A Decade of Corporate Governance Reforms in Spain (2000-2010)*

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1. Introduction

In a narrow sense, corporate governance (CG) deals just with the set of relationships between the firm and its shareholders (Shleifer & Vishny, 1997). From a broader perspective, CG can be understood as the set of relationships between the firm and the shareholders, employees and other stakeholders involved in the governance of the firm (Blair and Roe, 1999; Aguilera & Jackson, 2003; Aguilera & Jackson, 2010). Following this last, broader perspective, the purpose of this chapter is to review some of the specific features of CG in Spain, with special emphasis on the relationship between Spanish firms and their shareholders, and the current state of the reforms of the employment relationship in Spain.

The review we present in this chapter is a continuation of previous works covering the patterns of Spanish CG (Eguidazu, 1999; Crespí-Cladera, 2001; Aguilera, 2006; Aguilera, 2003; Leech & Manjon, 2002). These earlier reviews depicted Spain's CG system as a hybrid model characterized by: newly privatized corporations owned by core national and foreign investors; a weak market for corporate control; increasing internationalization of financial markets; a dual labor market system; an emphasis on passive labor market policies; and a selective transplant of 'Anglo-Saxon' best CG practices, such as board independence or transparency and accountability practices (Aguilera, 2006).

This early characterization of CG in Spain is for the most part still valid today, although in the last decade, there have been some changes that need to be explored in detail. Partly triggered by the severe economic crisis since 2008, the Spanish government has reformed some of the CG mechanisms related to the financial system and the labor market that require and justify the update provided in the present chapter. Some of the reforms, such as that of the Spanish Savings Banks (*Cajas de Ahorro*) or the collective bargaining reform, are still ongoing, yet their effects are starting to be observed in the governance of some large Spanish corporations. For instance, the privatization of the savings banks will affect the ownership and control of listed firms. Similarly, the modification of the current employment contracts and the introduction of new collective bargaining rules will lead to higher labor market flexibility and firm-level negotiation between employees and the firm, rather than the industry- or state-level negotiation previously characteristic of Spanish CG.

Later in the chapter, we compare the evolution and current status of Spanish CG with those of other EU countries in order to assess whether there has been a process of convergence or divergence across developed economies over the last decade.

2. The Corporate Governance System

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In this section, we compare the current Spanish CG dimensions relative to a decade ago, to identify evolutionary paths, and to assess to what extent there has been convergence or divergence between Spanish CG and other industrialized countries. We define CG broadly and it includes both its institutional environment -such as the legal system, the financial system, the market for corporate control and the stock market- and governance features such as ownership type and ownership concentration. We discuss each of them in turn.

2.1. The legal framework of CG

In Spain, the legal regulation of CG has evolved in the last years in the context of a higher European legal harmonization. One significant landmark in the adjustment of Spanish regulations to the European legal framework was achieved in 1988 through the Equity Market Law that led to the creation of the *Comisión Nacional del Mercado de Valores* (CNMV). Then, in 2002, the Law on Measures to Reform the Financial System was passed to increase the efficiency and competitiveness of Spanish financial markets and to strengthen investor protection. This law incorporated several European Union Directives into Spanish law. In 2003, a Transparency Law was enacted in order to improve transparency of ownership and corporate control.

More recently, a June 2010 law (12/2010) introduced important reforms for the auditing profession, and to the stock market and corporate law based on the 1885 Commercial Law. This new law sought to comply with the EU harmonization policies and it entails, among other things, a substantive amendment to Spanish corporate law (specifically article 105.2) affecting listed corporations: namely, a prohibition on voting ceilings for shareholders, regardless of the number of shares they own. The amendment means Spanish law is closer aligned with some European countries -most notably Germany and Italy- that prohibit voting ceilings in the bylaws of listed companies. In practice, the new law will make entrenchment tactics more difficult for listed corporations and therefore it facilitates takeovers and the entry of new investors in the ownership of publicly listed Spanish firms.

Overall, the set of regulatory changes introduced in the last ten years foster efficiency in the securities, credit and insurance markets; they increase competitiveness in the financial sector; increase transparency and accountability; facilitate electronic trading and strengthen the Spanish market for corporate control.

In addition to legal developments, and partly as a reaction to the proliferation of corporate scandals (Enron, WorldCom, Parmalat, Arthur Andersen, Tyco, and so on), the Spanish stock market has developed several Codes of Good Governance with the purpose of improving the governance of listed firms. The first code was the 1998 *Olivencia Code of Good Governance* which sought to reform the operation of boards of directors. This first Code also introduced a voluntary ethical code of good governance. An updated Code of Good Governance, known as the *Informe Aldama*, was issued in 2003, and comprises a set of recommendations to increase transparency and security in the financial markets. Although this Code was voluntary (comply or explain basis), a subsequent Law (26/2003) enforced listed companies to publish an Annual Report of Corporate Governance (IAGC) with detailed information on CG practices and structures of corporation.

The last advancement in the field of CG codes took place in 2006 with the introduction of the Unified Code of Good Governance, known as *Informe Conthe*, which sought to harmonize and update the recommendations of the Olivencia and Aldama Codes. The Unified Code is also voluntary, and introduces new practices such as a limit of 12 years for independent board directors or the recommendation to fully disclosure director's individual remunerations.

Taken together, the recommendations introduced by these three codes of good governance seem to move Spanish CG towards Anglo-American practices. Kabbach de Castro and Crespí-Cladera (2011) have compared codes in Spain, Germany and the UK and uncover a remarkable similarity despite their differences in legal origins in these three countries as shown in Table 1, although they also point to critical differences in non-compliance explained mostly by ownership structure.

Table 1. Corporate governance codes: Spain, UK and Germany

Code Characteristics	Spain	UK	Germany
Code Name	Unified Code on Good Corporate Governance: Informe Conthe	The Combined Code on Corporate Governance	German Corporate Governance Code
Date of introduction	2006	1998, reviewed 2003, 2006, 2008, 2009, 2010	2002, amended 2003, 2005, 2006 2007, 2008, 2009, 2010
Antecedents	Código de Buen Gobierno ('The Olivencia Code"), 1998; The Aldama Report, 2003	Cadbury Report, 1992; Greenbury Report, 1995; Hampel Report, 1998; Turnbull Report, 1999; Higgs Report, 2003; Smith Report, 2003.	Baums Commission Report (Bericht der Regierungskommission Corporate Governance), 2001; Berlin Initiative Group - German Code of Corporate Governance (GCCG), 2000; Corporate Governance Rules for German Quoted Companies, 2000; DSW Guidelines, 1998; Gesetz zur Kontrolle und Transparenz im Unternehmensbereich (KonTraG), 1998
Issuing body	Committee organized by the government	Committee related to stock exchange, and business, industry and/or academic association	Committee organized by the government
Objectives	Improve firms' performance, competitiveness and access to capital	Improve quality of the board and its governance and supervision; improve quality of governance-related information available to equity markets	Improve firms' performance, competitiveness and access to capital

Compliance Mechanism	Comply or Explain: creates mandatory disclosure framework (in connection with listing rules) to encourage improved practices	Comply or Explain: creates mandatory disclosure framework (in connection with listing rules) to encourage improved practices	Comply or Explain: creates mandatory disclosure framework (in connection with companies act) to encourage improved practices
Scope of companies considered	Spanish publicly-listed companies	All companies incorporated in the UK and listed on the main market of the LSE	German publicly-listed companies
Legal origins	Civil law, French Origin	Common law	Civil law, German Origin

Source: Kabbach de Castro and Crespí-Cladera (2011).

Finally, in June 2002, the EU adopted the IAS (International Accounting Standard) regulation requiring European companies listed in an EU securities market, including banks and insurance companies, to prepare their consolidated financial statements in accordance with IAS/IFRS (International Financial Reporting Standards) starting with financial statements for financial year 2005 onwards. Consequently, Spanish and other EU listed companies listed have followed IAS/IFRS since 2005, further increasing harmonization of accounting, auditing and CG practices across European countries.

2.2. The financial system

Liberalization, privatization of large public companies, integration with the EU, the launch of the Euro and an increasingly sophisticated customer base have all contributed to the transformation of Spain’s financial system into a modern market. However, after a decade of rapid growth, Spain entered a severe recession in 2008, leading, in particular, to a steep rise in unemployment (above 20 per cent in 2009 and 2010). The recession was triggered by the global crisis but has been reinforced by the sharp domestic adjustment already underway, caused mainly by the oversized residential construction industry. The crisis has accelerated reforms in the financial system, with significant changes in the *banking system*, *institutional investors*, the *stock market* and the *nature of corporate control* as we discuss below.

Spanish Banking System

The Spanish banking system is relatively sophisticated and well developed. Under the prudent supervision of the Bank of Spain (*Banco de España*), the Spanish financial system has shown an apparent high resilience to the *sub-prime* crisis that led to the collapse of Lehman Brothers and other US and EU banks. The resilience of Spanish banks to the financial crisis has been attributed to a lack of sophistication and international exposure of the financial instruments used (e.g., low exposure to US *sub-prime* loans) and the prudential supervision of the Bank of Spain.

The Bank of Spain is empowered to issue accounting ordinances to banks under its supervision, regulating the solvency provisions that cover credit risk. In June 2000, the Bank of Spain introduced a new statistical provision for Spanish credit institutions which should cover the expected losses of the non-impaired portfolio over the cycle and, therefore, counter the cyclical impact of specific provisions on the profit and loss accounts. This mandatory statistical provision partially reduced the exposure of Spanish banks to economic turbulences. However, not all banks in Spain have shown the same financial strength, and savings banks have proven to be, in general, more poorly managed than other types of banks.

In Spain, there are two types of institutions that dominate the sector: commercial banks and savings banks (*Cajas de Ahorros*). Spain's commercial banks are privately owned and publicly traded on the stock exchange. After an intense process of mergers and acquisitions during the 1990s, Banco Bilbao Vizcaya Argentaria (BBVA) and Banco Santander emerged as the two key players. In 2010, they were among the world's top 15 banks (Economist Intelligence Unit, 2010). As a result, there is a high concentration in the industry, with BBVA and Santander accounting for around 80 per cent of the country's commercial banking assets (Economist Intelligence Unit, 2010).

Savings banks account for roughly 50 per cent of the Spanish financial system. The concentration among savings banks has not been, traditionally, as pronounced as in the case of commercial banks. However this situation has been changing rapidly in the last three years. The 46 savings banks operating in Spain in 2009 have expanded throughout the 1990s and 2000s, following an aggressive strategy of mortgage and consumer credit which left them highly exposed to the collapse of the property market in 2008. Amid a rapid deterioration in asset quality in 2009 -non-performing assets rose by 45%-, the Spanish government and the Bank of Spain started a deep restructuring and consolidation in the savings banks sector. This restructuring is being monitored by the Fund for Orderly Bank Restructuring (FROB). In order to foster the consolidation process the bank of Spain introduced the new *Institutional Systems of Protection* (SIP) also called *"fusiones frias"*. The SIPs were born in 2009 as holdings of savings banks where the participating players transfer part of their economic and political power and share the business risks but they keep their autonomy as a legal entity. The idea behind the SIP was that "bad" saving banks could be refloated by operating under the umbrella of a solid financial holding of "good" and "bad" savings banks, without bearing the costs associated to merger and acquisitions. In addition to the SIPs and mergers, the Spanish government announced that those saving banks not able to access the capital markets to increase their core capital ratios will be nationalized by the end of 2011. This nationalization may be, however, temporal until confidence in these institutions is restored.

As a result of this consolidation, there has been an intense process of mergers and acquisitions of savings banks and, at the beginning of 2011, only 17 *cajas* out of 46 remained in the market. These 17 resulting savings banks were the result of acquisitions (La Caixa, BBK), SIPs (Bankia, Banca Cívica, Banco Base, Mare Nostrum, Caja 3), or mergers (Unnim Caixa, Catalunya Caixa, NovaCaixaGalicia, Caja España-Caja Duero, Unicaja). The five remaining independent savings banks are Ibercaja, Kutxa, Caja Vital, Caixa Pollença and Caixa Ontinyent.

In addition, Spanish savings banks started a privatization process in 2010, similar to the privatization of Italian savings banks of the 1990s (Carletti, Hakenes and Schnabel, 2005), that will blur the legal and economic differences with the commercial banks and will foster competition in the financial sector.

The savings bank reforms affect the CG of corporations since they represent more than 50 per cent of the financial system in terms of deposits and loans and since banks –both saving banks and private banks- play a major role in the ownership of Spanish listed firms (see Table 2). In Table 2, we observe how the proportion of bank debt over total debt in Spanish listed firms (26 per cent) has increased since 2000 (21.9 per cent) and it is considerably higher than in some other EU countries such as France (12.5 per cent), Germany (12.9 per cent), Austria (15.9 per cent) and Portugal (25.1 per cent). Italian (33.1 per cent) and Belgian (33.1 per cent) corporations show, however, even a higher reliance on bank debt.

Table 2. Listed firms' bank debt over total debt for selected countries

	2000	**2008**
Spain	21.9	26.0
Austria	27.3	15.9
Belgium	18.3	33.1
France	14.8	12.5
Germany	14.1	12.9
Italy	32.5	33.1
Portugal	33.4	25.1

Source: Banco de España, 2009, p. 169.

The concentration and privatization process of Spanish savings banks will allow them to gain size, increase their core capital ratios and improve their access to funds in the wholesale market - three essential conditions for restoring financial stability. Furthermore, savings banks such as CalalunyaCaixa, Novacaixagalicia and Bankia started to divest some of their industrial participations in listed companies in 2010. As the ownership percentage of savings banks in listed companies is quite significant, the divesture process will have an impact in the CG of large Spanish corporations (see Table 3). For instance, the substitution of savings banks for commercial banks, institutional investors and stock exchange investors in the ownership of listed companies will result in a less politicized CG. It is also likely that, as the stock market and commercial banks replace savings banks, companies will be steadily forced to pursue more short-term strategies since the ‘patient capital’ supplied by the savings banks will represent a lower percentage in the next decade. This search for short-term efficiencies will create, in turn, pressures within companies to restructure labor management practices and traditional employment contracts in order to improve productivity at the firm level.

Table 3. Mergers of Spanish savings banks and ownership percentage in Spanish listed corporations

Old merged Savings banks	New Savings bank	Portfolio of companies	Ownership percentage
Caixa Catalunya	**CatalunyaCaixa**		
Caja Tarragona		Gas Natural	1.6%
Caja Manresa		La Seda de Barcelona	1.1%
		Colonial	0.6%
		Abertis	0.4%
Caja Madrid	**Bankia**		
Bancaja		Banco de Valencia	38.7%
Caja Laietana		Realia	27.7%
Insular		Iberia	23%
Caja Ávila		Indra	20%
Caja Segovia		NH Hoteles	15.7%
Caja de la Rioja		Mapfre	15%
		SOS Corp.	14.7%
		Iberdrola	5.9%
		BME	4.7%
		Abertis	0.9%
		Colonial	0.7%
Caixa Galicia	**Novacaixagalicia**		
Caixanova		Pescanova	24.9%
		Tecnocom	20%
		Sacyr	8.9%
		Elecnor	6.9%
		Banco Pastor	5.4%
		Adolfo Dominguez	5.1%
		GAM	5.1%
		Quabit	4.1%
		NH Hoteles	2.7%
Caja Murcia	**Mare Nostrum**		
Caja del Penedés		Miquel y Costas	18.1%
Caja Granada		SOS Corp.	7.5%
Sa Nostra		Neuron	7.2%
		Rovi	4.4%
		Fersa	4.1%
		Enagás	2.7%
		NH Hoteles	2.7%
		Sacyr	2%
		Iberdrola	0.6%
		Ferrovial	0.2%
Caja Navarra	**Banca Cívica**		
Cajasol		GAM	9.3%

Caja Burgos		Tubacex	8.8%
Caja Canarias		Fluidra	8%
		Amper	7.6%
		Dinamia	7.5%
		SOS Corp.	7.1%
		Unipapel	5.1%
		Campofrio	4.1%
		Cie Automotive	3.3%
		CAF	2%
		Grupo San José	1.8%
		Enagas	1.3%
		Iberdrola	0.5%
La Caixa	**La Caixa**		
		Gas Natural	35.7%
		Abertis	24.7%
		Repsol YPF	11.9%
		Telefonica	5%
		BME	5%
Cajastur	**Banco Base**		
CAM		Sol Melia	6%
Caja Cantabria		Natra	5.3%
Caja Extremadura		Ence	5%
		Indra	5%
		Enagas	5%
		GAM	5%
BBK	**BBK**		
		Iberdrola	7.2%
		Enagas	5%
		Red Electrica	2.2%
Caja Duero	**Caja Duero & Caja España**		
Caja España		Uralita	5.2%
		FCC	2.4%
		Iberdrola	0.8%
Manlleu	**Unnim**		
Sabadell		Abertis	1.6%
Terrassa			
Kutxa	**Kutxa**		
		CAF	20%
		Natra	9.1%
		NH Hoteles	6.1%
		Zeltia	3%

Source: Expansion (2011a).

Institutional investors

The presence of institutional investors (investment companies, insurance companies, pension funds and other forms of institutional savings) has been limited in Spain relative to other OCDE countries and has been stagnated since 2000, as shown in Table 4. While in the period between 2000-2008, the weight of institutional investors increased in France and in Germany, in

Spain it increased just over one per cent from 59.2 per cent in 2000 to 60.5 per cent in 2008. Overall, the presence and influence of institutional investors in Spain is still undeveloped in comparison to other EU countries and 'Anglo-Saxon' economies - in the United States, for example, institutional investors represented 211.2 per cent of the GDP in 2008 (Table 4).

Table 4. Financial assets of institutional investors (as percentage of GDP) (1)

	2000	2008
Spain	59.2	60.5
Austria	84.1	128.2
France	130.7	171.4
Germany	99.3	117.3
Italy	94.3	86.7
Japan	106.1	148.4*
Portugal	52.1	65.4
United States	185.1	211.2

(1) Investment companies, insurance companies, pension funds and other forms of institutional savings.
* 2007 data.
Source: OECD database on institutional investors' assets.

Stock market

The Spanish stock market is highly concentrated with a small number of players in the utility, telecommunications, banking, construction and energy sectors dominating the trading and capitalization. Following the massive privatization program of the 1990s, the introduction of electronic trading and the development of national and foreign investment funds, Spain's stock markets underwent a significant transformation and sustained growth for almost two decades, and the Madrid Stock Exchange is now one of the leading stock markets in the EU.

One of the most important reforms has been the integration of the former four different Spanish stock markets (Madrid, Barcelona, Bilbao and Valencia) into a single holding company, *Bolsas y Mercados Españoles* (BME), with responsibility for trading, clearing and settlement. One key landmark was the creation of the New Market (*Nuevo Mercado*) in 2000, along the lines of the US NASDAQ, the French Noveau Marché or the German Neuer Market, in order to foster investment in highly technological firms. However, *Nuevo Mercado* lost momentum shortly after the dotcom crisis and closed just seven years later in December 2007. In 2008, a new sub-market was created, the MAB (*Mercado Alternativo Bursátil*), aimed at highly innovative start-ups that need to raise funds in the market in order to grow. As of early 2011, the MAB remains a small market with just 13 companies.

The stock market capitalization as a percentage of GDP in 2008 was 59.3 per cent (see Table 5). In 2008, the market capitalization of Spanish listed companies was higher than France (52.3 per cent), Germany (30.3 per cent), Italy (22.7 per cent) and Portugal (28.2 per cent) and close to highly developed stock markets such as Japan (65.9 per cent) and the United States (81.7 per cent). All percentages in Table 5, except for Austria, decrease from 2000 to 2008 due to the dotcom bubble burst shortly after 2000.

Table 5. Market capitalization in selected OECD countries (as percentage of GDP)

	2000	2008
Spain	86.8	59.3
Austria	15.7	17.5
France	108.9	52.3
Germany	66.8	30.3
Italy	70	22.7
Japan	67.6	65.9
Portugal	53.6	28.2
United States	154.7	81.7

Source: World Bank (2009).

Market for corporate control

The market for corporate control is a powerful tool by which markets discipline underperforming managers and firms (Fama and Jensen, 1983; Jensen and Meckling, 1976). This CG mechanism is prevalent in 'Anglo-Saxon' economies. Although the market for corporate control had traditionally not been very active in Spain due to high ownership concentration, firm entrenchment, and the strong control of savings banks, in the last decade the number of takeover bids has been steadily increasing (Table 6) reaching a peak in 2007 with 16 completed takeovers representing a total cash value of 43,179 million Euros. Only in the years following the global financial crisis (2008 and 2009) has this number decreased to the low values of 2008.

The increase in the value of takeover bids in Spain over recent years might indicate certain degree of convergence with other OECD countries. However, the low total number of takeover bids in Spain in 2008 indicates a still-weak market for corporate control, particularly if we take into account that one or two transactions actually account for almost all the takeover value for the entire period (e.g., the Gas Natural and Union Fenosa transaction alone totaled 5.7 billion Euros in 2009).

Table 6. Spanish takeover bids (millions of Euros)

	2000	2002	2004	2006	2008
Authorized					
Number	16	17	19	21	6
Potential Amount	3,059	5,589	7,865	62,615	3,658
Carried out					
Number	14	17	18	14	6
Amount	2,606	4,318	4,648	18,997	3,319

Source: CNMV, 2008, 2009.

Finally, one major barrier to takeovers has traditionally been the existence of a “golden share” in most European countries, including Spain, by which national governments keep certain critical veto decision rights over privatized corporations. In practice, golden shares often deter new entrants from acquiring major stakes in firms regarded as having national strategic interest. This shareholder rights constraint has recently been suppressed in many EU countries triggered by several resolutions of the Court of Justice of the European Union. In Spain, the last golden shares expired in 2006 (Repsol), 2007 (Telefonica) and 2008 (Endesa).

2.3. Ownership Structure of Spanish Firms

One key dimension of CG is the ownership structure of the largest listed firms in a country. Ownership structure varies across national systems and is shaped by country-level characteristics such as stock market development and the nature of state intervention and regulation (La Porta et al., 1998; Aguilera and Jackson, 2010). We analyze the two main features that characterize ownership structure: *ownership concentration* and *ownership type*.

Ownership concentration in Spain

Ownership concentration levels in Spain, as measured by the stock percentage of the largest shareholder, remained relatively constant over the last years (see Table 7), with the common denominator of persistently high. The stability of concentration over time matches the trend in other advanced EU countries. Table 7 depicts ownership concentration by sector. The highest concentration is found in real estate (43.4 per cent) and oil and energy (42.3 per cent), and the lowest in technology and telecommunications (16.3 per cent). The size of the corporation also affects ownership concentration. IBEX-35 (blue chip companies) companies’ concentration (35 per cent in 2008) is generally lower than other listed companies where the single largest shareholder has, on average, a larger participation (about 50 per cent in 2008). One interesting feature of the Spanish case, however, is that small listed firms tend to have an even lower ownership concentration than IBEX-35 and large listed firms (less than 30 percent in 2008).

Table 7. Ownership concentration of Spanish Firms by sector (percentage of largest shareholder)

	2004	**2006**	**2008**
Oil and Energy	25.7	27.4	42.3
Raw materials, construction	39.8	39.7	38.1
Consumer products	24.6	27.4	30.8
Consumer services	35.6	40.3	37.9
Financial services	46.3	44.0	38.6
Technology and telecommunications	22.4	11.2	16.3

Real state	44.0	57.7	43.4
TOTAL	**34.5**	**37.2**	**36.4**

Source: Fundación de Estudios Financieros (2009).

Ownership type

For the last two decades, foreign investors have accounted for more than one third of the total market capitalization of the Spanish Stock Exchange (Table 8), holding for 37 per cent of market capitalization compared to 20 per cent in the mid-1990s. This increase in their participation is related to the major stakes they are acquiring in large listed companies. For instance, in the last few years, the governments of Qatar and United Arab Emirates invested and gained major stakes in firms such as Iberdrola, Cepsa and other corporations in the energy sector. Telefonica, another IBEX-35 blue chip, might be the next objective of Qatari funds (Expansion, 2011b).

One significant feature of Spanish CG is the drop in the ownership participation by the state. The public sector share fell from 16 per cent in 1992 to less than one per cent in 2007 (see Table 8). Following an intense privatization process, the stock formerly owned by the state is now in the hands of foreign investors, collective investment institutions and households. Between June 1996 and April 2001, Spanish state coffers received 30 billion Euros as a result of selling 40 state-owned enterprises such as Endesa (electricity), Aceralia (steel), Iberia (flagship airline) and Telefonica (telecommunications). Due to the recent financial crisis, the Spanish government announced in 2010 a new round of privatizations, such as the 30 per cent it holds in the national lottery company (*Loterías y Apuestas del Estado*) and the 49 per cent of the Spanish air navigator and airport operator (*AENA*). These two partial privatizations alone are valued at 13 billion Euros and their sell would consolidate the long run trend towards a lower participation of the state in the CG of Spanish corporations.

Another pattern modifying ownership structure is the increased percentage owned by domestic (non-financial) companies due to, among other things, the rise of cross-ownership among listed Spanish firms for strategic and diversification purposes and the increased listing of subsidiaries of some large corporations. Cross-ownership, for instance, is prevalent in the Spanish construction sector and contributed to the cascade effect of bankruptcies observed in 2009 and 2010.

Spanish collective investments' share of domestic stocks has risen since 1992 but at a lower volume than expected and, at 18 per cent in 2007, this percentage was still significantly lower than other EU countries such as France (29 per cent), Germany (24 per cent), Italy (23 per cent) and UK (44 per cent). This is due partly to the fact that Spanish households are investing directly in Spanish stocks but are, indirectly, entrusting their investments in foreign shares to investment funds.

Finally, we must highlight how, during the privatization period (1996-2002), individual investors and domestic households increased their share in formerly state-owned companies. In

2007, their percentage accounted for 20 per cent, significantly higher than other EU countries such as France (7 per cent), Germany (13 per cent) and the UK (13 per cent).

Table 8. Ownership structure of listed companies in 2007: various countries (percentage of ownership)

	Spain	France	Germany	Italy	UK
Foreign Investors	37	41	21	14	40
Collective investment	18	29	24	23	44
Domestic firms	25	13	40	26	3
Individual investors /households	20	7	13	27	13
Public sector	0.2	10	2	10	0.1

Source: Federation of European Securities Exchanges (FESE), 2008.

2.4. Board of Directors[1]

The board of directors is an essential mechanism by which the interests of different stakeholders –and especially shareholders- are balanced and dealt with. Traditionally, Spanish boards of directors were characterized by powerful chairmen, presidential style, lack of effective control over directors with executive power, board entrenchment, discretion by the chairman to appoint and dismiss the directors, no formal procedures to evaluate the chairman's performance, overly large boards which inhibit active participation or the lack of truly independent directors, and self-perpetuation of the board of directors (Ricart, Alvarez and Gifra, 2005).

In 2008, Spanish listed firms had, on average, 11 directors on the board; comfortably within the 5-15 directors recommended by the 2006 Spanish Unified Code of Corporate Governance. At that time, each director had served for an average of 6.8 years. The number of independent directors rose to 32 per cent out of the total and the percentage of women directors reached 7.6 per cent. As in many other Latin countries, "interlocking" directors are frequent in Spain. Thus, in 2008, 28.4 per cent of Spanish directors served in another corporate subsidiary. Also, 23.8 per cent of independent directors and 16.4 per cent of executive directors served in another unrelated (i.e., non-subsidiary company) board.

Although the *Olivencia*, *Aldama* and, more recently, the *Unified Code of Corporate Governance* have all introduced new guidelines to modify some of these issues, the above characterization is still valid for some listed companies in 2011. There are three main areas

[1] The data provided in this section comes from *Fundacion de Estudios Financieros* (FEF) (2009), unless specified otherwise.

where the Spanish boards lag behind what it is typically defined as an effective board: chairman's independence, transparency on directors' remuneration and some particular aspects related to the power and functions of independent directors.

Board independence

Board independence is essential for effective CG. From the earliest discussions of the fundamental agency problem, theorists were aware that boards of directors, as the stewards of the shareholders, would not be effective monitors of management if this relationship were tainted by self-interest (Fama & Jensen, 1983; Jensen & Meckling, 1976). Board independence typically focuses on two elements of board structure. One of these is the composition of the board, specifically the extent to which the board is comprised of members who may be reasonably independent of firms' CEOs. A second issue is the extent to which CEOs simultaneously serve as board chairman.

Board independence is fostered in Spanish corporations through both mechanisms: the appointment of independent directors and the separation of the functions of CEO and chairman. Independent directors are appointed because of their professional experience and accredited reputation. Their duty is to represent shareholder interests and they have to meet certain criteria, such as not having a previous working or business relationship with the corporation in the recent years, or absence of family ties with other firm directors. In practice, and within some of the general limitations described above, the selection and appointment of independent directors belongs to the board's nominations committee. Despite some critical voices raised against the supposed "independence" of some independent directors (Ricart et al., 2005), the number of independent directors in Spain increased at a steady rate over the last decade. In 2008 this number rose to 32 per cent of the total directors compared with the 30.8 per cent in 2007 (FEF, 2009).

On the other hand, and despite some recent positive progress, the CEO-chairman separation is still weak in Spain. In 2008, the percentage of listed corporations where the chairman is also the CEO was 62 per cent. There are, however, an increasing number of Spanish firms that seek to counter-balance the concentration of power at the hands of the CEO/chairman by appointing empowered independent directors with increased responsibilities to monitor the chairman.

Another mechanism used by Spanish corporations to improve board independence is the formal disclosure of conflicts of interest among directors (92 per cent of corporations in 2008) and the appointment of an internal auditing commission (*Comisión de Auditoría*) whose main objective is to ensure the full independence of external auditors (e.g., ensuring that the auditing firm revenues from consulting services are not larger than the auditing fees).

Directors' remuneration

One recurrent topic in CG is that of board directors' remuneration. In recent years there has been considerable debate on whether the introduction of performance related remuneration contributes to aligning directors' interests with those of shareholders or just triggers excessive risk-taking by directors and management (Bebchuk, 2009; Kaplan, 2009). After the recent waves of corporate scandals and financial crisis, some authors even argue that managers should be paid like bureaucrats (Frey & Osterloh, 2005; Salas, 2009) in order to avoid some dysfunctional behavior by top managers. However, the view that performance-related remuneration contributes to aligning managers' and shareholders' interests is still the predominant one.

In Spain, listed firms, in a mimetic fashion, have been adopting incentive schemes such as stock options and other performance related remuneration systems imported from 'Anglo-Saxon' capitalism. Hence, in the last ten years, the percentage of directors' fixed salary over total remuneration remained lower than 50 per cent, following a slightly decreasing trend, from an average of 44 per cent in 2004 to 39 per cent in 2008 (see Table 9).

Table 9 also shows how directors' average total remuneration increased substantially from 2004 (2,423,000 Euros) to 2008 (3,367,000 Euros), despite the financial crisis that started in early 2008. This growth could reflect a lack of effective control by shareholders over directors' remunerations, something that has been observed in the governance of many global banks after the financial collapse of Lehman Brothers, as well as an escalation in directors' working hours (e.g., the increased number of board meetings due to intensification of due diligence, mergers, acquisitions, corporate restructuring and so on).

Finally, regarding individual director's remuneration disclosure, the number of Spanish listed firms that include this issue in their shareholders' annual meeting has been steadily increasing over the last decade up to a peak of 35 per cent in 2008 (FEF, 2009).

Table 9. Directors' total fixed salary over total remuneration in Spain (percentage)*

	2004		2006		2008	
	Total remuneration (thousand Euros)	Fixed salary percentage	Total remuneration (thousand Euros)	Fixed salary percentage	Total remuneration (thousand Euros)	Fixed salary percentage
Oil and Energy	5,145	41	6,613	35	5,217	41
Raw materials, construction	2,043	43	2,590	28	2,621	34
Consumer products	1,441	42	1,392	46	1,664	46
Consumer services	2,208	49	2,952	51	2,795	46
Financial services	3,634	42	5,703	25	6,891	34
Technology & telecom	3,255	57	4,708	47	5,893	41
Real state	1,621	41	3,017	30	2,547	44
TOTAL	**2,423**	**44**	**3,246**	**34**	**3,367**	**39**

Source: Fundación de Estudios Financeros (FEF), 2009, p.62.

* Total remuneration refers to the average total remuneration of Spanish listed companies based on a survey of 130 firms carried out by *Fundación de Estudios Financieros* (FEF, 2009).

3. The Employment Relations System

The historical background regarding the origins and evolution of industrial relations and the employment contract has been covered, to a large extent, in earlier works (Aguilera, 2006; Aguilera, 2003). Therefore, we will not go deeply into the historical antecedents of Spanish industrial relations; instead we will just summarize here some of the more recent developments in the Spanish labor market over the last decade (2000-2010).

Earlier reviews of the Spanish employment relations system has shown that Spain has followed a unique, idiosyncratic approach to labor management, inherited from the Francoist, paternalistic industrial relations (Aguilera, 2006; Aguilera, 2003), which has led to a persistent lack of geographical worker mobility, lack of market-powered incentives for workers, low productivity and, in general, to rigid employment contracts and working conditions which cannot be easily modified in response to economic cycles.

The creation of autonomous regions (*Comunidades Autonomas*) after the Franco regime led to a hard-to-sustain expansion of the public administration. As shown in Table 10, employment in the public sector has continued to grow, in spite of the privatization of state-owned enterprises of the late 1990s and the financial crisis of 2008 that forced many EU countries to lay off workers in the public sector. Despite the intense adjustment in the private sector, where 1.2 million jobs were destroyed in 2009 (INE, 2010), the number of workers in the public sector continued to grow during the period, reaching a peak of 3,168,000 public sector employees by 2010 (Table 10).

Table 10. Public and private sector employment in Spain (1990-2010) (thousands).

	1990	**2000**	**2010**
Public sector	2,106	2,443	3,168
Private Sector	7,167	9,842	15,378
Total Employed (‘000s)	**9,273**	**12,285**	**18,546**

Source: Instituto Nacional de Estadística (INE).

Nevertheless, both private and public job creation in Spain was a success story from 1994 to 2008. The number of total employees doubled in 20 years from 9,273,000 employees in 1990 to 18,546,000 in 2010. During this time, Spain experienced a prolonged period of impressive employment growth, successfully absorbing a large inflow of immigrants (OECD, 2011). As a consequence of this intense growth, the unemployment rate dropped from 25 per cent in 1993 to 8 per cent in 2007, in what was called the Spanish "economic miracle" until 2008 when the model collapsed. The global financial crisis that started in 2008 triggered a sharp increase in Spain's unemployment rate, mainly in the construction and manufacturing sectors. At the beginning of 2011, unemployment in Spain was above 20 per cent.

Given the persistently high unemployment rate, the EU and international organisms (OECD, IMF), as well as many scholars and economic policy agents have urged the Spanish government to introduce several unpopular reforms of the industrial relations and employment contracts. The suggested reforms primarily affect the costs of dismissal and the collective bargaining system.

3.1. Dismissal cost reforms

The Spanish employment system evolved over the years towards an extreme labor market dualism, between a primary stable sector composed of workers with permanent contracts, rising wages, social benefits and high dismissal costs, and a secondary unstable segment composed mainly of workers with temporary contracts and precarious job conditions. In this second group, we find many young employees and women. In addition to this dualism, the Spanish labor market includes a large number of workers in the underground economy and unemployed workers dependent on public subsidies.

In order to reduce this duality, in September 2010 the Parliament adopted a labor reform aimed at diminishing the upper range of dismissal costs for permanent employment contracts and to reduce the difference in dismissal costs between temporary and permanent contracts in three ways. First, the passed law makes it easier for firms to have dismissals accepted by the courts as justified, reducing the severance payment of firms substantially, from the current practice of 45 days' wages per year of seniority to 20 days' wages. Under the new law, the firm can dismiss an employee paying 20 days wages if the firm is going through a bad economic situation, for instance. Second, the law broadens the base for which the permanent contract with reduced severance payment of 33 days' wages per year of seniority can be applied, reducing the costs for the firm.

Finally, an employee's capital fund will be created and will enter into force in January 2012. This last measure is intended to be anti-cyclical because, instead of paying the total amount of severance pay at dismissal, employers would regularly pay an amount equal to a certain number of days' wages per year into this fund so that the worker may benefit from this fund in the event of dismissal, geographical mobility, for training purposes, or in the case of retirement. Also, the fund is kept in the worker's account so that he can change employers voluntarily without penalization.

3.2. Collective bargaining system reform

Traditionally, collective bargaining has been another point of divergence with other EU countries and it is one of the main reasons behind the structural high unemployment rates in Spain. The Spanish collective bargaining system is characterized by an intermediate degree of centralization in which negotiation takes place primarily at the sectoral or regional level. Such a system has been argued to be less favorable for employment compared to bargaining at the firm level because it tends to introduce nominal wage rigidity (Bassanini and Duval, 2006) and it impedes firms' efforts to rapidly adapt to economic shocks. The rigidity imposed by the current collective bargaining system forces firms to fire workers en masse when the economic situation deteriorates because they do not have sufficient leeway to implement internal changes in the working conditions and thus enable the firm to navigate through the crisis without dismissals (OECD, 2011).

The labor market reform approved by parliament in September 2010 partially addresses some of the chronic deficiencies of the Spanish regulatory framework. First, the new law widens the causes under which firms can opt out from collective agreements, favoring agreement between employers and employees under certain conditions specified in the new law. Second, the new regulation opens up companies' internal flexibility arrangements in terms of reductions in working time when necessary.

In addition to these changes, further reforms of the collective bargaining process (e.g., elimination of ex-post wage indexation) are expected before June 2011, aimed at fostering direct negotiation and decision making on working conditions at the firm level, directly between employees and employers.

Overall, these measures should be able to resolve some of the endemic problems of the Spanish labor market rigidity such as the lack of geographical mobility, low inter-firm mobility, wage rigidity and the weak adaptation of working conditions to economic cycles. The effective implementation of these measures in listed firms will reduce the gap between labor management in Spain and other EU countries. This, in turn, will lead to a higher cross-national convergence of CG practices.

4. Concluding Remarks

The first decade of the twenty-first century has been marked by a high number of corporate scandals and the deepest financial crisis since the Great Depression. The CG of countries worldwide has evolved, in turn, to respond to the challenges imposed by these events, and Spain is no exception to this trend.

Our review of the Spanish case illustrates how this country presents a unique, hybrid model of CG closer to that followed in countries with a French civil law tradition but with some selective transplants of 'Anglo-Saxon' CG practices in the sphere of CG codes, the legal framework, the financial system, ownership structure, board of director structure and the functioning and system of employment relations. Spanish listed firms in 2010 had more independent and diverse boards, a more developed financial system where savings banks will concentrate (through mergers and acquisitions) and which will, similar to other EU countries such as Italy, slowly be replaced by private commercial banks and a more flexible labor market with fewer frictions than in 2000.

However, CG in Spain still shares most of the characteristics of Latin corporate governance systems such as high ownership concentration, the high weight of banks in the financial structure and governance of the firm, underdevelopment of institutional investment and the State's paternalistic approach to employment contracts that leads to an excess of subsidies, low employee participation in the governance of the firm and higher unemployment than in other EU countries.

At the same time, although listed companies comply for the most part with the recommendations of the Unified Code of Good Governance in terms of increased transparency, board independence, accountability, diversity, performance-related remuneration and, in general, more effective boards, there is still a significant percentage of companies which do not follow all the guidelines of the Code (mostly those with high ownership concentration and regarding issues of board independence and disclosure of directors' remuneration).

In conclusion, despite the progress made by Spain over the last decade, further reforms of the CG mechanisms are required in the years to follow so that we can truly talk about a complete convergence with other CG systems within the EU. These reforms need to include greater enforcement of the Unified Code, further development of the stock market and the financial system (i.e., savings banks), a tougher market for corporate control and the recent and still ongoing labor market reform.

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