SHAREHOLDER PROTECTION AND BANK BOARD QUALITY - AN INTERNATIONAL PERSPECTIVE

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Abstract

This study analyzes the quality of banks' boards of directors across Europe and the United States (US). We investigate the interactions between the legal protection of investors and ownership concentration to explain the quality of boards at 190 of the largest publicly-traded US and European banks in 2005, well before the unraveling of the financial crisis in 2008. Overall, our results show that in Europe, where legal protection of shareholders is lower than the US, the quality of boards is lower when ownership is more concentrated. Since there are lower expected costs of conflicts with minority shareholders in Europe, the controlling shareholders maximize their own interests by promoting a board of lower quality. In contrast, since there are higher expected costs of conflicts with minority shareholders in the US, the controlling shareholders promote a board of higher quality, thereby limiting their legal responsibility in case of conflicts. Thus, the quality of the board depends upon the interaction between institutional factors (investor protection) and firm-specific characteristics (ownership concentration).

Keywords: Board of Directors; Banks; Cross-Country; Investor Protection; Ownership Concentration

JEL classification: G21, G38

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1. Introduction

Several studies have attempted to determine whether the corporate governance of banks was related to the causes and the consequences of the recent global financial crisis (Beltratti & Stulz, 2009; Erkens, Hung & Matos, 2009; Grove, Patelli, Xu, & Victoravich, 2011) and also whether corporate governance explained the financial crisis that occurred a decade earlier in Asia (Johnson, Boone, Breach & Friedman, 2000; Mitton, 2002). For example, Erkens et al. (2009) examine this issue at 296 of the world's largest financial firms. They find that firms with more independent boards and institutional ownership suffered larger losses and were not more likely to replace their CEOs for poor performance during the crisis period. Beltratti and Stulz (2009) analyze the cross-section of stock returns of 98 large banks across the world from July 2007 to December 2008. Using conventional indicators of governance, they find that banks with a board structure that promotes minority shareholder interests performed worse during the crisis. Grove et al. (2011) report that US banks, which were more leveraged and had a CEO who also held the role of chairman, performed worse during the crisis period.

While interesting, these studies assume that corporate governance is exogenous, which is not necessarily the case. In fact, in their survey of the economic literature on boards of directors, which is a key mechanism of corporate governance, Hermalin and Weisbach (2003) point out that board of directors are endogenously determined governance mechanisms for addressing agency problems inherent to many organizations[2]. Linck, Netter and Yang (2008) confirm that board structure across US firms is consistent with the costs and benefits of the board's monitoring and advising roles. Guest (2008) concludes that UK boards play a weaker monitoring role than US ones, and that board structure determinants differ in predictable ways across different institutional settings.

[2] Sometimes, the researchers try to solve this endogeneity problem by testing the role of board on firm outcomes (see, for example, De Andres & Vallelado (2008), who use a sample of large international commercial banks).

Our work enriches this literature by studying the impact of institutional factors on board quality at US and European banks. We are particularly concerned about the relationship between institutional characteristics, especially the degree of legal protection of investors, and firm-specific characteristics, especially the degree of the ownership concentration of banks, to explain the quality of the board of directors. We postulate that in the US where legal protection of minority shareholders is important, the quality of the board is not linked to ownership concentration. The main reason is the motivation of managers and controlling shareholders to limit conflicts of interest with minority shareholders since the expected costs (lawsuits, etc.) are potentially high. Blockholders are especially interested in promoting the presence of independent members to the board in order to exempt their responsibilities in case of future problems[3]. In the contrast of Europe, where legal protection of minority shareholders is generally lower, we hypothesize that the quality of the board is lower when ownership is more concentrated. The expected costs resulting from conflicts with the minority shareholders are weak (low probability of lawsuits). Thus, the controlling shareholders do not hesitate to control the board of directors in order to protect their own interests.

Kim, Kitsabunnarat-Chatjuthamard and Nofsinger (2007), also examine the relation between minority shareholder protection laws, ownership concentration, and board independence. Using a sample of large firms from 14 European countries, they find that countries with stronger shareholder protection rights have firms with lower ownership concentration and with more independent directors, and that ownership concentration and board independence are negatively related. Our approach is different given that we consider, first, that board independence depends on ownership concentration and second, that the interaction between legal protection and ownership concentration is crucial to explain the quality of the board.

To test our hypothesis, we investigate board quality by employing ten conventional variables which measure board quality (Larcker, Richardson & Tuna, 2007): board size (number of directors), proportion of independent members, number of meetings of the board, duality (CEO is Chairman of the board), presence of an audit committee (AC), proportion of independent members in the AC, number of meetings of the AC, presence of an compensation committee (CC), proportion of independent members in the CC, and number of meetings of the CC. We also construct an index, which measures the overall quality of the board. Our sample includes 190 large banks in 2005, before the financial crises: 125 US banks and 65 European banks from 12 countries. Each country in our sample has at least three banks, with a minimum of 2 billion dollars of total assets. We examine the period before the financial crisis unraveled because it is possible that the board structure at banks may have since changed or may be in a transitory state as a reactionary measure to poor performance and the possibility of a bank's failure.

Our results confirm our hypothesis. The degree of concentration does not impact the quality of the board of US banks because managers and blockholders are trying to limit the expected costs of conflicts by encouraging the emergence of high-quality boards. In contrast, a significant difference exists between European banks with a low and a high ownership concentration. The quality of the boards is lower when ownership is more concentrated. This result shows that the weak protection of shareholders in Europe encourages controlling shareholders to prefer a lower-quality board in order to extract private benefits. This result confirms that the interaction between legal protection and ownership structure is a key factor in explaining board quality.

Our study contributes to the literature in two main ways. First, it enriches the legal and finance literature, developed by LaPorta, Lopez-de-Silanes, Shleifer and Vishny (1997, 2000) by showing that the quality of the board depends upon the interaction between institutional factors (investor protection) and firm-specific characteristics (ownership concentration). Also, our study complements a recent study (Haw, Ho, & Wu, 2010), which investigates the relations among concentrated control, legal and regulatory regimes, and a set of bank operating characteristics. However, that study focuses upon the impact of ownership concentration and legal institutions on bank performance, not board quality, and uses a sample of commercial banks in East Asia and Western Europe, similar to two other studies (Doidge, Karolyi, & Stulz, 2007; Chhaochharia & Laeven, 2009). Our study contributes to this debate about whether governance attributes are determined by country factors or firm characteristics by showing that the interaction between country factors and firm characteristics is important in determining board quality.

Second, our study complements the literature on the determinants of the board's composition in the banking sector. Pathan and Skully (2010) analyze the trends and endogenous determinants of boards of directors for a sample of 212 US bank holding companies from 1997 to 2004, but all the other previous studies on the determinants of boards had focused only on non-financial firms. Our results should be of interest for regulators in the banking industry.

[3] Other advantages of using independent directors in companies with concentrated shareholding have already been discussed by Dahya, Dimitrov and McConnell (2008). They analyze the relation between corporate value and the proportion of the board made up of independent directors in 799 firms with a dominant shareholder across 22 countries. They conclude that a dominant shareholder could offset, at least in part, the documented value discount associated with weak country-level shareholder protection by appointing an independent board.

The remainder of the paper is divided into four sections. Section 2 describes the sample selection and the variables used in the study. Section 3 presents the characteristics of the board's quality in the 190 banks. Section 4 presents our study's analysis of board quality across countries. A summary of the results and the conclusions are presented in Section 5.

2. Sample and variables

Initially, we identified all US and European banks with the following characteristics: 1) they had no mutual or cooperative status, 2) their shares were listed on a stock exchange, and 3) their data was available on Datastream in 2005 (before the financial crisis). Then, we reduced the 2005 sample to large banks with a minimum of $2 billion dollars of total assets and with 2005 annual reports available on their website. Finally, only countries in which at least three banks were available were selected. These criteria allowed us to conduct a study of 190 banks: 125 in the US and 65 in 12 European countries. Our sample is very interesting in comparison of other recent studies in the financial industry. For example, Erkens et al. (2009) use a larger sample of 296 financial firms (125 US firms, 131 European firms, and 40 firms from other regions) but our sample is bigger than that of Beltratti and Stulz (2009), who study 98 banks around the world.

Table 1 provides some indications on the characteristics of these banks. We show that European banks in our sample were significantly larger than their US counterparts. The mean value of total assets at US banks is about $38.4 million (SD = $5.1 million) while the mean value of total assets at European banks is about $318.5 million (SD = $60.9 million). The same pattern emerges in terms of total shareholders' equity with average total equity of about $3.4 million (SD = $501 thousand) and $11.7 million ($3.7 million), at US banks and European banks, respectively. Moreover, among European countries, significant differences exist. In particular, French and UK banks are significantly bigger than Greek, Portuguese and Austrian banks.

Table 1. Sample Description

	N	Mean	Median	SD	Min	Max
Panel A. Total Assets (in millions)						
Austria	3	$80,897	$48,065	$87,590	$14,466	$180,160
Belgium	3	329,863	384,545	302,204	4,052	600,993
Denmark	4	107,623	19,027	185,125	7,280	385,156
France	5	832,882	1,001,872	589,707	198,429	1,485,919
Germany	6	347,053	167,612	440,453	9,964	1,167,800
Greece	9	27,736	23,365	25,255	2,611	71,169
Ireland	3	126,314	157,164	59,286	57,964	163,814
Italy	7	212,341	24,863	334,943	7,502	922,791
Portugal	4	46,824	47,364	37,040	2,529	90,039
Spain	9	194,609	60,943	313,847	8,490	945,858
Switzerland	6	439,906	21,108	679,026	8,215	1,562,254
UK	6	1,016,167	1,131,909	555,863	214,598	1,587,061
Europe	65	318,456	60,943	468,671	2,529	1,587,061
US	125	38,421	5,134	160,031	2,022	1,269,892
All	190	134,223	8,474	330,038	2,022	1,587,061
Panel B. Equity (in millions)						
Austria	3	$3,003	$3,311	$2,048	$819	$4,881
Belgium	3	12,980	16,648	7,918	3,893	18,399
Denmark	4	3,629	1,119	5,459	481	11,795
France	5	25,150	27,837	18,274	6,332	48,130
Germany	6	10,384	4,593	13,285	574	35,385
Greece	9	1,536	1,268	1,306	134	3,692
Ireland	3	5,711	6,119	2,989	2,539	8,474
Italy	7	10,612	1,497	15,341	542	41,611
Portugal	4	2,036	2,072	1,600	160	3,839
Spain	9	9,443	4,126	15,231	516	47,019
Switzerland	6	11,877	1,843	16,235	804	33,655
UK	6	40,166	29,867	30,131	11,880	91,027
Europe	65	11,710	3,692	17,384	134	91,027
US	125	3,390	501	13,485	149	105,507
All	190	6,237	782	15,405	134	105,507

2.1 Board quality

We assess the quality of the board with ten conventional variables concerning the composition and functioning of the board: size, proportion of independent members, number of meetings of the board, duality, presence of an audit committee (AC), proportion of independent members in the AC, number of meetings of the AC, presence of an compensation committee (CC), proportion of independent members in the CC, and number of meetings of the CC. We also use an aggregate variable which considers these ten variables in order to measure the overall quality of the board. All such board data were hand-collected in the banks' annual reports or proxy statements.

- SIZE is equal to 1, if the size of the board is lower than the median size of the board for the 190 banks of our sample (good quality), and 0 otherwise (low quality). As argued by Jensen (1993) and Hermalin and Weisbach (2003), as board size increases, boards' ability to monitor management decreases due to a greater ability to shirk and an increase in decision-making time which may impair board monitoring. Although a bank board is often larger at banks due to the complex organizational structure and the need for special committees such as a risk committee (Adams & Mehran, 2003), there is a point at which a board becomes too large (Andres & Vallelado, 2008) and impairs board performance.

- INDEP is equal to 1 if the board is composed of at least 50% of independent members (high quality) and 0 otherwise (low quality). Independent members serving on the board must not be current or former employees of the bank nor are they members who have business or personal (family) relationships. In the agency theory framework, the decision-making of independent directors is likely to be affected by inside directors which might increase managerial entrenchment.

- B_MEET is equal to 1 if the number of meetings of the board exceeds the median number of meetings for the 190 banks (good quality) and 0 otherwise (low quality). In the agency theory framework, frequency of board meetings may indicate active monitoring by the board (Conger, Finegolda, & Lawler, 1998). More frequent meetings indicates increased supervision of the top management in a more effective monitoring role which may mitigate agency costs and subsequently improve firm performance.

- DUAL is equal to 1 if two different persons are in charge of the company (high quality), and equal to 0 if the CEO is also the chairman of the board (low quality for this duality factor). Agency theory argues that separating the roles of CEO and chairman of the board can mitigate agency costs. As a leader of the board, the chairman of the board is responsible for monitoring the CEO's decision-making and overseeing the process of CEO hiring, firing, evaluation and compensation. The combination or duality of these two leadership roles would constrain the chairman from taking on an effective and objective monitoring role, thus promoting CEO entrenchment and intensifying agency conflicts. This argument is consistent with the findings of Grove et al. (2011) that duality impairs performance at US banks.

- AC is equal to 1 if there is an audit committee (good quality) and 0 otherwise (low quality). Financial control related to auditor monitoring, credible financial reporting, and monitoring over internal control is assumed to be stronger when such a committee exists. This is supported by the requirement of all major US stock exchanges and the Sarbanes-Oxley Act that all listed firms must have an audit committee.

AC_INDEP is equal to 1 if the percentage of independent members serving on the audit committee is at least 50% (high quality) and 0 otherwise (low quality). Based on agency theory, we argue that the monitoring ability of both the audit and the compensation committees will be significantly compromised if such a committee has a large percentage of non-independent directors and/or the chair of the committee is not independent. Non-independent directors on the audit committee will reduce the objectiveness and effectiveness of their monitoring over financial reporting and directly affect earnings quality (Klein, 2002; Vafeas, 1999). As well, all major US stock exchanges prohibit executive (inside) directors from sitting on the audit committee. This rule however does not preclude prior employees who have been separated from the firm for a stipulated period of time and other non-compensated related parties from sitting on the audit committee.

- AC_MEET is equal to 1 if the number of meetings of the AC exceeds the median number of meetings for the 190 banks (good quality) and 0 otherwise (low quality). A higher frequency of meetings among audit committee members is representative of a committee that is more active in monitoring the bank's financial reporting and internal control system.

- CC is equal to 1 if there is a compensation committee (good quality) and 0 otherwise (low quality). CEO incentives are assumed to be better defined when such a committee exists since the board committee is assigned the specific responsibility of designing a compensation package that promotes actions that drive positive performance without excessive risk taking.

- CC_INDEP is equal to 1 if the percentage of independent members serving on the compensation committee is at least 50% (high quality) and 0 otherwise (low quality). Non-independent directors on the compensation committee are more likely to side with executives, resulting in excessive or misaligned compensation packages (Sun & Cahan, 2009; Newman & Mozes, 1998).

- CC_MEET is equal to 1 if the number of meetings of the CC exceeds the median number of meetings for the 190 banks (good quality) and 0 otherwise (low quality). A compensation committee that meets more frequently is evidence that the committee is taking on an active role in designing and reviewing the CEO and other key executives' compensation packages.

- OVERALL is a measure of the overall quality of the board. It is between 0 and 10 (an un-weighted sum of the ten previous variables); 10 means that the quality of the board is high (more than 50% independent members on the board, the AC and the CC, no duality factor for the CEO, a small board, presence of an audit committee and a compensation committee, a high number of meetings of the board, the AC and the CC) and 0 means that none of these variables are present and, thus, the quality of the board is low. OVERALL is a dummy variable equal to 1 if the measure exceeds the median overall quality for the 190 banks in the sample (good quality) and 0 otherwise (low quality).

2.2 Shareholder legal protection

The idea that investors' legal protection affects the behavior of executives and investors has been developed by La Porta et al. (1997, 2000). In this paper, we use the measures developed by Choi and Wong (2007), who studied the impact of legal protection on the choice of auditors made by firms around the world. They determine the quality of the national legal environments by using a combined index, which is composed of a law enforcement index and an investor protection index provided by La Porta et al. (1997). Their combined index equals the sum of 100 percent of the investor protection index value plus 50 percent of the enforcement index value. This value is between 0 and 10; the higher it is, the greater the legal protection of shareholders. In order to distinguish countries with weak or strong investor protection, we use the classification of Choi and Wong (2007) as follows: if the index is lower than 7.2 out of 10, the protection is weak.

2.3 Ownership concentration

To assess the concentration of ownership, we use two variables. The first is the percentage of shares held by the main shareholder who holds more than 5% of the shares (FIRST_BLOCK). The second is the percentage of shares held by all blockholders (shareholders) who hold more than 5% of the shares (ALL_BLOCK). Higher values indicate higher ownership concentration.

2.4 Other variables

We also investigate the presence of three other variables that are related to board quality. CEO tenure (number of years the current CEO has held the position) which is expected to influence the quality of the board of directors. More entrenched CEOs have an incentive to favor the presence of non-independent directors in order to limit the pressure exerted by such a board and to limit the probability of board turnover (Huson, Parrino & Starks, 2001).

We also include banks' financial analyst following for each respective bank included in the sample**.** Lang, Lins and Miller (2004) investigate the relation between analyst following, ownership structure, investor protection and valuation. Their findings suggest that corporate governance plays an important role in analysts' willingness to follow firms and that increased analyst following is associated with higher valuations, particularly for firms not likely to have governance problems. We consider that monitoring by financial analysts means more pressure for managers. If there are numerous analysts following a bank, then the pressure is higher; it should lead to encouraging the emergence of a high quality board, thereby limiting the risk perceived by analysts and the adverse impact on the value of the bank.

Lastly, we examine whether the bank is cross listed in the US and Europe. Several studies have highlighted that cross listing of foreign companies in the US constitutes a "bonding" mechanism (Reese & Weisbach, 2002; Doidge, Karolyi, & Stulz, 2004; Siegel, 2005). That is, when a European bank takes the decision to cross-list on an US market, it should result in an increase of the quality of the board in order to limit the (increasing) expected costs of conflicts with minority shareholders.

3. Results

We analyze the quality of the boards of directors in US and European banks. Table 2 shows that 43% of the 190 banks in our sample have made a separation of CEO and Chairman of the board (the duality factor). This figure is significantly higher in the US, where 54% of banks made such a choice versus Europe where only 20% of the banks decided to separate the two functions ($t = 5.74$; $p < 0.01$; one tailed). Among European banks, the separation is more pronounced. In countries where legal protection of shareholders is higher (strong regime), significantly more banks have made such a separation at 30% versus 13% in countries with a weak regime or shareholder protection ($t = 4.78$; $p < 0.01$; one tailed). These results are consistent with the hypothesis of a higher quality of boards in countries where shareholder protection is stronger.

Table 2. Separation of CEO and Chairman of the Board

	% SEPARATION	N
All banks	43%	190
US banks	54%	125
European banks	20%	65
Weak (Choi & Wong, 2007)	13%	38
Strong (Choi & Wong, 2007)	30%	27

The results in Table 3 confirm this view. The mean number of board members at US banks is significantly lower at 12.7 members versus that at European banks with a mean of 14.6 members ($t = 2.89$; $p < 0.01$; one-tailed). In addition, the percentage of independent members is significantly higher in the US, with a mean of 70% against a mean of 50% in Europe ($t = 6.51$; $p < 0.01$; one-tailed). Finally, the number of meetings is slightly higher in European banks than in US banks, but the difference is small and insignificant with a mean of 10.5 meetings versus a mean of 9.5 meetings, respectively ($t = 1.25$; $p = 0.11$; one tailed).

Concerning the audit committee, large differences are also found since the presence of such a committee is required in the US, which is not the case in Europe. Only 60 European banks showed the existence of such a committee while all 125 banks in the US had such a committee. In the US, the average number of members on the audit committee is 4.1 with an average number of members on the audit committee of 4.5 in Europe ($t = 2.05$; $p < 0.05$; one tailed). The percentage of independent members is also significantly greater in the US, as on average 90% of the members are independent versus an average of only 70% independent members at European banks ($t = 5.35$; $p < 0.01$; one tailed). Further, this committee meets significantly more frequently in the US as compared to Europe with average meetings of 9.9 times and 6.3 times per year, respectively ($t = 5.49$; $p < 0.01$; one tailed). Similar results exist for the compensation committee which is required in the US. The US compensation committees are significantly larger with an average size of 4.4 members as compared to Europe with an average size of 3.5 members ($t = 3.92$; $p < 0.01$; two tailed). There is also a significantly higher proportion of independent members at US banks versus European banks with a mean of 90% and 70%, respectively ($t = 4.96$; $p < 0.01$; one tailed). The committee also meets moderately more frequently at US banks with a mean of 5.7 times versus a mean of 4.5 times ($t = 1.66$; $p < 0.05$; one tailed). European banks only have such a committee in 44 out of 65 banks.

Thus, we find that the overall quality of boards is significantly greater in the US. For the 125 banks, the average score is 7.6 while the average score of the 65 European banks is only 4.8 ($t = 5.49$; $p < 0.01$; one tailed). This result reflects significant differences in the governance exerted by the board on managers in US versus European banks.

Table 3. Board Characteristics

		Mean	Median	SD	N
Panel A. All banks					
Board of Directors	BOARD_SIZE	13.4	13.0	4.4	190
	%BOARD_INDEP	0.6	0.6	0.2	189
	BOARD_MEET	9.8	9.0	4.8	176
Audit Committee	AC_SIZE	4.3	4.0	1.3	185
	%AC_INDEP	0.8	1.0	0.3	184
	AC_MEET	8.8	8,0	4.3	172
Compensation Committee	CC_SIZE	4.2	4.0	1.3	169
	%AC_INDEP	0.8	1.0	0.3	169
	NB_MEET_CC	5.5	5.0	3.4	154
Board Quality	SCORE	6.7	7.0	2.2	190

		Mean	Median	SD	N
Panel B. European banks					
Board of Directors	BOARD_SIZE	14.6	15.0	5.1	65
	%BOARD_INDEP	0.5	0.5	0.2	64
	BOARD_MEET	10.5	10.0	6.1	51
Audit Committee	AC_SIZE	4.1	4.0	1.3	60
	%AC_INDEP	0.7	0.8	0.3	59
	AC_MEET	6.3	5.0	3.8	59
Compensation Committee	CC_SIZE	3.5	3.0	1.0	44
	%AC_INDEP	0.7	0.9	0.3	44
	NB_MEET_CC	4.6	3.5	3.4	44
Board Quality	SCORE	4.8	5.0	2.3	65
		Mean	Median	SD	N
Panel C. US Banks					
Board of Directors	BOARD_SIZE	12.7	12.0	3.8	125
	%BOARD_INDEP	0.7	0.7	0.2	125
	BOARD_MEET	9.5	9.0	4.2	125
Audit Committee	AC_SIZE	4.5	4.0	1.2	125
	%AC_INDEP	0.9	1.0	0.2	125
	AC_MEET	9.9	10.0	4.0	121
Compensation Committee	CC_SIZE	4.4	4.0	1.4	125
	%AC_INDEP	0.9	1.0	0.2	125
	NB_MEET_CC	5.7	5.0	3.3	125
Board Quality	SCORE	7.6	8.0	1.4	125

Table 4 confirms the existence of some significant differences between European countries where the legal protection of shareholders is weak or strong. For strong protection versus weak protection, the percentage of independent members that sit on the audit committee is not significantly higher (mean of 4.2 versus mean of 4.0; t= 0.57; p = 0.28; one tailed. However, the strong regime has significantly more independent members (mean of 80%) than the weak regime (mean of 60%) (t = 2.54; p < 0.01; one tailed). The audit committee in the strong regime also meets more frequently than the weak regime with average meetings of 6.5 versus 5.3 times per year, respectively, but the difference is not significant (t = 1.13; p = 0.13; one tailed).

A similar result is demonstrated for compensation committees which are generally less prevalent in countries where shareholder protection is weak. In strong regimes the compensation committee is significantly larger than in weak regimes with a size of 3.3 members and 3.7 members, respectively (t = 3.79; p < 0.01; two tailed). There are significantly more independent members sitting on the compensation committees of banks in the strong regime (mean = 80%) than the weak regime (mean = 60%) (t = 1.89; p < 0.05; one tailed). Lastly, the compensation committees at banks in the strong regime meet 5.5 times per year while the compensation committees at banks in the weak regime meet only 2.3 times per year. This difference is significant (t = 2.59; p < 0.01; one tailed).

Summarizing the quality of the board with the board score index, the quality of the board is higher when banks operate in an environment of strong shareholder legal protection (mean of 6.2) versus when protection is low (mean of 3.8) (t = 4.94; p < 0.01; one tailed). This result is similar to the classification of Choi & Wong (2007): a cutoff level of low protection is less than 7.2.

The results in Table 5 highlight that the overall quality of the board differs significantly depending on the concentration of ownership. In Panel A, we distinguish two sub-samples of equal size, based on the median ownership concentration, using the percentage of shares held by all blockholders. In Europe, the average overall quality is equal to 4.8, but it is lower when ownership is more concentrated (4.4 when the concentration is high versus 5.3 when the concentration is low; t = 1.65; p < 0.10; one tailed). In contrast, no differences were found in US banks: the quality is even slightly greater when ownership is concentrated with a mean score of 7.7 versus a mean score of 7.5 when concentration is less concentrated (t = 0.70; p = 0.21; one tailed). Panel B confirms these results. The distinction between low and high concentrated ownership is based on the median

percentage of shares held by the first shareholder. In Europe and in the US, the gap is slightly larger than before.

Finally, these various results validate our hypothesis. In the US, where legal protection of shareholders is high, the overall quality of boards is higher than in Europe, where legal protection is weaker. However, the relationship between legal protection and concentrated ownership is important. In the US, controlling shareholders are encouraged to have high quality boards in order to limit the expected costs of conflicts with minority shareholders. It is a way to shift responsibility to the board of directors. In contrast, in Europe, the controlling shareholders have no incentives to have a high quality board because the expected costs of conflict are low. Thus, by choosing a board of low quality, they can promote their own interests. These facts explain why the quality of boards is not different in the US, depending on whether ownership concentration is low or high, while in Europe the quality of boards is significantly lower when ownership is more highly concentrated.

Table 4. Board characteristics in Europe by investor protection

		Mean	Median	SD	N	Mean	Median	SD	N	Mean	Median	SD	N
Panel A. Weak and Strong protection		European banks				Weak protection				Strong protection			
Board of Directors	BOARD_SIZE	14.6	15.0	5.1	65	14.3	13.5	5.4	38	15.0	15.0	4.6	27
	%BOARD_INDEP	0.5	0.5	0.2	64	0.5	0.4	0.3	37	0.4	0.5	0.2	27
	BOARD_MEET	10.5	10.0	6.1	51	10.3	11.0	5.2	25	10.7	9.5	6.9	26
Audit Committee	AC_SIZE	4.1	4.0	1.3	60	4.0	3.5	1.5	34	4.2	4.0	1.1	26
	%AC_INDEP	0.7	0.8	0.3	59	0.6	0.6	0.3	33	0.8	0.9	0.3	26
	AC_MEET	6.3	5.0	3.8	51	5.3	4.0	4.3	25	7.2	6.5	3.2	26
Compensation Committee	CC_SIZE	3.5	3.0	1.0	44	3.3	3.0	1.0	18	3.7	4.0	1.0	26
	%AC_INDEP	0.7	0.9	0.3	44	0.6	0.7	0.4	18	0.8	1.0	0.3	26
	NB_MEET_CC	4.6	3.5	3.4	32	2.3	2.0	1.2	9	5.5	5.0	3.6	23
Board Quality	SCORE	4.8	5.0	2.3	65	3.8	4.0	1.8	38	6.2	6.0	2.1	27

Table 5. Bank characteristics

	Mean	Median	SD	N	Mean	Median	SD	N	Mean	Median	SD	N
Panel A. Concentration (All Block > 5%)	European banks				Low concentration		ownership		High concentration		ownership	
SCORE	4.8	5.0	2.3	65	5.3	6.0	2.1	33	4.4	4.0	2.3	32
DEG_PROT	6.8	7.0	1.4	65	7.0	7.0	1.4	33	6.5	7.0	1.2	32
TOTAL_5%	0.4	0.4	0.3	65	0.1	0.1	0.1	33	0.7	0.6	0.2	32
	US banks				Low concentration		ownership		High concentration		ownership	
SCORE	7.6	8.0	1.4	125	7.5	8.0	1.4	63	7.7	8.0	1.4	62
DEG_PROT	10.0	10.0	0.0	125	10.0	10.0	0.0	63	10.0	10.0	0.0	62
TOTAL_5%	0.2	0.1	0.2	125	0.1	0.1	0.0	63	0.3	0.2	0.2	62
Panel B. Concentration (First shareholder)	European banks				Low concentration		ownership		High concentration		ownership	
SCORE	4.8	5.0	2.3	65	5.5	6.0	2.1	33	4.1	4.0	2.2	32
DEG_PROT	6.8	7.0	1.4	65	7.1	7.3	1.4	33	6.4	7.0	1.2	32
FIRST	0.3	0.2	0.3	65	0.1	0.1	0.1	33	0.5	0.5	0.2	32
	US banks				Low concentration		ownership		High concentration		ownership	
SCORE	7.6	8.0	1.4	125	7.4	7.0	1.4	63	7.8	8.0	1.4	62
DEG_PROT	1..0	10.0	0.0	125	10.0	10.0	0.0	63	10.0	10.0	0.0	62
FIRST	0.1	0.1	0.2	125	0.0	0.1	0.0	63	0.2	0.1	0.2	62

Panel A of Table 6 shows that several characteristics of European banks are specific to the sample as compared to the sample of US banks. First, ownership is more concentrated in European banks: the largest shareholder holds 29% of shares on average, against 12% in US banks ($t = 5.44$; $p < 0.01$; one tailed). Further, all blockholders, with a 5% or greater ownership interest, possess on average 38% of the shares in Europe versus an average of 18% in the US ($t = 5.38$; $p < 0.01$; one tailed). Second, CEO tenure at US banks is significantly longer than at European banks (9.7 years on average in the US, versus 5.6 years on average in Europe; $t = 3.44$; $p < 0.01$; one tailed). This result is somewhat surprising since it is generally accepted that the legal and investor challenges for CEOs are greater in the US which may lead to greater CEO turnover. Third, nearly three times more analysts follow the European banks (mean of 19.3 analysts) as compared to US banks (mean of 6.6 analysts; $t = 10.68$; $p < 0.01$; one tailed). This result is also surprising since it is well known that the US financial market is more developed than the European markets. The explanation may result in the following of large European banks by US analysts, in addition to European analysts, while the reverse is not true.

For the 65 European banks, significant differences appear, according to the regime of legal protection of shareholders. Where protection is high, ownership is less concentrated with a 30% ownership stake of blockholders in strong regimes versus a 50% ownership stake in weak regimes ($t = 2.63$; $p < 0.01$; one tailed). CEO tenure is slightly longer at strong regimes with an average CEO tenure of 6.3 years versus 5.1 years at weak regimes although the difference is not significant ($t = 0.80$; $p = 0.21$; one tailed). Notably, more analysts follow banks in strong regimes with a mean of 21.5 versus a mean of 17.2 at weak regimes ($t = 1.59$; $p < 0.05$; one tailed). These results are valid for the weak and strong investor protection regimes of Choi and Wong (2007) in Panel B of Table 6.

5. Conclusions

In investigating the quality of banks' boards of directors in 12 European countries and the US, we analyzed the relationship between the legal protection of investors and ownership concentration to explain the quality of boards of 190 of the largest publicly-traded US and European banks in 2005, well before the unraveling of the financial crisis in 2008. Overall, our results show that in Europe, where legal protection of shareholders is lower, the quality of the board is lower when ownership is more concentrated. This result is probably from the lower expected costs of conflicts with minority shareholders in Europe which enables the controlling shareholders to maximize their own interests by promoting a board of lower quality. In contrast, where the expected costs of conflicts with minority shareholders are higher in the US, the controlling shareholders promote a board of high quality, thereby limiting their responsibility in case of conflicts.

Table 6. Bank characteristics

	Mean	Median	SD	N	Mean	Median	SD	N	Mean	Median	SD	N
Panel A. US and European banks	All banks				European banks				US banks			
% FIRST	0.18	0.09	0.22	190	0.29	0.19	0.27	65	0.12	0.08	0.16	125
Total BH % > 5%	0.25	0.15	0.26	189	0.38	0.39	0.31	65	0.18	0.12	0.20	125
TENURE	8.5	6.0	8.17	175	5.6	4.0	5.32	52	9.7	7.0	8.85	123
ANALYST FOLLOWING 2005	11.6	8.1	10.2	137	19.3	19.0	12.1	36	6.6	6.1	4.0	84
CROSS-LISTING 2005	0.2	0.0	0.4	65	0.2	0.0	0.4	65	-	-	-	-
Panel B. Weak and Strong regimes (Choi & Wong, 2007)	European banks				Weak regimes				Strong regimes			
% FIRST	0.29	0.19	0.27	65	0.3	0.3	0.3	38	0.2	0.1	0.3	27
Total BH % > 5%	0.39	0.39	0.31	64	0.5	0.5	0.3	37	0.3	0.2	0.3	27
TENURE	5.6	4.0	5.31	52	5.1	4.0	4.71	21	6.3	4.0	6.1	21
ANALYST FOLLOWING 2005	19.3	19.0	12.1	53	17.2	14.0	13.3	27	21.5	22.8	10.4	26
CROSS-LISTING 2005	0.2	0.0	0.4	65	0.1	0.0	0.2	38	0.3	0.0	0.5	27

This evidence indirectly supports the significance of greater legal protection of minority shareholders from controlling shareholders in European countries that lack protective laws in terms of formal law or stock exchange listing requirements. It also suggests that minority shareholders in countries whose laws promote and protect shareholder rights are probably more likely to be able to have the kinds of boards that they prefer. Thus, this research adds an important link to the explanation of the consequences of investor protection for financial market development.

This finding may be more important at banking firms than non-banking firms (i.e., manufacturing firms, technology firms, etc.,), given that banks are considered to be extremely complex and opaque which results in information asymmetries that intensify agency problems (Morgan, 2002). Also, the presence of depository insurance creates a form of moral hazard for banking managers, which is not present in other industries. These heightened agency conflicts at banking firms, coupled with many lower quality boards, could be explanatory factors, regarding bank performance during recent global economic problems where risk taking and high leverage have contributed to the ongoing banking crisis in both the US and European Union, particularly in Greece, Ireland, Portugal, and Spain.

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