information on executive's compensation. Considering the different languages as well as the reporting standards of 12 European countries, we limit our analysis to three consecutive years from 1995 to 1997 for 52 firms.[5]

Reported board remuneration differs greatly between the countries, with a minimum average per board member of 0.14 Mio. € in Italy and 0.73 Mio. € in Spain. Across all banks, the average per board member spans from 0.04 Million € to 1.87 Million €. One reason for these stark differences is that the reports deal with very differently designed bodies of corporate governance. Consequently, the number of "board" members covered by the reports ranges from 2 to 35, and the remuneration per board member decreases with the size of the respective group. We argue that reports on large and inhomogeneous groups of managers might weaken the control effect of disclosure if the reports contain the aggregate only and not the individual remuneration. Finally, we observe that the level of disclosure within countries is rather homogenous, supporting the notion that banks tend to just fulfill the official requirements and not to give additional information voluntarily.

In the next section we discuss some general theories about the incentive effects of board remuneration and disclosure. Section 3 contains our empirical results on remuneration and disclosure and elaborates a disclosure index to evaluate the latter results. We conclude in section 4 with a short summary and some conclusions.

2 Incentives and Disclosure in Executives' Compensation

A well-known problem in large firms is the separation of ownership and control: whereas owners provide the firm's equity, the management decides upon the firm's products, its investments, etc. Different instruments like, for example, performance related compensation schemes, monitoring by outside directors, and reports by independent auditors may mitigate agency problems; these instruments are discussed and analyzed by the agency theory.

An increasing number of empirical researches on U.S. firms deals with these instruments and finds evidence for the predictions of agency theory. The studies analyze aspects like the pay-performance sensitivity of CEO compensation,[6] the short- and long-term pay-performance sensitivity,[7] the inclusion of relative[8] and individual performance measures,[9] and the influence of the degree

[3] See Barry/Brown 1985 and Coles/Loewenstein/Suay 1995.
[4] Conyon/Schwalbach 1999, p. 19.
[5] Although most of the banks in our study provided versions of their annual reports in English language, some of these did contain less information than the original reports.
[6] Jensen/Murphy 1990a, Hall/Liebman 1998.
[7] Boschen/Smith 1995.
[8] Antle/Smith 1986, Gibbons/Murphy 1990.
[9] Bushman/Indjejkian/Smith 1996.

of risk of the firm's environment.[10] Furthermore, they analyze the influence of different financial performance measures like accounting-based (earnings per share, pre-tax profit) and market-based performance measures (total shareholder return, stock performance vs. peer group).[11] These positive studies confront the highly stylized agency models with observable facts, thereby testing the theory's predictions.[12] Often, the confrontation leads to the inclusion of additional aspects into the theory and detailed statements regarding the necessary conditions for the effective use of the instruments. One reason for the extensive study of U.S. CEOs is the detailed publicly available information from the proxy statements of the financial reports, the reports of the compensation committees, Compustat's ExecuComp, and the annual surveys provided by Forbes.[13] The results of the respective studies might also be valuable for the control of European firms and managers, e.g., when introducing ESO in a European firm. A complete application, however, seems to be questionable due to different managerial labor markets, different markets for corporate control, and, generally, different corporate governance structures.[14] For firms from various European countries, Conyon and Schwalbach (1999) find evidence for the influence of the corporate governance structure on executives' compensation. In addition, we expect that the different financial markets the banks are operating in, the different labor markets for bank executives, different disclosure regimes, and differences in the historical development of remuneration schemes influence the prevailing compensation. This provides an additional reason for analyzing the executives' compensation of European firms.

The financial reports of most European firms provide less information regarding the management's compensation, and extensive data sets are not available.[15] Therefore, there is only a small number of studies concerning the management's compensation in European firms, which are mainly based on surveyed data.[16] Due to different national disclosure rules the information disclosed varies between the European countries. Further differences follow, since some firms voluntarily disclose more information regarding the management's compensation than others.[17] As will be seen below, the combined effect leads to a wide range of different levels of disclosure.

In order to achieve the maximum shareholder value, the pay-off of managers for their activities should be aligned with the pay-off of owners.[18] Empirical studies by Brickley/Bhagat/Lease (1985) and DeFusco/Johnson/Zorn (1990) show a positive reaction of the firm's share price after the introduction of performance related long-range managerial compensation plans. In contrast with these results, the compensation of many managers tends to consist mainly of a fixed wage with no or only small additional performance related components. This might be the case because of manager's strong risk aversion, or because important dimensions of their tasks are unobservable and compensation based on observable dimensions alone would fatally distort the allocation of their effort on the different tasks.[19] Despite these arguments, the common assumption in applied corporate finance is that the sensitivity of manager compensation to firm performance is usually too low. Therefore a higher sensitivity should better align their interest with the shareholders' interest and thus increase shareholders' value.[20] However, a complex incentive scheme might be difficult to report and to understand and thus reduce transparency of remuneration.

There is evidence in the literature that the information disclosed by the firm influences the cost of equity capital, because more disclosure reduces the shareholder's non diversifiable estimation risk.[21] The negative correlation between disclosure and cost of equity capital[22] may be particularly

[10] Garen 1994. General surveys on this literature are provided by Rosen 1992 and Murphy 1999.
[11] See Antle/Smith 1986, Gibbons/Murphy 1990, Lambert/Larcker 1987, Sloan 1993.
[12] See, e.g., the study of the pay-for-performance sensitivity by Hall/Liebman 1998.
[13] Methods and Sources for estimating the compensation are described in Antle/Smith 1985.
[14] Charkham 1995.
[15] Kaplan (1999) for example analyzed international differences of the relation between executives' compensation and firm performance. He states that the necessary "data were unavailable for German executives."
[16] Abowd/Bognanno 1995, Schmid 1997, Schwalbach/Graßhoff 1997, Conyon/Schwalbach 1999.
[17] Just to name one example, the German Railway Company (Deutsche Bahn AG), e.g., announced that it uses the medium delay of its trains as a performance measure.
[18] On the implementation of such a pay-off function with respect to risk taking see Bulmash/Mehrez 1985.
[19] Holmström/Milgrom 1991.
[20] See for example Abowd 1990 for a positive relation between pay performance sensitivity (PPS) and firm performance.
[21] Barry/Brown 1995, Coles/Loewenstein/Suay 1995.

relevant for the investor's information regarding the management's compensation. An investor provided with sufficient information regarding form and magnitude of the management's compensation may be able to infer agency costs and the manager's potential to implement decisions that are goal congruent with shareholder's objectives. This provides a reason for the investor's interest in information about the management's compensation, and the performance measures used in evaluating and compensating the management, and might also motivate managers to provide shareholders with this information to ease equity financing. Furthermore, the "benefits of the public disclosure of top-management compensation are obvious since this disclosure can help provide a safeguard against `looting´ by management (in collusion with `captive´ boards of directors)."[23]

The investors may use annual financial reports as a basis for estimating the management's compensation scheme. Therefore it is of interest to which degree the financial reports support the investor's estimate. In order to compare the information disclosed in the annual reports we determine a disclosure index for each report.[24] Clearly, the level of disclosure will be highly influenced by each country's disclosure regime. Considering a change of the disclosure regimes, an expanded mandatory disclosure may have negative overall consequences on the shareholder value. This is especially true if the new rules require the disclosure of proprietary information above some endogenously determined amount of voluntary disclosure.[25] Since we do not address a change of the disclosure regimes, the disclosed information may well be optimal with respect to partial disclosure equilibrium. More precisely, the different information contents observable within one country, i.e., within one disclosure regime, may well provide evidence that different partial disclosure equilibrium exists and realized by the firms. However, the large proportion of banks just fulfilling the disclosure regimes supports our interpretation that bank managers are not allowed to choose the (apparently low) level of disclosure maximizing their personal utility. Furthermore, the optimal level of disclosure with respect to shareholder value could be above both, the level managers prefer, and above the mandatory level of disclosure.

Several factors may reduce the willingness of managers to disclose details of their compensation. First, political costs may reduce the disclosure level even for optimal compensation plans.[26] Managers might not be willing to disclose how much they really earn because they want to avoid public criticism.[27] Secondly a high number of analysts following a firm and evaluating information beyond what is disclosed in the annual reports may reduce the importance of information disclosed in the annual report.[28] And, if some information has been disclosed once voluntarily, financial analysts and other observers would expect to see the same information over and over again, and might regard it as a rather negative signal if the bank did not disclose the same level of information next year. Thus, immediate gains of voluntary disclosure might be little, whereas the opportunity costs for managers are high. According to these arguments, the relevance of information disclosed in the annual reports might be larger for smaller firms, whereas larger firms might tend to secrecy. However, because all banks in our sample are rather large, this reasoning might also explain why these banks keep close to the minimum legal requirements of disclosure about remuneration.

Incentives and disclosure level are in close interrelationship: If managers were efficiently stimulated, this might lead to better investment policies, but it would not reduce financing costs if the investors did not know about it. The manager's incentives to accept a performance-related compensation are decreased because thereby they cannot ease the fulfillment of their financial needs. Likewise, if compensation is not disclosed to shareholders, good decisions might take a long time to effect better results, whereas a disclosed compensation scheme could immediately increase the firm value through its commitment value, which is a corresponding effect to lower cost of capital. In both cases,

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[22] Botosan 1997. Alternatively, one can argue that greater disclosure enhances stock market liquidity and hence reduces the cost of equity capital. See Diamond/Verrecchia 1991.
[23] Jensen/Murphy 1990b, p. 270.
[24] Regarding alternative disclosure indices see Singhvi/Desai 1971, Buzby 1975, Chow/Wong-Boren 1987. Marston/Shrives 1991 give an overview over disclosure indices.
[25] Wagenhofer 1990.
[26] Watts/Zimmerman 1986.
[27] Our inter-country comparison does not support the notion that compensation actually decreases when managers have to disclose more information on their remuneration.
[28] Botosan 1997.

the market may react efficiently only to the disclosed information. Realizing the relationship between disclosure and efficient incentives, one major reason behind the SEC's 1992 change of compensation disclosure was to enable shareholders to better understand the linkage between pay and performance. They state that the "disclosure of the Compensation Committee's policies will enhance shareholder's ability to assess how well directors are representing their interests".[29] Thus, it is probably preferable if investors were completely informed about the relevant dimensions of board executives' compensation. In practice, they should know about the individual compensation of each board member with respect to his base salary, the short- and long-term incentive components, as well as the relevant performance measures, their weights and the structure of the incentive function. This detailed information, however, is not available even to investors in the U.S.[30] In the following, we will discuss to what degree investors receive such information about board remuneration in European banks.

3. Disclosure of executives compensation in annual reports in a cross-country comparison

3.1 Data set and data selection

We addressed the 72 European banks among the 150 largest banks from the Euro money 1996 listing of the world's top 200 banks ranked according to shareholders' equity.[31] Banks that were not able to make the annual reports accessible at acceptable expense, or which dispatched reports not suitable for scientific analysis have been excluded. Therefore the study is based on 52 large European banks from 1995 to 1997.[32] Thus, it uses data from a period before the tide of bank mergers swept over Europe and reshaped many of the national banking markets. Because our focus is on banks with relevance for the new unified European market and since most of the omitted banks had a rather regional character and/or a limited range of business and a special legal status, the loss should be not too great.[33] Usually we draw on consolidated data of the respective group.[34]

Our analysis deals with the compensation of CEOs plus top executives of European banks. These are the inside directors of a board of Anglo-Saxon style, or the members of the management board (Vorstand) of German banks. In principle, we do not deal with the compensation of persons who might only advise or control the executives, like outside directors or members of the supervisory board (Aufsichtsrat). Thus, we exclude their compensation from the analysis, whenever possible. However, in some banks, especially in France, Belgium, Sweden and Finland, remuneration is only presented in the annual reports as an aggregate number for the different institutions of corporate governance, e. g., in France for the Conseil d'Administration (supervisory board) and the general directors and directors of the group management. We had to accept these aggregated numbers, but took reporting on such big groups as less informative than reporting on the core management team. Scandinavian banks also present information on the earnings of the chief executive officer. Although this additional information contributes to transparency, we did not accept reporting on the income of a single person as a valid substitute for reporting on the remuneration of each individual board member and likewise used the aggregate numbers. To obtain the remuneration per person, we divided the total remuneration by the number of members of the respective group as given by the annual report.

Table 1 shows the number and origin of the banks contained in the data set.

[29] SEC Release 33-6962.
[30] Lo 1999 provides an overview regarding the compensation disclosure of US firms.
[31] See Euromoney, June 1997, pp. 169-173.
[32] The list of banks is in appendix 1.
[33] We thereby had to omit in our analysis, e.g., Dexia (Belgium), Group Caisse d'Espargne, Caisse des Dépots et Consignations, Group Crédit Mutual (France), Postbank (Germany), Instituto Mobiliare Italiano, Banca Monte dei Paschi di Siena (Italy), Sparbanken Sverige (Sweden) and Abbey National (United Kingdom), which would have been among their countries' representatives according to the shareholders' equity criteria. Note that most of these banks enjoy a special legal status.
[34] However, we took Kredietbank as representative for the insurance and banking conglomerate Almanji, and included both HSBC and its very significant European representative Midland Bank.

Table 1. Composition of European banks used in the analysis

	Number of banks	Percent
Austria (A)	2	3.85%
Belgium (B)	3	5.77%
Denmark (DK)	1	1.92%
Finland (FL)	1	1.92%
France (F)	7	13.46%
Germany (D)	11	21.15%
Great Britain (GB)	9	17.31%
Italy (I)	6	11.54%
The Netherlands (NL)	3	5.77%
Portugal (PT)	1	1.92%
Spain (E)	2	3.85%
Sweden (SWE)	3	5.77%
Switzerland (CH)	3	5.77%
Total:	52	100.00%

Some comments regarding omitted data: **Belgium**: compensation related data for *Generale Bank Group* was only available for 1997; it is also missing for *Kredietbank* in 1995. **France**: compensation related data for *Credit Commercial* in 1995 is missing. **Great Britain**: compensation related data for the *Bank of Scotland* was only available for 1997.

Table 2 gives an overview over the board remuneration and some additional information to characterize size and profitability of the respective banks.[35] To achieve comparable data, all amounts are in million €,[36] and we include only cash compensation as defined below.

Table 2. Total assets, shareholders' equity, net income and remuneration per executive

		Mean	Minimum	Median	Maximum	Std. Dev.
Austria	Total assets	62,954.30	48,930.86	53,854.62	113,459.92	24,898.85
	Shareholders' equity	2,436.35	1,864.43	2,182.15	3,708.14	671.76
	Net income	239.16	104.78	199.18	402.63	120.21
	Remuneration p.p.	0.49	0.39	0.45	0.70	0.12
Belgium	Total assets	103,042.52	83,653.48	97,096.54	145,862.30	22,165.22
	Shareholders' equity	2,542.64	2,066.96	2,451.50	3,381.92	463.67
	Net income	317.00	231.92	312.11	420.90	69.53
	Remuneration p.p.	0.15	0.13	0.15	0.17	0.02
Denmark	Total assets	62,910.90	53,218.97	61,388.00	74,125.73	10,536.25
	Shareholders' equity	3,448.13	3,151.18	3,515.36	3,677.85	269.69
	Net income	517.49	495.20	495.93	561.33	37.97
	Remuneration p.p.	0.27	0.19	0.27	0.35	0.08
Finland	Total assets	48,757.88	46,662.66	48,814.68	50,796.29	2,067.40
	Shareholders' equity	2,585.73	2,264.49	2,537.41	2,955.28	347.92
	Net income	289.03	10.33	295.13	561.64	275.70
	Remuneration p.p.	0.15	0.14	0.15	0.16	0.01

[35] Numbers for profit and shareholders' equity are calculated ex minority interests.
[36] For the reader's convenience, all amounts are said to be in Euro although until 1998 the common European currency was its predecessor, the Ecu. The exchange rates between the national currencies and the Ecu are taken from: Statistisches Jahrbuch 1998 für das Ausland, edited by the Statistisches Bundesamt (Federal Statistical Office), Wiesbaden 1998, pp. 336 f.

Table 2 continued

France	Total assets	206,295.14	60,334.45	234,483.29	372,212.01	94,999.56
	Shareholders' equity	5,150.25	1,649.54	3,943.17	9,583.40	2,949.41
	Net Income	312.58	-440.15	242.41	924.09	377.30
	Remuneration p.p.	0.33	0.08	0.28	1.07	0.26
Germany	Total assets	212,383.21	34,644.40	190,207.74	531,040.73	107,529.07
	Shareholders' equity	5,798.11	1,610.67	4,800.32	16,337.07	3,752.85
	Net income	368.43	13.06	320.55	1,117.28	286.89
	Remuneration p.p.	0.66	0.41	0.57	1.36	0.25
Great Britain	Total assets	152,939.72	46,965.02	145,053.66	339,099.71	78,473.08
	Shareholders' equity	6,426.27	2,376.36	6,321.19	11,411.85	2,972.90
	Net Income	1,168.49	480.10	921.38	3,374.28	688.13
	Remuneration p.p.	0.71	0.29	0.63	1.43	0.28
Italy	Total assets	92,903.39	59,666.20	90,546.62	133,062.66	18,556.16
	Shareholders' equity	4,393.71	2,413.38	4,602.36	5,441.87	986.39
	Net Income	-101.79	-1,635.60	89.58	279.48	616.72
	Remuneration p.p.	0.14	0.04	0.11	0.34	0.10
The Netherlands	Total assets	233,487.19	139,836.11	227,312.15	378,308.91	74,880.18
	Shareholders' equity	11,925.16	8,408.77	10,729.44	20,858.44	4,011.16
	Net Income	1,278.66	679.85	1,262.03	1,856.630	432.07
	Remuneration p.p.	0.65	0.22	0.68	1.07	0.33
Portugal	Total assets	38,071.31	35,174.83	37,429.15	41,609.95	3,265.27
	Shareholders' equity	2,224.49	2,016.46	2,154.89	2,502.11	250.19
	Net income	361.74	254.45	297.66	533.12	149.98
	Remuneration p.p.	0.25	0.23	0.24	0.28	0.03
Spain	Total assets	116,802.99	86,719.77	114,598.96	156,459.86	24,378.30
	Shareholders' equity	4,097.27	3,495.71	4,015.24	4,678.03	426.64
	Net Income	602.45	462.54	590.55	788.78	120.86
	Remuneration p.p.	0.73	0.31	0.55	1.87	0.59
Sweden	Total assets	58,126.17	37,150.99	53,307.97	99,348.75	19,545.90
	Shareholders' equity	2,678.20	1,998.50	2,567.12	3,740.84	583.62
	Net income	535.42	271.22	556.76	694.37	128.73
	Remuneration p.p.	0.21	0.15	0.21	0.28	0.05
Total	Total assets	153,026.14	34,644.40	126,618.10	531,040.73	97,172.95
	Shareholders' equity	5,306	1,611	4,290.49	20,858	3,506.62
	Net Income	523.09	-1,635.60	427.67	3,374.28	584.75
	Remuneration p.p.	0.48	0.04	0.42	1.87	0.33

Variable descriptions: *Total assets* - the disclosed book value of total assets, whereas *shareholders' equity* is the disclosed book value of equity. *Net income* shows the bank's annual profit. Both, *shareholders' equity* and *net income* are calculated ex minority interests. *Remuneration p.p.* (per person) shows the disclosed compensation of the management board, divided by the number of its members. All values are in million €.

The Swiss banks included in the data set do not appear in this table because the respective annual reports contain no information about executive remuneration. Both the largest and smallest banks in the sample (with respect to total assets) are from Germany, i.e., Deutsche Bank, which is about fifteen times bigger than BHF Bank. Average remuneration is still more diverse, ranging from a minuscule 0.04 for an Italian bank to a solid 1.87 million €. However, we will have to discuss how to understand the low Italian figures. On the other hand, the already very substantial salaries earned in Great Britain are calculated without gains from stock options and would exceed by far the top earnings of their European counterparties when taken together with gains from the execution of options which were given as part of the salary.[37] Thus, even if the income of Italian top executives is in reality far greater than presented in the annual reports, remuneration seems to differ very much in European banking.

[37] To name the most striking example, Sir Nicholas Goodison of Lloyds TSB received a total of 5.556 million pounds or about 8 million € in 1997 due to the execution of stock options, gaining 5.196 million pounds thereby.

Generally, the European countries differ with respect to the information disclosed in the annual reports about the executives' compensation, and so do quite a number of banks in the different countries. Nonetheless, certain common features exist for certain groups of countries. Therefore, we present an overview over the characteristics of reporting in the different groups. In a second step, we will develop a ranking for the disclosure based on the individual annual reports of the 52 European banks. However, before going into details it is necessary to point out the different components of executive compensation annual reports might disclose and the different dimensions of reporting on these components.[38]

3.2 Disclosed Components of executive compensation

In the annual reports we can identify three basic components of board compensation: Cash compensation, stock options, and some forms of credit to board members. On each of these three components some additional remarks with respect to their information content seem to be necessary.

Cash Compensation. Cash compensation, defined in a rather broad sense, consists of a base salary, performance related annual and long-term bonuses and share saving programs, as well as non-monetary benefits. Pension commitments can also be understood as a component of the salary. External observers are expected to prefer information about the monetary equivalent of all these elements, i.e., the annual report have to fulfill its stewardship task. To get a better insight into incentives, investors might be interested in what portion is fixed and what depends on performance, what is actually paid and what the executive received as a pension commitment. Because the borderline is not clear cut between bonus plans, performance related payments, share saving plans etc., outside observers are expected to prefer a distinct disclosure of fixed payments and performance related gains.

Stock Options. Employee stock options (ESO) are the trendiest instrument to provide incentives for managers. With respect to the level of disclosure they cannot be seen in such a favorable light, because they generate a number of new problems. The first one refers to the value of the options at the date they are granted. Often it might not be intended to inform shareholders about this crucial aspect, neither through naming an explicit number nor through detailed information which might allow sophisticated outsiders to undertake the valuation task on their own. However, even if the bank had the intention to do so, the conditions of these options are usually rather complex, thereby posing severe obstacles to valuation. Thus, firms grant stock options to their employees seemingly without being able to evaluate the transfer of wealth. Furthermore, the option's vesting conditions influence their value. Therefore, we expect an investor to be interested to learn which of the options the board members are obliged to keep and which one they keep at free will.

Credit. Usually bank executives receive some kind of credit from their bank. The gains from such a credit arrangement depend on the managers' outside options, i.e. under which conditions they could borrow the same amount on the market. However, most annual reports don't specify the conditions of bank lending to related parties, and it is not possible to calculate the opportunity costs without knowing the creditworthiness of the individual executive or the entity related to him which receives the credit. Thus, bank lending to managers usually distorts any calculation of the executive's compensation. The distortion might be reduced if credit were only given at market conditions, as is stated in (only) one of the annual reports. Nonetheless, even in this case, outsiders cannot prove the creditworthiness of the manager, who might even get no credit at all on the lending market. However, the quantitative importance of lending to executives is usually not too significant, with some remarkable exceptions, especially in Italy.

3.3 Characteristics of the disclosure of executives compensation in different European countries

Two different ways to say no: Italy and Switzerland. Reporting on remuneration of Swiss and Italian executives is very similar: both lack substantial information. However, this denial is presented in a different way: The annual reports of the three Swiss international banks do not even mention that executives are compensated. This is a rather unique feature in European banking which, among the surveyed banks, can otherwise only be found in the report of the French Banque Populaire, which

[38] See also Murphy 1999, pp. 9-24.

might exculpate itself for being just a network of small co-operative banks. The Italian reports present some numbers, but these are obviously too low, seemingly representing only compensation for the activities as board members and not as managers of the bank. The Italian reports also name the amount of credit to board members and parties related to them. This number is surprisingly volatile and sometimes very high both relative to the salary and in absolute terms, with a maximum of 580 Mio. € per board, or 41.5 Mio. € per board member. The reader can only guess what kind of transactions might be hidden behind these numbers.

Collectivism and limited disclosure: the (mainly) French speaking Europe. With the exception of Banque Paribas, reporting in Belgium and France is usually concerned with a rather large group of bank managers, i.e., from 17 up to 31, and the compensation per executive is respectively low. In the case of Banque Paribas, where remuneration is reported for a rather small group of 4 to 6 top managers, compensation reaches numbers which are (per manager) about three times higher (0.916 Mio. € compared to a maximum of 0.336 Mio. € for the other banks), showing the loss of information by averaging over a large group of executives. Information content for all banks in this group is likewise limited because only absolute numbers of compensation are presented with very limited additional information. Four of the French banks used ESO in 1997. Information on these plans in the annual reports is very limited and thus further reduces the degree of transparency. French banks don’t report on transactions with related parties. Thus, annual reports in Belgium and France don’t give very much insight into executive compensation.

Collectivism and disclosure: The Nordic countries. At first sight, the contents of annual reports with respect to board compensation in the Nordic countries seem to be quite similar to Belgium and France. With the exception of Den Danske Bank, remuneration is presented for a rather large group of top executives (12 to 35), and the average salaries are therefore relatively low. However, most annual reports present some extra information, in particular about the compensation of the CEO, about the proportions of fixed and variable payments, pension commitments or non-monetary benefits. The general impression is that of a very serious determination to explain structure and amount of executive’s compensation, which makes the Nordic reports second to Great Britain with respect to its disclosure level.

Germany: Legal form and disclosure. Reporting on board remuneration is rather homogenous in the annual reports of German banks, hinting that particularly German banks do not disclose very much beyond what is needed to comply with the law. Reports contain a total number for the salary of the management board, some information on pensions and the amount of credit to the board members and related parties. Less information is given by banks with a special legal or institutional status, i.e., by the Landesbanken, who are members of the public savings banks organization, and by the DG-Bank, which is member of the group of co-operative banks. Some of these banks don’t provide any information on pensions. The only bank not announcing the amount of credit to related parties is the Bankgesellschaft Berlin, at that time an unpromising hybrid between the private and the public sector. Out of the eleven German banks in the study, only Deutsche Bank intended to use ESO to provide incentives for managers, and the general meeting agreed to the necessary contingent capital increase in 1996. However, Deutsche Bank was engaged in an extended lawsuit, which did not let the program come into force during the observation period.[39]

Great Britain – what you see is what they get. Information on executives’ compensation in Great Britain is outstanding in Europe. It is the only country where numbers are presented for each individual executive, divided into salaries and fees, other benefits, performance-related payments and profit sharing. Since 1997 reporting on pension commitments, which had been somewhat dispersed in the years before, is generally presented with the increase of transfer value, i.e., the capital value for each individual board member. Only the amount of the transactions with related parties is given as an aggregate number and not for every individual director. However, the amount is generally low, except for the two Scottish banks in the data set. With respect to all these components of board remuneration, it is hard to imagine what else might be of interest to external observers.

Thus, only the stock option programs pose problems to the disclosed information, at least relative to the high level of disclosure with respect to the other components of board remuneration. The infor-

[39] Note that in 2001 the Deutsche Bank extended its reporting on board remuneration substantially. Other banks are expected to follow in the subsequent years after a respective initiative of the federal government.

mation about option programs is very detailed, stating for each executive the amount of options at the beginning of the year, the options exercised and the gains accrued thereby (or at least sufficient information to calculate this figure). However, maybe due to the valuation problem, there are no figures on wealth effects due to not executed options or the value of options granted during the year. And there is likewise no information on sensitivity of the executive's wealth to changes in share prices or any aggregated number that could inform shareholders about the incentive effect of the options.

Strategy and disclosure: The remaining small countries. In the remaining four countries, a generalization seems to be rather difficult. Two of the three Dutch banks (ABN and ING) have implemented stock option programs, but present rather different information about them. In addition, ING reports in more detail on pensions. Of the two Spanish banks included in the data, Grupo Santander reports on about 8 persons, whereas Banco Bilbao Vizcaya reports on the salary of 26 to 28 top executives. It might be interesting to know the reason why these banks decide to report so differently in the same institutional setting. But the annual reports are tacit about this and the actual figures do not confirm simple intuitive hypotheses (e.g., more of business in the Anglo-Saxon countries requiring a higher disclosure level). In contrast to this observation, the two Austrian banks are absolutely homogenous with respect to reporting on executive compensation.

3.4 Evaluation of disclosure level in annual reports

The usefulness of different kinds of information regarding executive compensation for shareholders or potential investors is hard to judge. Nonetheless, in the following we try to provide some insights by evaluating the disclosure level on an interval from 0 to 1. In the evaluation of the different elements of reporting we follow the structure above, i.e., we look at the cash compensation, credit and stock option programs.

Cash Compensation. The information on cash compensation may refer to the base salary, annual and long-term bonuses, and on pension commitments. If this information is available in a comprehensive way, the value of this component in the ranking is 1. If not, the value is reduced. E.g., we value the base salary of Italian banks R_B with 0.2, because the numbers seemingly do not represent the full compensation of the board and are therefore highly questionable. To aggregate these numbers, we follow two different approaches. In the first one, each component gets an individual weight representing roughly the assumed importance for the overall executive compensation. These weights are 0.4 for the base salary itself, 0.3 for the pension (R_P), 0.1 for non-monetary benefits (R_N) and 0.2 for information on performance related payments (R_V). To get the overall valuation for the cash compensation, the weighted sum R_S of the values for the four components of reporting on the salary is itself weighted with a number representing the size of the group (group-factor) for which information is available. If numbers are available for each member of the board, this factor is 1. Otherwise, it is $G = 1-(n-1)/g$, with n being the number of persons in the group. This function captures the idea that the information content is reduced if the reported group is too large, with $1/g$ as the importance granted to this concept. We choose $g = 100$. However, except for countries with quite similar results, the overall ranking is robust with respect to different values for g on a sensible range, e.g. from 50 to 320. The alternative approach is to give equal weights to every category, thus pretending not to evaluate the relative importance of the categories. In this approach we also omit the group-factor. However, the qualitative results of our analysis do not differ at all, so in the following we present the results of the first approach.[40]

Credit. Most of the banks publish only the total amount of credit to the whole group of executives, which leads to a ranking of $R_C = 0.4$ weighted with a group factor G as described above. Higher values are attained if some information about the interest rates is given. The weight for this dimension of executive compensation is much harder to determine. On the one hand, it is not sensible to give the same weight to very different amounts of credit. On the other hand, an exact weight cannot be deducted because the lending condition and the monetary advantage for the executives are unknown. As a compromise, we assume that the advantage is usually 5% of the amount, or 1% if it is explicitly stated that the credit is given only at market conditions. Under these assumptions we calculate the monetary advantage from the amount of credit stated in the annual report and compare it with

[40] Results of the second approach can be found in appendix 2.

the amount of cash compensation as described above. We use the relative amount of each to weight the transparency of both components with weights w_C for credit and $w_S = (1 - w_C)$, which thereby add up to a number representing transparency of both salary and credit.[41] This number also represents the disclosure level for banks that did not compensate their executives with stock options.

Stock Option programs. As mentioned above, stock option programs are generally not helpful for the report's disclosure level. Likewise, the disclosure on ESO differs greatly, and the respective rankings R_O consequently ranges from 0 to 0.7. The highest value for R_O is attributed if the disclosure contains the number of options at the beginning of the period, the number of options granted and executed during the period and the gains accrued due to execution. Without explicit numbers for the gains, the ranking is 0.5. Other reports present only the number of shares the executives could buy, which receives a ranking of 0.2. Again, the valuation is weighted with the group factor if the report is on a group and not on each single member of the board. For firms with ESOs, these are weighted with $o = 0.3$, whereas the combined value for salary and credit receives the weight $(1 - o) = 0.7$. However, testing for the sensitivity shows that the final ranking of the countries is robust to different and even extreme values of o.

Overall Valuation. For each bank i, we value the disclosure level of reporting according to the described method. Thereby we usually rely on the 1997 annual reports. Earlier reports would in some cases reduce the disclosure level, e.g. in the case of reporting on pension commitments in the United Kingdom. In order to estimate the relative importance of credit and cash compensation through w_C and w_S and to determine the number of board members n we used the average from data from 1995, 1996 and 1997, as far as available. The overall disclosure level for the individual bank R_i can be described as follows:

$$R_i = DG_O R_O + (1 - D)\left(w_S G_S R_S + w_C G_C R_C\right), \text{ with}$$

$$D = \begin{cases} o \text{ if remuneration contains a stock option program (with } o = 0.3), \\ 0 \text{ if not,} \end{cases}$$

$$G = 1 - \frac{(n-1)}{g}, \text{ with } g = 100,$$

$$R_S = 0.4R_B + 0.3R_P + 0.1R_N + 0.2R_V,$$

and all other variables as defined above and all $R \in [0, 1]$.[42] The evaluations of disclosure for each bank can be found in appendix 1.

Whereas in some countries the results for the individual banks show a low variance, we observe a wide spread in other countries, which leads to overlapping ranges of rating between the different countries. Figure 1 visualizes this result; especially, we observe that the worst UK disclosure is better than the disclosure of (almost) all other non-UK banks.

Taken the qualitative method of evaluation into account, one should not overemphasize the importance of the actual amounts or differences between these figures. However, the ranking of the countries, i.e., Great Britain first, some of the small countries second, Germany third, France and Belgium following and Italy and Switzerland closing the line, proved to be robust with respect to the attribution of different evaluations and weightings to the compensation components disclosed in the reports, in particular different values of o and g. The robustness is due to the fact that a bank presenting less information with respect to one dimension also tends to be less precise with respect to others.

[41] Note that the salary does not include pension commitments because in most annual reports information is not sufficient to attach a certain value to pension commitments. Because the weights described above are only very rough proxies, this additional source of incorrectness should not disturb too much.

[42] Note that n and consequently G is 1 if the annual report states the numbers for the individual member of the board. For a single bank, different values for G are possible (i.e., e.g., $G_S \neq G_C$) if in one of the categories the figures refer to the whole group of board members and in another figures are specified for each member of the board.

Thus, French banks do not only present information on rather large groups of executives, but do also conceal the amount of credit to related parties and are not informative on stock option programs. Some shifting might be possible, but only if extreme values are attributed to credit, stock option programs or the group factor.

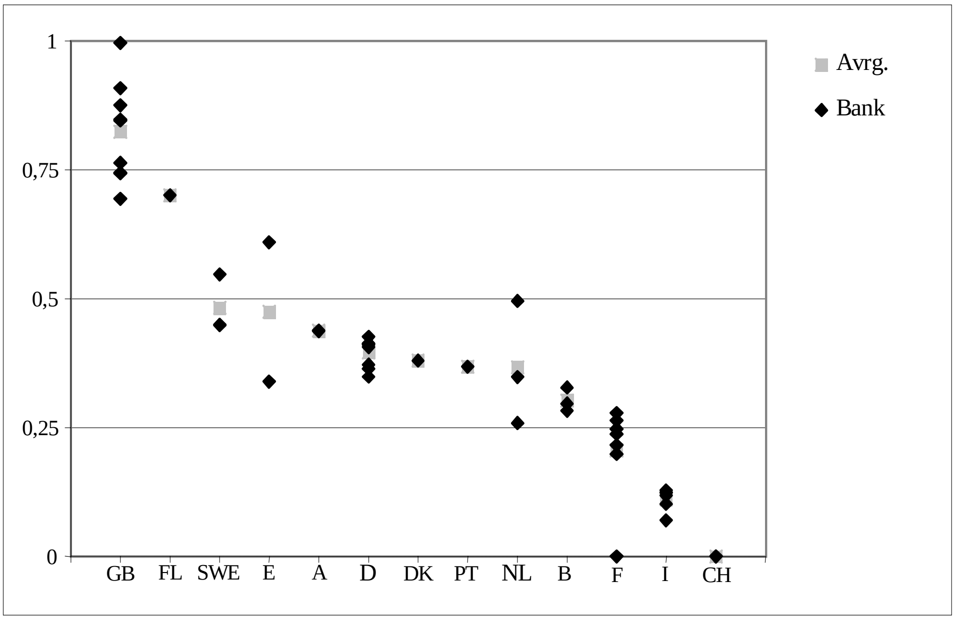

Figure 1. Distribution of Disclosure Level for the European countries[43]

5. Conclusions

A comparison of board compensation as given in the annual reports suffers from the drawback that it compared not only banks of different size and profitability, but also reports on very different groups, sometimes containing only members of the core management and sometimes including several groups of lesser significance. A respective extension had to control for such aspects. The actual paper contains no statement about how well board members in the different countries are paid.

However, we observe remarkable differences with respect to the components of compensation and reporting on board remuneration. The former concerns particularly the use of stock option plans and other highly powered incentive schemes, and might be seen as an intermediate state in the process of the diffusion of these innovations from Anglo-Saxon Europe to the continent. Thus, the banks on the common European market might, in the long run, reach a higher degree of conformity with respect to the methods to incentivize board members. Does the same expectation apply for the disclosure on board remuneration? The high degree of robustness of our ranking with regard to different values of the evaluation parameters might result from a different fundamental attitude towards disclosure in the respective financial systems, and not just from different ideas about how to report certain facts. Such fundamental notions can be deeply embedded in the respective economy and culture and will not easily change. Thus, we expect these differences in disclosure to be more persistent.[44]

Finally, it is debatable if regulatory measures were needed to enhance disclosure and, thereby, corporate governance. The high degree of homogeneity of disclosure in the different countries and the close adherence of many banks to the respective minimum legal requirements show that managers are not very willing to respond to the assumed market demands for more disclosure, thus opening

[43] The relative robustness of this ranking can be seen in appendix 2, where the results for a simpler disclosure index with equal weights to all categories (basis salary, pension, non-monetary benefits, performance related payments, credit, stock options) and without a group factor are presented. Only the Netherlands and Belgium gain a better relative position, whereas for all other countries the qualitative results are more or less the same.

[44] At least in Germany, recent efforts to enhance corporate governance might lead to a system with a disclosure level similar to the UK.

the road for welfare-enhancing state intervention. However, it could be argued that, in a true common market, the country with the highest minimum requirements will set the standard for the other countries. From an European perspective, it might be preferable if such a standard were set collectively in the European Union.

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Appendix 1. Bank list and disclosure level

Country	Bank	Disclosure level
Austria	BankAustria	0.44
	Creditanstalt Wien	0.44
Belgium	Bank Brussels Lambert	0.28
	Generale Bank Group	0.30
	Kredietbank	0.33
Denmark	Den Danske Bank Konzern	0.38
Finland	Merita Bank Ltd.	0.70
France	Banque Nationale de Paris	0.24
	Banque Paribas	0.22
	Banque Populaire	0
	Credit Agricole Indisuez	0.26
	Credit Commercial de France	0.20
	Credit Lyonnais	0.25
	Societe General Group	0.28
Germany	Bankgesellschaft Berlin	0.35
	Bayerische Hypo	0.41
	Bayerische Landesbank	0.43
	Bayerische Vereinsbank	0.41
	BHF-Bank	0.43
	Commerzbank	0.41
	Deutsche Bank	0.41
	DG Bank	0.36

Appendix 1 continued

	Dresdener Bank	0.41
	NORD/LB	0.37
	WestLB	0.36
Great Britain	Bank of Scotland	0.69
	Barclays	0.74
	Halifax	0.99
	HSBC	0.76
	Lloyds TSB	0.91
	Midland Bank	0.85
	NatWest	0.85
	Standard Chartered	0.74
	The Royal Bank of Scotland	0.87
Italy	Banca Commerciale Italiana	0.12
	Banca di Roma	0.10
	Banca Nazionale di Lavoro	0.12
	Cariplo	0.07
	Credito Italiano	0.13
	SanPaolo di Turino	0.12
The Netherlands	ABN AMRO	0.26
	ING Bank	0.50
	Rabobank	0.35
Portugal	Caixa Geral de Depositos	0.37
Spain	Banco Bilbao Vizcaya	0.34
	Grupo Santander	0.61
Sweden	Nordbanken	0.55
	Skand. Enskilda Banken	0.45
	Svenska Handelsbanken	0.45
Switzerland	Credit Suisse	0
	Schweizerischer Bankverein	0
	UBS	0

Appendix 2. Disclosure level with equal weights to all criteria and without group factor