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Corporate Governance in European Banking

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Abstract

The banking systems of the EU-15 countries presents varied characteristics, including features from the Anglo-Saxon market based system and more bank-based system, prevalent in most of continental Europe. The pluralistic structure of EU banking systems, the varied nature of corporate governance arrangements and different business models represent a strength of the EU banking sector but also a factor that may hinder further integration and the emergence of a truly European banking model. This paper presents a survey of the corporate governance features of banking institutions in the EU-15 countries. Working on the notion that corporate governance is influenced by cultural values, we presented an analysis clustering EU countries on the basis of their legal system, language family and proximity as indicators of cultural differences. Our results highlight that cultural and legal differences are still strongly embedded in national cultural identities and these seem to drive the majority of difference in corporate governance arrangements.

Keywords: corporate governance, EU banking, financial integration, cultural differences

JEL Classification: G21; G34

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1. Introduction

Since the signing of the Treaties of Rome in 1957, the European Union (EU) has grown to a union of 27 member states and a population of nearly half a billion citizens. Nowadays, the EU is the largest integrated economic area in the world, accounting for more than 20% of the world's GDP.¹ The financial sector has played a key role in the process of EU economic growth. Since the introduction of the First Banking Directive in 1977 (77/780/EEC), the deregulation of financial services, the establishment of the Economic and Monetary Union and the introduction of the euro have helped creating the Single Market for financial services. European authorities consider financial integration one of the key issues for making Europe more efficient and competitive and, ultimately, for contributing to sustainable economic growth (ECB, 2005). Indeed, EU financial integration has brought with it a range of benefits, from increased income generation, to improvements in technology and risk management, increased access to funds, risk diversification and deepening of financial markets.²

Despite the positive achievements, critics argue that the Single Market can never operate properly across an area with such different cultures and levels of wealth. Whether it is a question of North to South or East to West, there seem to be identifiable cultural fault lines across the European continent. There are, of course, common values and some European common culture, but definitions are complex.³ It is therefore apparent that, even with the recent emphasis on integration, Europe is not a monolithic bloc of countries. Quite to the contrary, EU authorities struggle to find a common European identity that can generate widespread support in all member states. Europeans mostly identify themselves with their own nation and the dominance of national interest over the common EU interest became all the more obvious during the recent financial crisis. The injection of public funds into troubled financial institutions highlighted the gap between the rhetoric of an integrated Europe and the reality of national interests. Still, far from being powerless, the EU has been at the forefront of the coordination of the rescue plans designed by the Member States and of the reform of the financial system (EC, 2008, 2009a).⁴

¹ World Economic Outlook Database (IMF, 2010).

² There is a vast literature on EU financial integration. Freixas et al. (2004) review the objectives of the Financial Services Action Plan (FSAP) to integrate European Financial Markets. Most studies find some evidence of integration in money, bond and equity markets and in wholesale banking (Emiris, 2002; Cabral et al., 2002; Hartmann et al., 2003; Baele et al., 2004; Manna, 2004; Guiso et al., 2004; Capiello et al., 2006). However, most empirical evidence suggests that significant barriers to the integration of retail banking markets still exist, driven mainly by cultural and political differences (Berger, 2003; Berger et al., 2003; Heuchemer et al., 2009). Gropp and Kashyap (2009) propose a new test of integration based on convergence in banks' profitability (ROA) while Casu and Girardone (2010) propose the use of efficiency measures.

³ Guiso et al. (2006) define culture as customary beliefs and values that ethnic, religious and social groups transmit fairly unchanged from generation to generation. In other words, it refers to those inherited, long standing traditions, or "slow moving" components of culture that remain fairly unaltered during an individual's lifetime. These include commonality of religion; commonality of language; somatic and genetic distance and geographic proximity. In addition, there are factors that may capture more recent aspect of cultural tradition, but unlikely to be substantially altered during an individual's lifetime (hence contributing to their cultural norms); these include the origin of the legal system, a country's history of wars and history of political institutions (Guiso et al., 2006, 2009; La Porta et al., 1998; Tabellini, 2010). A full analysis of the different components of culture is outside the scope of this paper. Nevertheless, cultural factors may affect corporate governance features. Consequently, we attempt to include a cultural perspective in our analysis, as detailed in Section 3.

⁴ See also De Larosière Group (2009) report.

It is argued that the Single Market for financial services was in a way too successful, as it allowed the creation of cross-border financial institutions that are too large relative to individual member states, thus highlighting the need for an integrated framework for cross-border crisis management and resolution (EC, 2009b; Fonteyne et al., 2010). Regulators have also begun to question the suitability of financial institutions' supervisory systems and investigate whether existing corporate governance mechanisms in financial institutions are incomplete or poorly implemented (EC, 2010).

The impact and outcomes of the crisis have however been different within the EU member states, with some countries' banking systems worse affected than others. For example, because of their conservative business models, Italian banks have done better than their larger UK and continental peers. While this conservatism and lack of global ambition were previously seen as major weaknesses, analysts now applaud Italian banks for their focus on traditional banking models.⁵

Post crisis, European bank managers are facing a difficult business environment and the strategic implications of this could be substantial. It is likely that the future of EU banking will be shaped by regulatory initiatives that will favour stability over profitability (ECB, 2010). Against this backdrop, this paper surveys the corporate governance features of banking institutions in the fifteen countries that were members of the European Union prior to the latest enlargement (Fourth Enlargement, Phase 1 in 2004 and Phase 2 in 2007).⁶ While we aim to account for European diversity, there is still a large disparity between the countries comprising the EU-15 area and the newer member states. This is true in terms of the overall standards of living⁷, but also in terms of management and corporate culture. For this reason, we focus on the area also known as "old Europe", comprising: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Luxembourg, Italy, the Netherlands, Portugal, Spain, Sweden and the United Kingdom. The remainder of this work is structured as follows: Section 2 reviews the different systems, structures and models in EU banking. Section 3 offers an insight on bank corporate governance features in the EU-15, taking into account national and cultural differences. Finally, section 4 concludes.

2. EU banking: systems, structures and models

The banking systems of the EU-15 countries presents varied characteristics, including features from the Anglo-Saxon market based system (prevalent in the US, UK and the Netherlands) and more bank-based system, prevalent in Germany and in most of continental Europe.⁸ In recent years, the demarcation lines of this common classification of financial systems have become increasingly blurred and it is nowadays generally accepted that bank intermediation and capital market funding

⁵ The impact of the financial crisis on the Italian banking system has been relatively moderate compared to other countries. Italian banks have largely remained focused on traditional retail operations and corporate lending, relying on customer deposits to fund day-to-day operations. Because of the limited presence in their balance sheets of the assets hit hardest by the crisis and their lower dependence on wholesale funding, Italian banks mostly avoided the huge losses and publicly-funded bailouts (Bank of Italy, 2010).

⁶ On 1 May 2004, Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovenia and the Slovak Republic joined the European Union. Bulgaria and Romania joined in 2007.

⁷ Although standards of living have improved considerably over the past decade (in the new member states, income per capita rose from 40% of the old member states' average in 1999 to 52% in 2008) significant differences among member states remain (European Commission 2009c).

⁸ For a review of the literature on comparative financial systems see Allen and Gale (1995); Thakor (1996); Allen and Gale (2000). For a review of banking structures in the EU, see Goddard et al. (2010).

activities are complementary. Nevertheless, to better understand the different characteristics of the EU-15 banking systems, it is useful to briefly address the main typology that distinguishes the two common types of financial systems. These differences are also reflected in two main models of corporate governance, the more liberal Anglo-Saxon model and the more concentrated continental model.

In a bank-based system, banks are the most important source of external financing for firms, although at a various extent. Bank-client relationships are close and the universal banking model is widespread. Informational barriers are more significant, as incumbent banks have informational advantages over new entrants (Petersen and Rajan, 1994; Dell'Araccia, 2001; Hauswald and Marquez 2006). In countries where the universal banking model prevails, the share of foreign ownership is lower, consistent with the idea that entry is more difficult (Steinherr and Huveneers, 1994; Affinito and Piazza, 2008). The corporate governance regime is pluralistic and mainly stakeholder-oriented, and allows different stakeholder groups to play an active governance role. Ownership is often concentrated and corporations tend to be controlled by large shareholders (including banks).

In a market-based system, on the other hand, capital markets usually are the main sources of firm financing. Bank-client relationships are typically at arm's length and thus have less contractual flexibility than relationship-based finance. Even though universal banking activities are allowed in all EU countries following the implementation of the Second Banking Directive (89/646/EEC), market-based systems tend to favour bank specialisation, either by law or tradition. In addition, in market-based countries, non-bank financial intermediaries also play an important. Corporate governance is shareholders-oriented rather than stakeholders-oriented, ownership tends to be dispersed and the mechanism of management control relies mostly on market forces.

Llewellyn (2006) considers two further dimensions when describing the different structures of EU banking systems: Shareholder Value models (SHV) and Stakeholders Value models (STV). The former is based on the notion that banks are primarily firms whose main objective is to maximise shareholder value. In contrast, in the STV model, a bank has many stakeholders and profit maximisation, while important, is not necessarily the exclusive, or even primary, objective of bank management. This distinction is also a reflection of cultural difference: the SHV is typical of Anglo-Saxon systems while the more general STV model is found in continental Europe, where there is a legacy of state ownership, pluralist ownership structure is more prevalent and the market in corporate control is less active.

In terms of EU banking systems integration, until 2007 the trend was towards a degree of convergence in the direction of a more market based approach with emphasis on ROE maximisation. Post-crisis, because of the vast losses and the substantial government intervention in the banking sectors across the EU, there is little public support for banks returning ROE ratios of well above 20%, as these have mostly proved to be unsustainable (ECB, 2010). The emphasis is now to ensure that bank profitability is "*sustainable*" and returns to investors "*fair*".

In this context, the pluralistic structure of EU banking systems, the varied nature of corporate governance arrangements and different business models represent a strength of the EU. In the remainder of this paper we will present a brief analysis of EU banking structures and corporate

governance arrangements to identify factors that might contribute to the emergence of a truly European banking model as well as factors that may increase the existing segmentation of EU banking markets.

2.1 EU Banking Structure

National banking systems within the EU vary considerably in terms of bank size, types of banks and ownership structure. Table 1 illustrates the main structural characteristics of the EU-15 banking sectors in the year 2009. Market differences are apparent, both in terms of number of banks and overall size of the banking sector. Larger countries, such as Germany, Italy and the United Kingdom, have more fragmented markets, whereas smaller countries, such as the Netherlands, Finland and Greece being characterised by more concentrated banking sectors.

< Insert Table 1 >

Table 2 illustrates the breakdown of each country's banking sector total assets into size groups and into domestic (large, medium-sized and small banks) and foreign-controlled branches and subsidiaries.⁹ Large banks dominate the banking sector in the UK, Sweden, the Netherlands and France, whereas no bank passes the "large" threshold definition of the European Central Bank (ECB) in Austria, Finland, Greece, Ireland, Luxemburg and Portugal.¹⁰ Indeed, British banks account for nearly 18% of the total consolidated assets of EU banks, followed by German and French banks, with 13% and 15% respectively.

A large share of the domestic banking sector in some EU countries is foreign owned, particularly in Ireland, Belgium, Finland and Luxemburg. Traditionally, foreign banks specialised in the commercial and wholesale markets, but in recent years they have made significant acquisitions in the retail banking business.

< Insert Table 2 >

In terms of banking models, the EU banking landscape is dominated by large universal banking groups that have also considerable activities abroad; over the last two decades EU large banks have grown in size and have broadened geographically and in terms of products offered. Although both diversified and specialised banks were affected by losses, write-downs and recapitalisations during the crisis, diversified institutions have proven to be more resilient, possibly owing to clearer synergies between private, retail, corporate and investment banking. Also, diversified or universal banks are based on strong customer relationships and more stable sources of funding (deposits), making them on average better able to withstand liquidity shocks (ECB, 2010).

Recent developments support therefore the view that the universal banking model will gain further importance within the EU, although the development will be shaped by the new regulatory framework implementing stricter capital and liquidity requirements. The next step is to investigate

⁹ The ECB defines foreign banks as subsidiaries and branches that are controlled by either an EU or a non-EU parent that is "foreign" from the reporting country's point of view. The data for these institutions are excluded from the definition of the domestic banking sector (ECB, 2010).

¹⁰ "Large" banks are defined as credit institutions with assets totalling more than 0.5% of the total consolidated assets of EU banks. The total consolidated assets equalled to €39,589 billion in 2009 and relates to the total consolidated assets of the EU-27 banks, as estimated by the European Central Bank (2010).

whether a particular corporate governance structure also appears to support a banking model that has proven more favourable to financial stability.

3. Bank corporate governance in the EU-15

To analyse the corporate governance features of EU banks, we collected an original dataset which includes data on all listed commercial banks and bank holding companies (BHCs) incorporated in a EU-15 country as per June 2009.¹¹ We restrict the analysis to banks with comparable corporate governance structures, and therefore we exclude co-operative, savings, private and Islamic banks. These exclusions do not prevent full sample representativeness for our specific purposes: the aggregate market capitalisation of the banks in the sample accounts for more than 96 per cent of the total EU-15 banks market capitalisation (see Table A1 in the Appendix).

Table 3 illustrates the main features of our sample. While our main focus is on EU banks, for comparative purposes, we also collected information on a sample of over 800 US listed-US incorporated banks. Our final EU-15 sample is composed by 165 observations, of which 114 are commercial banks and 51 are bank holding companies.¹² Adams and Mehran (2008) argue that the organizational structure of a bank may have a significant impact on corporate governance features. This is because holding companies often have complicated hierarchical structures through their ownership or control of banks and other subsidiaries, each separately chartered with its own board. Thus, it is plausible that the coordination of activities across subsidiaries occurs through these boards. This seems particularly relevant in countries such as the US and the UK where publicly traded banks are all organized as banks holding companies (BHCs).

< Insert table 3 >

In an attempt to relate the corporate governance features of EU banks not only to the country of origin, but also to cultural features that some EU countries may share, we further analyse the sample by origin of the legal system and language family. The notion that corporate governance is influenced by cultural values is largely accepted by economic theorists, policy makers and market practitioners (Stulz and Williamson, 2003; Beck et al., 2003; Pagano and Volpin, 2005; Guiso et al., 2006, 2009; Tabellini, 2010).

Referring to the vast literature on the link among legal systems, institutional environment and corporate governance structures, La Porta et al. (1999) indicated that the efficiency of corporate governance rules differs between legal traditions and showed that common-law countries have stronger legal protection of investor rights than civil law countries. Empirical research indicates, for

¹¹ We considered all banks listed on a major stock exchange (NYSE Euronext; London Stock Exchange; Deutsche Boerse; Mercado Continuo Espanol; Luxembourg Stock Exchange; Irish Stock Exchange; Athens Stock Exchange; NASDAQ OMX Nordic Exchange; and Wiener Boerse). We also considered banks listed on additional stock exchanges in Europe (e.g. Berlin, Hamburg, Munich and Stuttgart Stock Exchanges; and Xetra). Data are gathered from Thomson OneBanker, a Fitch dataset which includes comparable market and accounting information on banks.

¹² Following Bankscope's classification – a Fitch/Bureau Van Dijk dataset on banks' financial statements, and ratings -, we define as commercial those banks mainly active in a combination of retail banking (individuals, SMEs), wholesale banking (large corporates) and private banking and not belonging to groups of saving banks, and co-operative banks; as BHC the holding companies of banking groups.

example, that that the Anglo-Saxon system of common law proves more efficient in protecting shareholders' rights (La Porta et al., 2002; Gugler et al., 2003). Laws in different countries are typically not written from scratch, but rather taken from a few legal families or traditions (La Porta et al. 1998). Two broad traditions may be identified: common law - which is prevalent in Anglo-Saxon countries - and civil law, which developed from Roman law. Nowadays, the resulting legal systems reflect both the influence of these two traditions and the changes introduced by individual countries over time. La Porta et al. (1998)'s classification of countries legal systems has become a standard reference; we therefore divide the EU-15 countries according to the origin of their legal system into common law countries (the UK and Ireland) and civil law countries (the remaining 13 countries).¹³

To classify countries by language family, we adopt the official language classification by Haveman¹⁴ and identify five main linguistic areas (Romance, English, German, Nordic and Greek). We then cluster EU countries according to their linguistic origin: Romance (i.e. languages that derive from Vulgar Latin) in the case of Spain, France, Italy, Portugal and Luxembourg; English in the case of Ireland and the UK; and German (i.e. languages that derive from Western German) for Germany, Austria, the Netherlands and Belgium. We then form a fourth group (Nordic) to include those countries not belonging to one of the above mentioned linguistic areas (Denmark, Finland and Sweden). These countries should be separated according to their different origin (Nordic and Finno-Ugric); nevertheless it would add an excessive fragmentation to the analysis. We finally separate Greece, as the Greek language does not share its origin with any of the above mentioned groups.

We further group countries according to their geographical proximity. The geographical distance between two countries and their proximity can have significant effects on bilateral trust affecting both economic and financial exchanges (Guiso et al., 2009). We thus identify four main groups according to their proximity: (i) Southern Europe, which includes Portugal, Spain, Italy and Greece; (ii) Anglo-Saxon countries (Ireland and the UK); (iii) continental Europe - Austria, Belgium, France, Germany, Luxembourg and the Netherlands; and (iv) the Nordic countries group - Denmark, Finland and Sweden.

In the remainder of this paper we apply these cultural classifications to the analysis of corporate governance features, both with reference to the characteristic of the board and to the characteristics of the CEO. In particular, as far as the features of the board are concerned we look at board size, type of board (one-tier vs. two-tier) and average board tenure. In addition, to account for cultural characteristics and board diversity, we consider the presence of women, employees, external and other firms' representatives as well as the presence of international board members. For the CEO, we consider age, gender, average tenure in the bank and average tenure in the sector. We also gathered information on whether the CEO holds an MBA, and was previously employed in the same bank or in the financial sector.

¹³ It is common to further distinguish civil law countries in French, German and Scandinavian legal origin. However, we do not adopt this further classification for the purpose of this analysis.

¹⁴ Following, among others, Guiso et al., (2006), we gather data from Jon Haveman's website: <http://www.macalester.edu/research/economics/PAGE/HAVEMAN/Trade.Resources/TradeData.html>.

3.1 Main features of boards of directors in EU banks

The size and composition of the board of directors constitute the two dimensions of board structure that have been studied most extensively. Improving board structure is one of the core objectives of corporate governance initiatives undertaken by international regulators (OECD, 2004; Basel Committee, 2006, 2010).

Board size

Several studies have hypothesised a negative correlation between board size and firm performance (Jensen, 1993; Hermalin and Weisbach 2003). As board size increases, boards become less effective at monitoring management because of free-riding problems amongst directors and increased decision-making time. In the financial services industry, though, the negative relationship between board size and bank performance does not seem to hold and overall results are mixed. Possible explanations rely on regulatory issues, on informational asymmetries and on organisational structure (Eisenberg et al., 1998; Spong and Sullivan, 2007; Adams and Mehran, 2003, 2008; Andres and Vallelado, 2008).

The mean size of a board in the banking sector ranges from 16-18 directors (Adams and Mehran, 2008; Andrés and Vallelado, 2008). In our sample of EU-15 listed banks, board size is of fifteen members on average. As illustrated in Table 4, differences at the country level are relevant. Swedish banks have the largest boards, with approximately twenty-four members, followed by Irish banks (twenty-one) and Austrian banks (nineteen). Finnish banks, on the other hand, have the smallest boards (10.5 members on average), followed by Danish and Dutch banks (11.2 and 12 members on average).

< **Insert Table 4** >

One-tier v. two-tier board

Looking at board specification, differences among European countries are relevant. A first distinction is between one and two-tier boards.¹⁵ Broadly speaking, in a one-tier structure the board performs all tasks, while in a two-tier structure advisory and monitoring functions are carried out separately. While a one-tier structure is thought to favour information sharing, a two-tier structure can minimise interference from large shareholders (Adams and Ferreira, 2007). Therefore a two-tier board may have developed as a valuable option in continental Europe where firm ownership is more concentrated. The two-tier structure is predominant in Germany and was recently adopted by some Italian banks. On the other hand, sole board is prevalent in Anglo-Saxon countries, where the emphasis is on board independence through the presence of external directors (Hermalin and Weisbach, 2003).

Table 4 illustrates the breakdown of board specification by country, legal system, language family and proximity. Fifty-six per cent of the banks in the sample have a two-tier board system. The preference for a dual board system is confirmed in civil law countries; whereas a sole board system prevails in common law countries. In the US, 88.5 per cent of banks adopt one-tier board. In the EU

¹⁵ In some countries this choice might be dictated by the existing regulatory framework.

sample, country-specific differences are relevant. In Austria, Germany and Sweden more than seventy-five per cent of banks have a two-tier board. In contrast, a one-tier board has been chosen by 100 per cent of banks in Ireland, Luxembourg and the Netherlands. Interestingly, eighty-nine per cent of Spanish banks favour a one-tier board. In recent years, Spanish banks have been particularly active in the UK banking market, characterised by one-tier board prevalence. Looking at language families, German-speaking countries predominantly chose two-tier boards (eighty per cent) for their banks.

Average length of tenure

The second board specification of interest is the average length of tenure.¹⁶ Longer tenure may have a positive effect on bank corporate governance, leading to major stability and deeper knowledge of the bank's business model. This could help the board to better carry out both the advisory and the monitoring tasks. In addition, as longer tenure is linked to higher entrenchment, an established board should be able counterbalance more effectively a CEO's power. However, longer tenure can also signal lower board dynamism (Schleifer and Vishny, 1997). Despite the potential relevance, factors determining the board length of tenure and turnover received less attention in the literature compared to other board features. Reasons include that the composition of the board changes only moderately over time. Turnover is also influenced by the rules for election in the board (e.g., proposal from previous board; nomination by the CEO or by a nomination committee). Yermack (2004) documents a positive correlation between board turnover and CEO turnover, thus casting doubts on inference drawn on the correlation between board turnover and firm performance. Interestingly, he also documents significantly lower turnover rates for female directors, while Faleye (2007) finds that electing boards on staggered terms has no significant effect on board turnover. Del Guercio et al. (2008) find that firms attacked by activist investors (for example mutual funds and private investment groups) experience a higher level of director turnover.

Average tenure of bank boards in the EU-15 is four and a half years. In the US, on average directors remain in charge nearly twice as long (8.2 years). In civil law countries tenure is longer compared to common law countries (4.6 vs. 3.6 years). Countries belonging to the Romance language group have the longest tenure in the EU (5.1 years) whereas English-speaking countries have the shortest length of tenure (3.6 years). Looking at proximity, Nordic countries have the longest tenure whereas Anglo-Saxon countries still remain at the bottom of the ranking. Once again differences among countries are striking: length of tenure ranges from seven-year in Spain to two-year in Greece.

Board composition and board diversity

Board composition is another relevant board feature, crucial to aligning the interest of management and shareholders (Hermalin and Weisbach, 2003). The composition of boards varies according to the representation of insiders, outsiders, shareholders or stakeholders, which have different monitoring capacities and interests. The literature has focussed mainly on the relative proportion of non-executive directors and outside directors, including other firms representative, employees

¹⁶ Turnover is usually computed as one over the length of tenure and gives the probability of changing the board in the following year (Weisbach, 1988; Perry and Peyer, 2005).

representatives and external members. More recently, board diversity has become the focus of public debate as well as academic research, with the emphasis towards fostering gender diversity, together with ethnic diversity and age dispersion of board members. The main argument to support diversity is that a more diverse management team tends to be more creative, more innovative and, when making decisions, may consider a wider range of alternatives. In addition, more diverse boards should protect minorities, guarantee differing opinions are taken into account, and be harder to manipulate. However, diversity may also bring costs: heterogeneous boards may be less efficient; the decision-making process may be slower and as the likelihood of reaching consensus may be smaller (Carter et al. 2003; Carter et al. 2010).

As women directors add to the diversity of the board, their inclusion can also have mixed outcomes. Although the literature on the impact of women's presence on the boards of directors of banks is still in its infancy, Mateos de Cabos et al. (2009) indicate that women are less likely to appear on smaller boards and where preference for homogeneity is stronger. In other words, homogeneous boards that are male-dominated will continue holding back the access of women to top positions on banks. As a consequence, they suggest that cultural differences explain part of the heterogeneity in the presence of women on the boards, and that differences among European countries are significant. In general, empirical studies focusing on firm demand for female directors underline the role of the country's socio-political beliefs and attitudes towards women, work and families, the gender historical role in the government, public and private initiatives in increasing the possibility of individual woman's career progression (Terjesen et al., 2008).

<Insert Table 5 >

Differences in board composition in EU banks are illustrated in Table 5. In European bank boards, other firms' representatives and external members usually account for around 15 per cent of the board members; while women and employee representatives are respectively 9 and 7 per cent. EU banks include a wider array of representatives in their boards compared to US banks. External and other firm representatives are present in Spain and Luxembourg (51 and more than 20 per cent of board members). The presence of other firms' representatives is usually associated to bank cross holdings; hence a higher percentage is noticeable in those EU countries such as Austria, Germany and Portugal where cross holdings are common practice.

Heterogeneity in board composition may be also partially explained by differences in legal systems: in common law countries board diversity seems greater in terms external and women members (29 and 11 per cent versus 14 and 9 per cent). In contrast, employee and other firm representatives are present predominantly in countries with civil law systems (7 and 15 per cent vs. 0 and 7 per cent). These differences may be caused by existing laws; in some EU countries regulations guarantee a minimum presence of employee and other firm representatives on board of directors.¹⁷ As a

¹⁷ Mitbestimmung (co-determination, i.e. the presence of workers on firms' board) was introduced in Germany by law. Co-determination is regulated by three statutes for different sectors of the economy and sizes of company. The system which provides the most extensive form refers to the coal, iron and steel industry, governed by the 1951 Montan-Mitbestimmungsgesetz. Companies in other industries with between 501 and 1,999 employees are covered by the corresponding provisions of the 1952 Betriebsverfassungsgesetz, under which employee representatives occupy only one third of seats on the supervisory board. Lastly, the 1976 Mitbestimmungsgesetz covers all standard forms of company normally employing more than 2,000 employees. This provides for equal numbers of representatives from the

consequence, in Austria and Germany the average number of employee representatives is more than twice the average of all other European countries.

Cultural differences among countries in terms of board diversity can also be identified by looking at language families and proximity. As can be seen from Table 4 and 5, in German-speaking countries, the average size of board of directors is of 14.5 members, which includes employee representatives (16 percent) and other firm's representatives (21 per cent) but few external representatives. In English speaking countries, on the other hand, board size is slightly larger (15.8 members on average), and includes external representatives (29 per cent) and women (11 per cent) but no employees representatives. As expected, in Southern European countries (which are often under the spotlight for perceived gender inequalities in the workplace due to more traditional cultural values), women presence is below the EU average (although this is not the case in Spain). In Nordic countries, on the other hand, we find the largest presence of women on boards, greater than in English speaking countries, including the US.

Table 5 also illustrates a proxy for the cultural diversity of the board. In this context, we measure cultural diversity by the number of nationalities represented by board members. This spans from one (i.e. all directors are national of one country and no foreign director are present) in Finland and Ireland, to seven different nationalities (in Italy). Among the EU-15 countries, only Belgium, Portugal and the UK have a prevalence of multicultural boards (67, 60 and 70 per cent of banks have foreign board members). In contrast, Denmark, Greece and the Netherlands have a prevalence of domestic board members (only 4, 17 and 14 per cent of banks have international members respectively). Multicultural board members can increase board diversity and therefore add new perspectives to board discussion. However, cultural misunderstanding and mistrust may occur and cause inefficiency in board meetings. These cultural biases are so rooted that they affect even the equity portfolio allocation of professional investors in equity funds (Guiso et al. 2006).

English-speaking countries host the higher number of multicultural boards (63.6 per cent). Nordic countries have the least international boards (6 per cent). Interestingly, Southern and continental Europe show similar patterns (28 vs. 32 per cent of banks with international boards). Even if European Union laws guaranteed the free movement of workers within the EU (Article 30 EU Treaty), cultural barriers such as differences in languages still prevent full board internationalisation. English-speaking countries seem to represent the preferred destination for foreign workforce (including high flying international bankers). To compare the EU and the US, almost all US banks have fully domestic boards (only 8 per cent of banks have foreign board members). A possible explanation relies on different immigration policies. In the US, immigrants have to apply for work visa and green card applications can be part of the hiring package. In the EU, working visas are required only for non-EU citizens.

employee side and the company side on the supervisory board, which consists of 12, 16 or 20 members according to the size of the company.

3.2 CEO features in European banking

This section of the analysis concentrates on the impact of Chief Executive Officers (CEOs) features for corporate governance. Bank CEOs are key decision makers and their personal attributes and behavioural biases (for example risk aversion or overconfidence) affect both the quality of the information available to the board of directors and corporate investment decisions (Adams and Ferreira, 2007; Malmendier and Tate, 2005, 2005; Thakor and Goel, 2008).

The managerial power hypothesis argues that CEOs may be able to control board decisions due to higher managerial influence.¹⁸ This situation is more likely to arise where shareholding is dispersed and passive, where board are large and heterogeneous, and where CEOs are older, and with longer tenure in the bank. This may exacerbate agency problem, since the board becomes less effective in monitoring CEO behaviour. Adams et al. (2005) argue that in firms run by powerful CEOs - that is those who can consistently influence board decisions - the risk of judgement errors is higher, thus increasing the variability of firm performance. There is a vast literature on managerial compensation in the financial sector and its impact on managerial decision and risk taking (John and Qian, 2003; Chen et al., 2006). More recently, the emphasis has been on the role of managerial compensation in the recent financial crisis, but results are mixed (Fahlenbrach and Stulz, 2009; Beltratti and Stulz, 2009; DeYoung et al., 2009; Erkens et al., 2009; Chesney et al. 2010).

To investigate CEOs features in EU banking we refer to the following variables: age, gender, average tenure in the bank, average tenure in the financial sector, education (MBA) and career trajectory, as illustrated in Table 6.

<Insert Table 6 >

European banks CEOs are on average fifty-six years old, similarly to US banks' CEOs. CEOs' career trajectories are mostly internally focused (employee to executive): fifty-two per cent of CEOs have been previously employed in the same bank. The average tenure in the bank (as employee as well as CEO) is of ten years and the average length of employment is the banking sector of almost twenty-nine years. EU banks CEOs have therefore a long standing expertise in the industry, which is likely to provide them with reputation and power. In Belgium, Finland, Luxembourg, Portugal and Ireland more than eighty per cent of bank CEOs are promoted internally. This guarantees continuity in bank management policy and culture, resulting in longer tenure and lower turnover. Internal managerial promotion and CEO succession planning are important strategic decisions for companies, as they affect managerial incentives, firm valuation, and CEO entrenchment. However, insider CEOs may have an increased control over the board of directors and this may hinder change.

Another variable that can both increase CEOs control over the board of directors and hinder change is CEOs age. On average, older CEOs with longer tenure are, *ceteris paribus*, more powerful. In Austria and Portugal, bank CEOs are on average sixty-two years of age, with long tenure both in the

¹⁸ On the role of CEO compensation in overcoming agency problem see, among others, Oxelheim and Wilborg (2008).

bank and in the financial sector (more than twenty and more than thirty-two years respectively). On the other hand, relatively younger bank CEOs are found in Finland, Ireland and Sweden (fifty years old or younger, on average). Italian banks have relatively young CEOs (fifty-three year old, on average), despite the fact that CEO tenure is below EU average. A possible explanation may be that a relative higher percentage of CEOs (thirty eight percent) are outsiders rather than internal promotions. Interestingly, banks in English-speaking countries not only have on average older CEOs, but also have CEOs with the longest tenure in the sector (thirty-four years). Furthermore, seventy-five per cent CEOs are internally hired. As internal career is notoriously slower, banks in English-speaking countries have far more entrenched and conservative CEO on average than other EU countries.

The proportion of women reaching top positions is still very low in most EU countries: only two per cent of European bank CEOs are women, the same representation as in the US. Sweden, with twenty-five per cent women CEO, the UK (nine per cent) and France (four per cent) are the only European countries above the average. In absolute terms, "Latin-speaking" countries share the same number of women CEO as Nordic and English-speaking countries. However, confirming commonly held beliefs about the role of women in the workplace in Southern Europe there are no female bank CEOs. This evidence reflects the mixed results in the literature. Given the fact that not all banks have women in senior positions, it is difficult to identify the relationship between female participation and firm performance. Levi et al. (2008) examine whether the gender of CEOs or corporate directors plays a role in the pricing of and returns on mergers and acquisitions. Their results suggest differential abilities of men versus women in discovery of target company values with women appearing to be able to reach more realistic values. Huang and Kisgen (2009) analyse whether men and women differ in corporate financial decisions. They find that acquisitions made by female CFO firms have significantly higher announcement returns and argue that women appear to undertake greater scrutiny and exhibit less hubris in acquisition decisions. While the academic literature may recognise the benefits of female participation in firms top managements directors, this recognition is still poorly reflected in the actual appointments.

Without entering the debate whether an MBA makes a better CEO, we collected data on specialised post-graduate qualifications. On average, twelve per cent of EU banks CEOs hold an MBA. In the US this percentage is slightly higher (14 per cent). MBA are popular among bank top executives in Ireland, Spain and the UK: over twenty seven per cent of CEO holds an MBA. This may be the case because both Spain and the UK host the highest-ranked business schools in Europe.¹⁹ Usually firms can better gauge the value of an MBA qualification if the business school awarding the degree has a strong reputation in the same country where the firm's prevalent business and headquarters are located. It may also be the case that MBA students would pursue careers in the same country where they obtain their qualifications. This may be particularly the case for the UK, currently the most developed financial market in the EU. MBA are popular in English-speaking countries, where 33 per cent of CEOs holds the qualification compared to 8 per cent of CEOs in German speaking

¹⁹ According to Financial Times Global MBA Rankings 2010, in the highest twenty positions ten schools are based in the US, three in Spain, two in France, and in the UK: <http://rankings.ft.com/businessschoolrankings/global-mba-rankings>.

countries and 2 per cent of CEOs in Nordic countries. This result points out the higher relevance attached to MBA education in Anglo-Saxon countries and in southern Europe.

4 Conclusions

Despite the EU efforts towards financial integration and the creation of a EU banking model, our survey of the corporate governance features of banking institutions in the EU-15 countries indicates that country specific characteristics still play an important role. Working on the notion that corporate governance is influenced by cultural values, we presented an analysis clustering EU countries on the basis of their legal system, language family and proximity as indicators of cultural differences.

The standard classification of a more market based Anglo-Saxon system versus a more bank-based continental European system seems to be still prevalent in shaping corporate governance arrangements. Looking at board characteristics, a two-tier board is the predominant structure in continental Europe (particularly in German-speaking countries). On the other hand, sole board is prevalent in Anglo-Saxon countries and, interestingly, in Spain.

In continental European civil law countries board tenure is longer, boards are more heterogeneous but less multicultural. CEOs tend to be younger and to have followed an external career path to the top job. In English-speaking, common law countries, boards are slightly larger, board tenure is shorter, boards are less diverse in terms of employees or other firm representatives, but include a larger proportion of external representatives, women and foreign members. CEOs are on average older. Furthermore, the majority of CEOs are internally hired and a significant proportion holds an MBA.

Cultural and legal differences are still strongly embedded in national cultural identities and these seem to drive the majority of difference in corporate governance arrangements. Prior to the crisis, it was possible to notice a certain degree of convergence towards a more market-based, shareholder value oriented model. The financial crisis has reversed this trend and brought about a revival of more traditional banking models. On the other hand there are signs that this reversal may only be temporary, as increased labour mobility, standardised post-graduate specialised MBA courses and the emergence of more diverse and multicultural boards may act as a catalyst to reduce structural and cultural differences within the EU.

The sole common feature on both Anglo-Saxon and continental European countries seems to be the under-representation of women on boards. The proportion of women CEOs of EU banks is only two percent, the same as in the US. However, some interesting insights can be drawn from cultural classifications. Firstly, differences among language families do not fully reflect commonly beliefs. "Latin-speaking" countries have more women and more international representatives on bank boards' than German speaking countries and equivalent to Nordic countries. Southern Europe also has banks with younger CEOs compared to both continental and Anglo-Saxon peers.

We would have expected stronger similarities between “Latin” and German speaking countries, since both adopt a universal banking model. However, individual countries’ banking systems have shaped it according to their different requirements and backgrounds. Similarities can be found in terms of CEOs features, but there are noticeable differences in terms of board size and board structure, where “Latin-speaking” countries displays features closer to the Anglo-Saxon model rather than to the traditional continental European universal banking model. This is also reflected in differences in the percentages of external and employee’s representatives. It seems that a third possible model, combining features of the two baselines models emerged in a number of EU countries.

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Table 1: EU banking structure

	N. of banks	N. of branches	N. of Employees	Total Assets (EUR millions)	HHI	CR5
AT	790	4,167	77,246	1,036,597	414	37.2
BE	104	4,316*	65,985*	1,155,506	1,622	77.1
DK	164	1,996	50,101	1,104,536	1,042	64.0
FI	349	1,538	24,879	387,630	3.120	82.6
FR	712	38,479	492,367*	7,155,460	605	47.2
DE	1,948	39,411	685,550*	7,423,967	206	25.0
GR	66	4,078	65,673	490,134	1,184	69.2
IE	498	1,228	38,178	1,323,584	881	58.8
IT	801	34,035	322,575	3,691,965	353	34.0
LU	147	229*	26,416	797,460	288	27.8
NL	295	3,137	110,000	2,217,008	2,032	85.0
PT	166	6,430	62,221	520,188	1,150	70.1
ES	352	44,431	267,383	3,433,283	507	43.3
SE	180	2,147	49,071	934,534	899	60.7
UK	389	12,360	471,095	9,420,998	467	40.8

Notes: AT = Austria; BE = Belgium; DK = Denmark; FI = Finland; FR = France; DE = Germany; GR = Greece; IE = Ireland; IT = Italy; LU = Luxembourg; NL = Netherlands; PT = Portugal; ES = Spain; SE = Sweden; United Kingdom = UK. HHI = Herfindahl Index. CR5 = five firm concentration ratio.

All values refer to the year 2009. * denotes 2008 values when 2009 figures are not available.

Source: European Central Bank (2010)

Table 2: EU banks size groups (domestic and foreign banks)

	Total assets of Credit Institutions			
	(EUR millions)			
	Large	Medium	Small	Foreign-controlled
AT	0	747	121	272
BE	514	75	2	600
DK	592	108	41	164
FI	0	103	15	264
FR	5,849	249	4	215
DE	5,057	1,976	607	77
GR	0	385	1	104
IE	0	517	0	822
IT	1,747	656	12	236
LU	0	86	5	783
NL	2,149	379	2	118
PT	0	396	6	109
ES	2,073	1,291	44	333
SE	1,105	109	8	3
UK	6,941	326	32	2,352

Notes: Data based on the consolidated banking data (CBD) provided by members of the Banking Supervision Committee. The CBD data cover nearly 100% of the EU banking sector. Large domestic banks are defined as banks with assets totalling more than 0.5% of the total consolidated assets of EU banks, whereas medium-sized banks have total assets of between 0.005% and 0.5% of total consolidated assets. Banks with total assets of less than 0.005% of total consolidated assets are considered small. The total consolidated assets for the year 2010 refer to €39,589 billion. Foreign banks are defined as subsidiaries and branches that are controlled by either an EU or a non-EU parent that is “foreign” from the reporting country’s point of view (ECB 2010).

Table 3: Sample features - by country, legal system and language family

	Number of banks (percentage)	Number of BHCs (percentage)	Total number of observations
AT	2 40%	3 60%	5
BE	- 0%	6 100%	6
DE	18 95%	1 5%	19
DK	33 94%	2 6%	35
ES	8 89%	1 11%	9
FI	2 40)	3 60%	5
FR	20 87%	3 13%	23
GR	9 75%	3 25%	12
IT	17 81%	4 19%	21
LU	- 0%	2 100%	2
NL	2 29%	5 71%	7
PT	1 20%	4 80%	5
SE	2 50%	2 50%	4
GB	- 0%	11 100%	11
IE	- 0%	1 100%	1
overall EU	114 69%	51 31%	165
US	133 15%	740 85%	873
Legal system			
Civil law	114 75%	39 25%	153
Common law	- 0%	12 100%	12
Language family			
Romance	46 77%	14 23%	60
English	- 0%	12 100%	12
German	22 59%	15 41%	37
Nordic	37	7	44

	<i>84%</i>	<i>16%</i>	
Greece	9	3	12
	<i>75%</i>	<i>25%</i>	
<hr/>			
Proximity			
<hr/>			
Southern Europe	35	12	47
	<i>74%</i>	<i>26%</i>	
Anglo - Saxon countries	-	12	12
	<i>0%</i>	<i>100%</i>	
Continental Europe	42	20	62
	<i>68%</i>	<i>32%</i>	
Nordic countries	37	7	44
	<i>84%</i>	<i>16%</i>	
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Table 4: Board size and specifications - by country, legal system and language family

Country	Size (avg)	1 tier board	2 tier board	Average board length of tenure (year)
AT	19.6	20%	80%	6.2
BE	15.8	67%	33%	6.0
DE	13.6	12%	88%	3.6
DK	11.2	58%	42%	5.2
ES	13.8	89%	11%	7.0
FI	10.5	50%	50%	4.7
FR	18.1	43%	57%	6.1
GR	14.3	33%	67%	2.1
IT	17.8	38%	62%	3.3
LU	14.0	100%		5.4
NL	12.0	100%		3.5
PT	18.8	60%	40%	6.7
SE	23.8	25%	75%	3.8
GB	15.3	64%	36%	3.6
IE	21.0	100%		3.0
Overall EU	15.2	44%	56%	4.5
US	12.9	89%	11%	8.2
<hr/>				
Legal system				
Civil law	15.2	42%	58%	4.6
Common law	15.8	58%	42%	3.6
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Language family				
Romance	17.2	53%	47%	5.1
English	15.8	58%	42%	3.6
German	14.5	20%	80%	4.4
Nordic	12.6	53%	47%	5.0
Greece	14.3	33%	67%	2.1
<hr/>				
Proximity				
Southern Europe	16.2	49%	51%	4.0
Anglo - Saxon countries	15.8	58%	42%	3.6
Continental Europe	15.8	29%	71%	4.8
Nordic countries	12.6	53%	47%	5.0

Table 5: Board features – by country, legal system and language family

Country	External members	Women	Employees representatives	Other firms representatives	International boards
AT	0%	11%	26%	19%	40%
BE	21%	11%	0%	12%	67%
DE	0%	8%	25%	26%	29%
DK	3%	12%	18%	2%	4%
ES	51%	10%	0%	51%	22%
FI	26%	14%	2%	14%	
FR	8%	12%	2%	12%	26%
GR	20%	9%	2%	10%	17%
IT	24%	4%	0%	13%	29%
LU	25%	0%	0%	21%	50%
NL	0%	6%	0%	8%	14%
PT	12%	3%	0%	28%	60%
SE	18%	19%	7%	7%	25%
GB	32%	11%	0%	7%	70%
IE	5%	14%	0%	10%	
Overall EU	15%	9%	7%	15%	27%
US	3%	12%	7%	0%	8%
<hr/>					
Legal system					
Civil law	14%	9%	7%	15%	24%
Common law	29%	11%	0%	7%	64%
<hr/>					
Language family					
Romance	20%	8%	1%	19%	30%
English	29%	11%	0%	7%	64%
German	4%	9%	16%	19%	34%
Nordic	9%	14%	14%	4%	6%
Greece	20%	9%	2%	10%	17%
<hr/>					
Proximity					
Southern Europe	26%	6%	0%	20%	28%
Anglo - Saxon countries	29%	11%	0%	7%	64%
Continental Europe	6%	10%	10%	16%	32%
Nordic countries	9%	14%	14%	4%	6%

Table 6: CEO features – by country, legal system and language family

Country	Average CEO's age	Average tenure in the bank at 2010 (year)	Average tenure in the sector at 2010 (year)	CEO previously employed in the same bank	CEO previously employed in the banking sector	MBA	Female CEO
AT	62	28.5	38.0	60%	60%	0%	0%
BE	63	10.2	33.3	83%	100%	17%	0%
DE	57	8.6	30.3	42%	42%	5%	0%
DK	53	10.7	30.0	31%	40%	0%	0%
ES	58	15.7	33.8	78%	67%	33%	0%
FI	47	10.3	14.0	80%	60%	20%	0%
FR	57	5.8	26.6	35%	22%	4%	4%
GR	62	8.0	20.8	42%	50%	25%	0%
IT	53	9.7	28.6	62%	62%	19%	0%
LU	55	9.0	28.5	100%	50%	0%	0%
NL	53	6.4	23.3	43%	86%	14%	0%
PT	62	20.4	32.0	80%	60%	0%	0%
SE	47	11.8	20.5	75%	75%	0%	25%
GB	59	7.9	34.7	73%	73%	27%	9%
IE	50	2.0		100%	100%	100%	0%
Overall EU	56.1	10.4	28.7	52%	52%	12%	2%
US	56.6	15.7	30.4	64%	61%	14%	2%
Legal system							
Civil Law	54.3	5.0	34.7	86%	86%	64%	5%
Common law	56.0	11.9	27.7	62%	59%	11%	2%
Language family							
Romance	56.0	10.9	29.5	57%	47%	13%	2%
English	57.8	7.4	34.7	75%	75%	33%	8%
German	58.3	11.3	30.2	51%	62%	8%	0%
Nordic	50.8	10.8	23.6	41%	45%	2%	2%
Greece	62.1	8.0	20.8	42%	50%	25%	0%
Proximity							
Southern Europe	57.2	12.0	28.2	62%	60%	21%	0%
Anglo - Saxon countries	57.8	7.4	34.7	75%	75%	33%	8%
Continental Europe	57.7	9.6	29.2	47%	47%	6%	2%
Nordic countries	50.8	10.8	23.6	41%	45%	2%	2%

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Appendix

Table A1: Sample composition

Country	Sample features
AT	All banks and bank holding companies listed on the Wiener Stock Exchange. Oesterreich Volksbanken AG and Volksbank Vorarlberg have been excluded because savings banks. Wiener Privatbank is not considered as it is not a commercial bank
BE	All listed banks and banking groups on NYSE Euronext Brussels and incorporated in Belgium
DE	All commercial banks and bank holding companies listed on the Berlin, Frankfurt, Hamburg, Munich and Stuttgart Stock Exchanges and Xetra and incorporated in Germany. We exclude investment banks, non-credit institutions, real estate, cooperative and savings banks
DK	All listed banks and banking groups listed on NASDAQ OMX Nordic Exchange and incorporated in Denmark
ES	All banks listed on the Mercado Continuo Espanol and incorporated in Spain. Our sample does not include Caja de Ahorros del Mediterraneo CAM, since it is classified as savings bank
FI	All listed banks and banking groups listed on NASDAQ OMX Nordic Exchange and incorporated in Finland
FR	All listed banks on NYSE Euronext Paris and incorporated in France
GR	All banks listed on the Athens Stock Exchange and incorporated in Greece, except the Bank of Greece and T Bank S.A.
IE	We consider the only listed bank on the Irish stock exchange incorporated in Ireland. We exclude the national central bank, the Bank of Ireland.
IT	All commercial banks and bank holdings listed on LSE Borsa Italiana. Banca Popolare di Milano, Banco Popolare di Sondrio, Banco Popolare, Credito Valtellinese and UBI have been excluded since they are classified as cooperative banks. Mediobanca is classified as investment bank
LU	All banks on the Luxembourg stock exchange and incorporated in Luxembourg
NL	All banks and bank holding companies listed on NYSE Euronext Amsterdam and incorporated in the Netherlands
PT	All banks listed on NYSE Euronext Lisbon and incorporated in Portugal
SE	All banks listed on NASDAQ OMX Nordic Exchange and incorporated in Sweden, with the exception of Swedbank as it is classified as savings bank. We
UK	All banks and banking groups listed on the London stock exchange and incorporated in the UK at January 1 st 2009. We exclude Islamic bank of Britain and European Islamic bank.