TOP MANAGERS' COMPENSATION AND GOVERNANCE IN SPANISH FIRMS: EVIDENCE AND REFLECTIONS

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Abstract

In Spanish listed firms, taking into account the predominant modes of ownership structure, which are characterized by a high concentration of shares in the hands of a few shareholders who are strongly represented on the board of directors, it might suppose that there are strong stimulus for a close top managers' supervision and a straight interest alignment. However, the empirical evidence indicates the opposite, and this paradox needs to be explained within the theoretical framework of institutional theory. The high concentration of ownership and the high level of cross-holdings generate conflicting interests by those who have multiple roles as directors and top managers, suggesting that board's supervisory effectiveness may be compromised by social pressures in search of legitimacy. These features of Spanish firms are undermining governance mechanisms, and may explain the high pay levels, the low variable packages and, in general, the lack of connection between top managers' compensation and firm performance in comparison with those in other countries of Continental Europe.

Keywords: Corporate Governance, Compensation, Board of Directors, Ownership

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1. Introduction

Top managers constitute one of the key strategic groups for the survival and the success of the company. One of the most interesting areas of study, not only for academic and practical reasons, but also for considerations of social justice, is the matter of their compensation. The huge sums of money paid to top managers compared with other members of the organization have stimulated considerable debate. To this must be added the recent financial scandals in large and well-known companies, whose origin, in greater part of cases, has been the actions of the top managers focusing on their own interests.

Scholars have examined the dynamics of this problem on the basis of agency theory, analyzing whether top managers' compensation responds to variations in firm performance (Jensen and Meckling, 1976; Gomez-Mejia and Wiseman, 1997). To achieve this matching, they propose a range of governance mechanisms that make adequate top managers' supervision and reduce the negative effects of their opportunism, guaranteeing interest alignment between top managers and owners (Jensen and Murphy, 1990; Murphy, 1999). The effectiveness of those mechanisms has consequences in terms of the design of top managers' compensation packages (Core et al., 1999; Cyert et al., 2002). Although there are several mechanisms of governance available to companies, the most valuable in ensuring the appropriate top managers' compensation have normally been ownership structure and board of directors (Core et al., 1999).

There is already a substantial body of literature about the relationships between ownership structure, board of directors, top managers' compensation, and firm performance, although for the most part in an Anglo-Saxon context. Generally, studies have found that top managers' compensation is more modest and linked to firm performance when ownership structures are concentrated in the hands of non-manager directors, with a significant presence of institutional investors (Mehran, 1995; Khan et al., 2005), and boards of director are well dimensioned and balanced between insiders and outsiders, with an independence functionality of compensation committees (Hermalin and Weisbach, 2003; Dalton and Dalton, 2011).

However, studies in the Continental Europe context are scarce considering that models of organizational governance are significantly different from those in Anglo-Saxon companies (Pedersen and Thomsen, 1997; Faccio and Lang, 2002). There are more complex and heterogeneous interests in large Continental European companies governance as a consequence of the more concentrated and diverse structures of ownership, which results in multiple roles of managers-owners that has a direct and unequivocal effect on the design of top managers' compensation (Balkin, 2008; Gospel and Pendleton, 2005). Institutional theory (DiMaggio and Powell, 1983) present a theoretical framework from the perspective of social effectiveness to explain this phenomenon, taking into account the interplay of the interests of the different actors and their actions as they seek legitimacy in responding to the pressures of the organizational governance context (Kostova and Roth, 2002).

Considering this, there are several reasons why the analysis of top manages' compensation in Spanish listed firms should received particular attention from the perspective of corporate governance. First, because Spain is characterized by a relatively small stock market and, in consequence, the supervision mechanisms rely heavily more on contractual and internal monitoring than on the external control market of companies (La Porta et al., 1999; De Andrés et al., 2005). Second, because since 2007 companies have faced new regulations relating to the information about top managers' compensation, due to the implementation of *Código Unificado de Buen Gobierno* (2006) -similar in its philosophy to the Cadbury Code (1992). Third, because internal governance mechanisms are involved in concentrated ownerships, with very few majority shareholders and with significant cross-holding between them (Salas, 2002; De Miguel et al., 2004), which result on boards with multiple directors-managers roles (Baixauli-Soler and Sanchez-Marin, 2011; Sanchez et al., 2011). All of this supposes a new interesting scenario for analyzing the effectiveness of governance mechanisms and the consequences in terms of top managers' compensation and firm performance.

This article starts with a review of the literature on the relationships between top managers' compensation, ownership structure, and board of directors. This is followed by a detailed analysis of the characteristics of ownership structure and board of directors in Spanish listed firms, which makes it possible to explain the peculiarities of top managers' compensation. Finally, the article ends with the main conclusions, which are the object of discussion and reflections in terms of the future of effective organizational governance.

2. Top managers' compensation, ownership structure, and board of directors: empirical evidence

Owners may use contracts design as one way of reducing agency costs, establishing rewards that top managers receive in exchange for expecting firm's activities and results (Jensen and Meckling, 1976). Generally, owners will seek with contracts to ensure that rewards received by top managers are determined in such a way that the maximization of their personal wealth to be aligned with the maximization of economic value of the firm (Jensen and Murphy, 1990; Murphy, 1999). Then, majority of literature has concentrated on analyzing whether there is some relationship between what is paid to top managers –compensation- and what is retained by the organization –performance- (Gomez-Mejia and Wiseman, 1997; Tosi et al., 2000).

On this basis, studies that have gone furthest of contracts' limits, have examined the supervisory relationships between owners and managers and their social interactions (Westphal and Zajac, 1995). This view is based on effects of monitoring mechanisms through which owners supervise top managers on links between compensation and firm performance (Core et al., 1999; Cyert et al., 2002). In particular, studies in this line have examined several aspects related to the capacity of owners to monitor top managers' behaviors, founding that ownership structure and board of directors are elements that significantly affect supervision effectiveness and have an impact on top managers' compensation (Hermalin and Weissbach, 2003; Khan et al., 2005).

Top managers' compensation and ownership structure

Ownership structure refers to the form in which the title and rights are distributed to represent the social capital of the organization, being the endogen result that reflects the influence of shareholders and the movement of shares in the market (Berle and Means, 1932). Ownership structure operates as a natural mechanism of supervision by owners over top managers in the organization (Shleifer and Vishny, 1997).

However, as a result of technical and market restrictions, ownership structure of large companies is not merely a reflection of the equilibrium between owners and managers (Jensen and Meckling, 1976; Demsetz, 1983): although a higher level ownership concentration could avoid certain agency problems, it requires more specialized top managers who could be able to develop complex organizational structures that spread the risk among the owners.

Analysis of ownership structure and owners' capacity to supervise top managers may be conducted through the study of three principal features (Morck et al., 1988; Mehran, 1995): (a) type of control exercised in the company (absolute, majority, minority or internal) which makes it possible for shareholders to intervene; (b) level of ownership concentration among shareholders (percentage of shares that are directly or indirectly held by the main shareholders); and (c) institutional group that exercises control (family, other national companies, other foreign companies, financial institutions, public sector, or the market).

With reference to the ownership concentration, most of the evidence supports the idea that when ownership is concentrated there is better control of the top managers and, therefore, they are paid at lower level and more directly linked to firm performance (Tosi and Gomez-Mejia, 1989, 1994). However, this supposed positive relationship between ownership concentration and top managers' monitoring does not always result in an alignment of interests; the characteristics of the majority shareholder and his or her ability and incentives to exercise supervision also influence the extent to which top managers are effectively supervised (Rediker and Seth, 1995; Bozec and Bozec, 2007). The manner in which the majority shareholder can pursue his or her interests influences the effectiveness of supervision by the board of directors and has a significant influence on the top managers' compensation and its link to the firm performance (Werner et al., 2005).

In this sense, if top managers own a significant proportion of the company, this produces several distinct scenarios in relation to the design of compensation. Most of the literature presents a consensus that there is an inverted U-shaped relationship between managers' ownership, effectiveness of supervision, and compensation (Morck et al., 1988; Lambert et al., 1993). In general, if top managers own enough shares, it produces an "alignment effect", which reduces the agency costs because of the greater motivation and involvement of top managers in organization, so that their compensation will be determined to a certain extent by the firm performance. In this way, top managers will have lower levels of pay and more strongly tied to the organization's success (Sanchez-Marin et al., 2011). But if top managers own a sufficiently large proportion of shares to the extent that they can control the company, this produces an "entrenchment effect", as a result of which top managers now have the power to manage the board in accordance with their individual preferences. This inefficient situation for the company results in higher fixed salaries for top managers with relatively little connection to firm performance (Mehran, 1995).

Finally, the presence of significant institutional investors who can pursue their interests as owners can also imply of an influence over top managers' behavior monitoring and on the design of their compensation packages (David et al., 1998). Although there are some exceptions, where institutional investors do not improve the supervisory effectiveness of the board (Rajan, 1992), the most part of literature (Useem y Gager, 1996; David et al., 1998; Hartzell y Starks, 2003; Khan et al., 2005) recognizes that the presence of institutional investors will result in greater top managers' monitoring, which positively affect to firm performance. This has an influence on top managers' compensation, which is lower in overall terms and with a greater part being more strongly linked to performance.

From these arguments it is possible to conclude that the evidence supports the notion that in order to find compensation packages that align owners and managers' interests, and thereby reduce agency problems, ownership should be concentrated in the hands of a few shareholders, with a moderate share of top managers –so long as the point is not reached where they have the company control-, and with a significant presence of institutional investors (Tosi and Gomez-Mejia, 1994; Core et al., 1999).

Top managers' compensation and board of directors

As an intermediate organism between shareholders and managers, board of directors is the principal internal mechanism for resolving agency conflicts in the firm (Jensen, 1993) and, as such, focuses its efforts on the behaviors' monitoring of managers. Empirical studies suggest that board of directors' effectiveness as a supervisory mechanism mainly depend on three aspects (Hermalin and Weisbach, 2003; Denis and McConnell, 2003): (a) the board's characteristics in terms of both its composition and size, (b) the board's structure in relation to the presence of duality, and (c) the board's functioning in relation to the role of the committees through which it operates.

In relation to board size, researchers have not arrived at definite conclusions as to whether there are a number of directors that optimizes effectiveness of top managers' supervision. In general, studies suggest that supervision effectiveness increases with the number of board members, and that this is reflected in reduced levels of top managers' pay and bonuses more directly related to firm performance (Yermack, 1996). However, an excessive number of directors may have a negative effect on the monitoring capacity, making the board less effective in the supervision of top managers –for example, Jensen (1993) indicates that there should not be more than 10 board members- and in the design of aligned compensation packages. Thus, as Coles et al. (2008) indicate, the supervisory effectiveness of the board improves when its size reflects the level of company's complexity.

With reference to the board composition, empirical evidence suggests that the supervisory effectiveness is better if there is a majority of external (non-executive) directors (Boyd, 1994; Conyon and Peck, 1998), and it is especially supportive if those external directors might be qualified –and act- as independents (Dalton et al., 1998). Although this relationship has been presumed to hold, as indicated by the recommendations of various codes of good governance, research's meta-analyses have not found evidence that the presence of independent directors does in fact improve the effectiveness of top managers' supervision (Dalton y Dalton, 2011). Notwithstanding this, it seems that there is a certain inverse relationship between the top managers' pay level and the proportion outside directors who are independent (Core et al., 1999; Sanchez-Marin et al., 2010).

Another relevant element related to supervisory effectiveness of boards is duality, which is produced when the firm's CEO is at the same time the chairman of the board (Rechner and Dalton, 1991; Boyd, 1995). In the case of duality, top managers participate actively in the board of directors functioning, converting it into a organ that is subject to personal preferences, including issues related to compensation packages (Conger and Lawler, 2009). Although the latest evidence on this question is ambivalent, especially in relation to the links between duality and firm performance (Dalton and Dalton, 2011), the majority of studies have found that the level top managers' compensation is higher and less closely tied to firm performance when the chief executive officer is also the chairman of the board (Boyd, 1995; Baixauli-Soler and Sanchez-Marin, 2011).

In relation to compensation committees, although there is not a clear consensus as to whether the existence of such a committee reduces the agency costs (Klein, 1998), in general, it has been found that compensation committees controlled by independent members have a positive influence on the effective setting of top managers' compensation packages (Daily et al., 1998; Vafeas, 2003). In this case, the existence of a strong compensation committee is related to lower levels of top managers' pay and highly linked to performance (Conyon y He, 2004; Conyon y Peck, 1998).

Therefore, we can conclude that, although the evidence is not extremely conclusive, especially in relation to the link between board and firm performance (Dalton and Dalton, 2011), as far as the top managers' compensation are concerned, it is likely that the board, in order to be effective, should have a number of directors suited to the firm's complexity, a significant presence of external independent directors, a non-duality structure, and a compensation committee that operate in an independent manner.

3. Governance mechanisms and top managers' compensation in Spain

From an institutional perspective, the design of top managers' compensation packages is not only determined by principal-agent conflicts, but also by conflicts between the diverse interest groups – stakeholders- in the organization in response to institutional and social pressures, and looking for legitimacy (Balkin, 2008; Gospel and Pendleton, 2005). It is necessary, in this sense, to know the peculiarities of ownership structure and boards of directors of the Spanish listed firms in order to obtain a global explanation of the determinants of top managers' compensation from the perspective of how is affected by governance mechanisms –ownership structure and board of directors- and to what extent is configured as an element which allows to align interests for gaining organizational efficiency.

Ownership structure in Spanish firms

What are the main features of Spanish firms' ownership structure? Salas (2002), focusing on listed firms found, in relation to the nature of control, that 75% of the Spanish firms are distributed fairly between family control groups, financial institutions and other companies. Furthermore, according to the type of control, almost 60% of firms are under absolute or majority control. With regard to the figures of capital concentration, Salas (2002) points out that the major shareholder owns more than 25% of shares in 70% of companies, while the first shareholder owns the majority of shares in 35% of companies.

Santana and Aguiar (2006), analyzing Spanish listed firms' ownership structure based on the last owner, found that about 50% of companies are controlled by family groups, noting a growing trend in this area and that follows a reverse direction in the case of the presence of financial institutions as last owners, which control about 18% of companies. Thus, these authors confirm the existence in Spain of highly concentrated ownership structures and mainly family controlled, saying that it is the typical structure of countries with weak defense of the interests of minority shareholders and foreign investors by the legal system (De Miguel et al, 2004).

The *Observatorio de Gobierno Corporativo* (2009) also reaches similar conclusions to those of previous studies. First, it notes the high shareholding concentration that characterizes Spanish listed firms, as well as in Continental Europe, which is reflected in the largest shareholder, who reaches 36.4% of shares, and in the three major shareholders, who own around 50% of property. As regards the typology of dominant shareholder, it point out that 22.8% corresponds to the non-financial companies, 16.5% to financial institutions, and 19.8% to individual investors and families, ascending the freefloat to 39.2%. Also, it is revealed high rates of concentration of ownership in boards, with a 23.6% on average, from which 9.8% are in the hands of the director managers.

Finally, the *Informe Anual de Gobierno Corporativo de las Sociedades Cotizadas en España* (2009) noted that, at the aggregate level, the ownership distribution is divided into significant non-director shareholders (34.1% of the shares), board of directors (29.0%), and freefloat (35.8%). With regard to ownership concentration, in 31.4% of firms there is any physical or legal person exercising majority control, while in 75% of firms the sum of significant shareholders and shares owned by the board exceed 50% of ownership. In addition, a 75.3% of director managers keep significant shares' participation in their companies, of which approximately one-tenth exceed 10%. Finally, there is a high rate of cross-holding shares between Spanish listed firms: 35 firms are significant shareholders of 47 companies.

In short, all the previous studies confirm, without exception, that ownership structure of Spanish listed firms is very concentrated, with few shareholders who have a large proportion of shares, with high cross-holding shares, with a more direct and highest family group shareholding, with a moderate presence of institutional investors, and with few variations in the power structure of the firm.

Board of directors in Spanish firms

The *Pronunciación del Círculo de Empresarios* (1995) argued that "the competitive, social and political context in which the Spanish company has traditionally been developed has led to a passive and opaque board of directors expressed in the lack of independence of the non-manager directors, the underrepresentation of minority shareholders, the scarce and delayed information provided, the small internal debate, the insufficient dedication, and the conflicts of interest". It is clear that this is not the current situation of Spanish boards. They have been improving due, primarily, to the rules and principles of good governance developed over the past two decades and which have been compiled and published in the recent *Código Unificado de Buen Gobierno* (2006). Several studies help us to shed light about the current features of board from the point of view of its supervisory effectiveness.

Salas (2002) stated on the boards of listed companies in Spain that, in general, their participation in the social capital tends to be elevated, reaffirming the close connection between owners and top managers in the majority of firms. With regard to its size, find that directors in the Spanish companies averages 11, while the median of the distribution is 9, size that can be considered as reasonable. As regards the board composition, 25% of directors are internal or top managers, and therefore, the remaining 75% are external directors –although it does not refer to their level of independence.

García and Gill de Albornoz (2004) find that the average size of the boards in Spanish listed firms is 11.5 directors and indicate a slight downward trend in their sizing. In their composition, in a consistent way with the (highly concentrated) typical ownership structure of the Spanish companies, dominical directors are the most represented, with an average of 40% of the total representation, followed by the independent directors, with a 38%. On the other hand, 90% of boards have over 51% of external members (dominicals and independents), while only 9% is composed totally by external members.

The *Observatorio de Gobierno Corporativo* (2009) evidence that boards of directors average 11.3 members and that the proportion of independent directors is 32.4%, although in more than half of companies freefloat capital is underrepresented by the independent directors. Also there is not proportionality between dominical and independent directors and the capital which they represented. As regards the board structure, 62.7% of firms present duality, being the chairman of the board also the CEO of the company. In the functioning vein, compensation committee operates in 93% of firms, and is composed by 52.5% of independent directors, and chaired by an independent in 72.7% of firms.

Finally, also the *Informe Anual de Gobierno Corporativo de las Sociedades Cotizadas en España* (2009) shows similar results. In 85.3% of firms, the board size is between 5 and 15 members, and the average number of directors is situated in 10.4. The average proportion of external directors is 81.7%, of which 30.5% are independent directors. The board structure indicated that chairmen are mostly top managers in 70.5% of the firms; in 58.3% of companies the chairman assumes duties of CEO. With regard to compensation committee, 84.6% of firms have constituted it, being formed, on average, by 3.6 directors, half of which are independent and whose president is independent in 75% of times.

It can be concluded, based on these studies, which the board of directors of the Spanish listed firms moderately follows the recommendations of the *Código Unificado de Buen Gobierno* (2006). Thus, have an average size –in line with the recommended-, an insufficient proportion of independent directors, an excessive presence of duality CEO-chairman, as well as a detrimental and high percentage of directors in several boards of different companies, and, finally, an appropriate level of compensation committees with a moderate proportion of independent members.

Top managers' compensation in Spanish firms

The study of top managers' compensation in Spain is limited by the lack of public information about them. Contrary to what is happen in U.S. and U.K., Spanish listed firms are not obligated to report on the detailed compensation, limiting to report it at the aggregate level, in spite of transparency principles arising from the *Código Unificado de Buen Gobierno* (2006).Spanish listed firms show low levels of individualized information for top managers and directors. For this reason, to make an analysis of the top managers' compensation must be limited to use aggregated data provided by the *Comisión Nacional del Mercado de Valores* –the Spanish Security Exchange Commission-.

The *Informe Anual de Gobierno Corporativo de las Sociedades Cotizadas en España* (2009) notes that average compensation perceived by the board members reach 3.05 million euros in 2009, with an average by director of 291,725 euros, representing an increase of 7% over previous year. The average pay by manager director is 1.1 million euros, increased 11.7% over previous year. The compensation of external directors amount 104,365 euros, representing a decrease of 2.1% annual, although do not affect equally all the types of directors: compensation of dominical and other external directors declines annually 5.7% and 13.6% respectively, while independent directors increased, on average, 6.5%. Finally, the number of non-manager directors amount to 1,216 and their average pay stand at 416,590 euros, which represents an increase of 1.3% over previous year. As regards the compensation components, fixed pay per board has continued to grow, with a rate of variation of 0.8% over previous year, and variable pay –which only has been paid for 50% of firms- has reached an average of 1.33 million euros per board, increasing 9.1% over previous year.

A more detailed analysis of these data can be found at the *Observatorio de Gobierno Corporativo* (2009), which states that listed firms' boards pay reach approximately 3.36 million euros (3.05 million more 316,493 euros for the positions occupied by some directors in affiliated companies). Manager directors individual compensation average 1.1 million euros, while for external directors, the average pay is 89,000 euros for dominicals and 97,000 euros for independents. The individual average remuneration for non-director managers reached 405,000 euros. With regard to the components, 40% of total compensation of the board is approximately fixed pay, which has been increasing in the last few years, just accompanied by minimal and temporary variations in the variable pay and stock options.

Furthermore, the *Observatorio de Gobierno Corporativo* (2009) provides a uniform basis to show the link between total boards' compensation and the total firms' benefits. The findings state that while average reduction of firms' benefits reached 8% in the last two years, the in total board's compensation average decrease only 0.29% and 0.72%, respectively. This evidence suggests a high level of rigidity in compensation that, moreover, is worsened by frequent "golden parachutes" contracts for top managers –a practice implemented by two-thirds of companies-, contributing to blur the connection between top managers' compensation and firm performance.

From an academic perspective, Gispert and Ortín (2002), after a revision of the Spanish empirical evidence, state that top managers' compensation is weakly linked to shareholders' wealth. These authors point out that, although there is not a similar study to Jensen and Murphy (1990) in Spanish context, the scarce evidence indicate that top managers' compensation are more related to firm size than to firm performance. In this sense, one of the main conclusions of the Heidrick & Strugless Report (2006) is that, in majority of Spanish companies, top managers always get their compensation –mainly in fixed pay components-, regardless of performance of the firm.

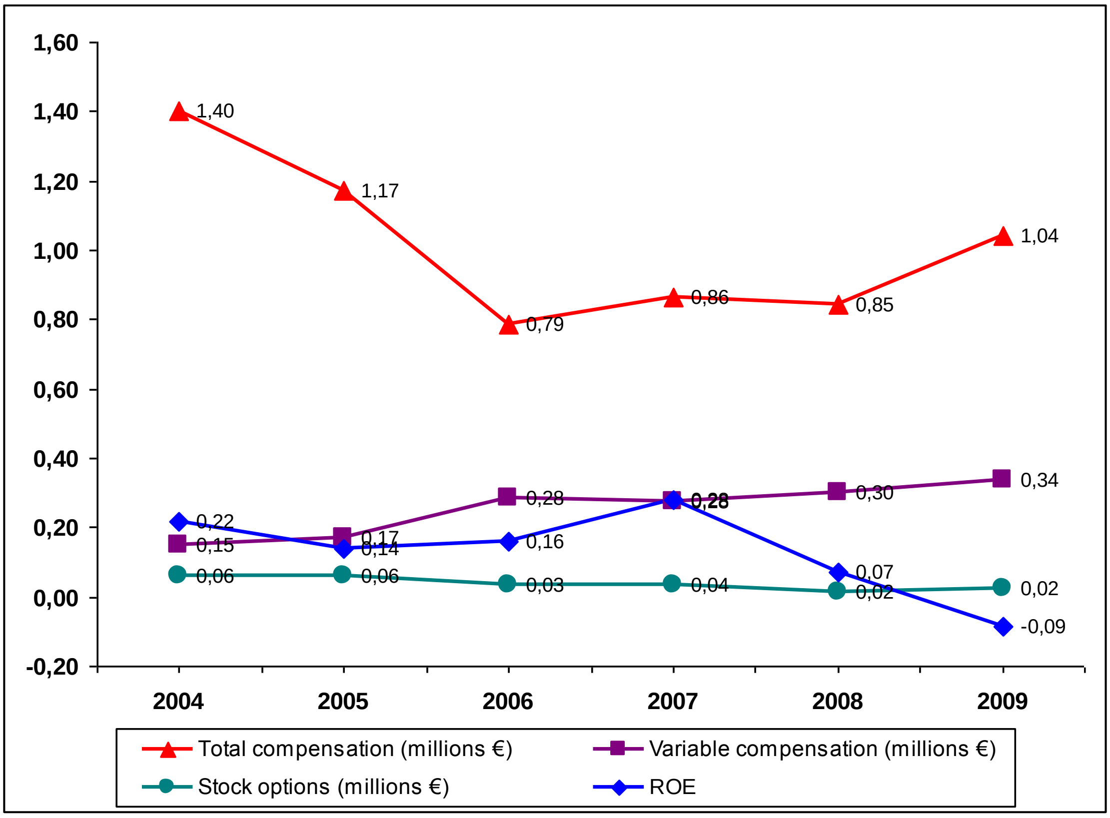
Nevertheless, more recently studies linked to corporate governance have clarified these general conclusions. Thus, Sánchez-Marín et al. (2010) found that, for the period 2004-2006, Spanish listed firms reduce top managers' total pay when smaller is the number of directors and greater is the proportion of external directors in the board. In addition, authors note the moderating effect of boards: lower pay levels of top managers as a result of more board's supervisory effectiveness are associated with higher firm performance. However, although pay level has moderated, the greater linkage of variable pay with firm performance is still pending.

In another recent article, Sanchez-Marin et al. (2011) analyze the ownership structure and board of director's influence on top managers' compensation of Spanish listed firms in the period 2004-2007. Results show that the degree of concentration of ownership and the typology of shareholders –top managers, institutional investors, and external owners- significantly determine the board's supervisory effectiveness and, at the end, influence top managers' pay level. The high concentration of ownership and the high level of cross-holdings counteract, in most cases, the board's supervisory effectiveness which explains high levels of compensation top managers received during the period analyzed.

Moreover, Baixuali-Soler and Sanchez-Marin (2011), examining a more comprehensive panel data covering the period 2003-2007 found that board characteristics and ownership structure of the Spanish listed firms' moderate capacity to adjust top management team pay level to changes in economic and complexity factors. Authors conclude that corporate governance system peculiarities significantly influence the determination and adjustment of top managers' compensation and that association among board, ownership structure, and compensation is lower in Spain than in Anglo-Saxon countries and Continental Europe. The high concentration of ownership and the heavy dependence and social intervention of boards with regard to top managers explains theirs high pay level scarcely linked to firm performance.

Finally, analyzing these relations from a global perspective, figure 1 shows data on individual top managers' compensation of Spanish listed firms during the period 2004-2009. As noted, average trend of total compensation has fallen during the period until reaching 1.04 million euros in 2009. Meanwhile, return on equity (ROE) of companies has experienced a growing until 2007, falling subsequently to reach negative figures in 2009. However, proportions of variable pay have increased throughout the period and amounts of stock options have remained stable. Furthermore, it should be note the low weights of variable components –they do not exceed 30% in 2009- in total compensation of top managers.

Figure 1. Individual top managers' compensation and performance for Spanish listed firms. 2004-2009



Source: Developed by the author using data from Spanish Security Exchange Commission.

Hence, empirical evidence overwhelmingly indicate a lack of appropriate link between top managers' compensation, both in fixed and variable pay, and performances of Spanish listed firms. In comparative terms (La Porta et al., 1999; Gospel and Pendleton, 2005; Balkin, 2008; Baixauli-Soler and Sanchez-Marin, 2011) this lack of linking is more severe in Spain than in other countries of Continental Europe and in the US and UK. The Spanish listed firms must, therefore, further articulating more efficient boards around ownership structures that facilitate top managers' supervision in order to set adequate compensation packages as suitable mechanisms for strategic alignment between ownership and management (Gispert and Ortín, 2002).

4. Conclusions and discussion

Corporate governance is the system by which an organization sets and integrates internal and external control mechanisms that balance the potential conflicts of interest, arising from the separation between the ownership and control (Demsetz, 1983; Denis and McConnell, 2003). This article examines the forms and conditions that both board of directors and ownership structure should be taken to become effective supervisory mechanisms influencing design of top managers' compensation towards increased levels of sensitivity to variations in firm performance.

Both board of directors and ownership structure, by adopting the forms and conditions stablished by literature (Core et al., 1999; Cyert et al., 2002), may be configured as effective supervisory mechanisms that reduce agency costs aligning owners and managers' interests and improving firm performance (Jensen and Meckling, 1976; Jensen and Murphy, 1990). The influence of such mechanisms in the design of top managers' compensation is, therefore, quite clear due to such compensation desing is used as a tool for monitoring top managers' behaviors (Gomez-Mejia and Wiseman, 1997). However, power of top managers may often lead organizations to inefficiencies in such supervisory mechanisms, resulting in inappropriate compensation designs and negative performance effects (Murphy, 1999; Tosi et al., 2000).
International empirical evidence has found that ownership structure, although a less direct supervisory mechanism than board of directors, has significant effects on top managers' compensation and firm

performance (Core et al. 1999; Khan et al., 2005) conditioning the board's supervisory effectiveness. In general, literature has showed that, in order to set compensation packages that align owners and managers' interests, ownership must be concentrated in the hands of few owners (Werner et al. 2005), with a significant involvement of top managers -without having the organization control- (Tosi and Gomez-Mejia, 1989, 1994), and with a significant presence of institutional investors not linked either with the management or with the rest of owners (David et al., 1998).
International evidence has not been so harmonized examining effects of board of directors on firm performance (Dalton and Dalton, 2011). Nevertheless, literature has been found some positive influences at compensation level (Hermalin and Weisbach, 2003) in the sense that top managers receive lower pay levels and more closely associated with performance when the board size conforms to the dimension of firm complexity (Yermack, 1996; Coles et al., 2008), when there is a majority presence of independent directors (Boyd, 1994; Conyon and Peck, 1998), when there is not duality in CEO and chairman positions (Boyd, 1995; Conger and Lawler, 2009) and when there are compensation committees functioning in a independent manner (Daily et al., 1998; Vafeas, 2003).

On the basis of studies carried out from a more institutional vision (Balkin, 2008; Gospel and Pendleton, 2005), this article support the idea that board peculiarities and ownership structure of the Spanish firms have a great significance in the effectiveness of supervision of top managers and, therefore, in the design of their compensation (Baixauli-Soler and Sanchez-Marin, 2011). Spanish top managers' compensation is characterized by a high fixed pay proportion, while variable part –quite suited for aligning interests between managers and owners and solve agency problems- has a low weight and is still slighty related to firm performance. Thus, empirical evidence in Spain indicate that the weakly linked of top managers' compensation package to shareholders' wealth is a direct result of the inefficient corporate governance system –ownership structure and board of directors- (Baixauli-Soler and Sanchez-Marin, 2011; Sanchez-Marin et al., 2010, 2011).

In this sense, Spanish listed firms are characterized by a ownership structure insufficiently inclined towards the independence and effective monitoring of their boards of directors, which are heavily institutionally intervened as a result of high levels of concentration and cross-holding between directors and managers (Salas, 2002; De Miguel et al., 2004). These results that, in principle, could be positive from the viewpoint of agency arguments –the greater ownership concentration, the lesser top managers' pay level- are not convince from an institutional perspective: in comparison terms with the rest of Continental European countries, Spain is situated among those that higher level of compensation give to their top managers (Heidrick & Struggles Report, 2007).

It seems to be deduced that the main problem of organizational governance in Spanish firms are related to ownership structure which, in turn, determines the board's supervisory effectiveness. The high concentration of ownership is not used to benefit minority shareholders and translating into pay cuts for top managers (De Andrés et al., 2005; Baixauli-Soler and Sanchez-Marin, 2011). First, because in most cases, ownership is concentrated in the hands of owners who are members of top management, which easily "entrench" themselves, because the low level of ownership needed in order to be influential on the Spanish boards (Sanchez-Marin et al., 2011). Therefore, top managers have a great discretion to override the board of directors and establishing themselves higher pay levels. And second, given the multiple cross-holding existing in Spanish listed firms (Salas, 2002; De Miguel et al., 2004), boards independence could be put into question, as a result of the multiple problems of agency they face (Rajan, 1992). As result, top managers' compensation is not affected and remains high despite the presence of majority owners.

Therefore, following Leech and Leahy (1991), who found a significant and negative relationship between ownership concentration and firm performance, not always a majority shareholder eliminates agency problems because of, for several reasons, may not be enough involved in firm governance not exercising an effectiveness monitoring through the board. In the case of Spanish listed firms, it is clear that, due to institutional environmente affecting organizational governance, concentration is not beneficial to minority shareholder interests (Sanchez-Marin et al., 2011; De Andrés et al., 2005).

Despite these results, we believe that internal control mechanisms –such as board of director and ownership structure- are effective tools to align owners and managers' interests. In this sense, we think that in Spain there are clear opportunities to advance along this way, because, in the positive side, typical Spanish firms ownership structure (characterized by having a shareholding very concentrated, represented on board of directors, which reaches, on average, more than 60% of social capital, and which is usually controlled by a family group) also present strong incentives for boards to monitor top managers' behaviors when a variation in shareholders wealth takes place (Fernandez et to the., 1998). Moreover, privatizations in recent years have increased the presence in the Spanish market of companies with a more dispersed ownership structure, where shareholder representation on the board is much lower. These companies might be, in principle, the most likely benefit from the design of top manages' compensation schemes sensitive to changes in the wealth of shareholders.

Hence, only through effective board of directors and with structures of ownership that facilitate top managers' monitoring is how the design of compensation may be a mechanism that really operate in terms of strategic alignment between ownership and control. Even though the proposals and recommendations which, in this sense, has been through the introduction of codes of good corporate governance, there are still many actions to take to deep in this way (Baixauli-Soler and Sanchez-Marin, 2011).

Searching for effective organizational government systems required public and private economic institutions to further develop rules of good governance, which obligate firms to practice individualization and transparency with regard to top managers' behaviors and compensation. The objective of strengthening firms' reputation, through greater internal and external control must have an impact in a better functioning of boards, in a shareholding participation reinforcement in the decision-making process –especially minority shareholders-, indluding those of related to the design of pay systems linked to performance, avoiding short term decisions that may reduce the –economic and social- future value of the company. Success of these measures must primarily lie in an effective system of signals (Gispert and Ortín, 2002) implemented by key drivers in companies: managers, owners, directors.

Finally, these results suggest that there is still considerable room for improvement in the governance of the Spanish listed companies: on the path of progress in the implementation of the recommendations of the codes of good governance, on the path of the necessary awareness with respect to articulation of monitoring mechanisms, and on the path of the design of top managers' compensation systems linked to economic and social performance of the firm.

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