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РАЗНООБРАЗИЕ НА КОРПОРАТИВНИТЕ БОРДОВЕ: БАНКИ-МАЙКИ СПРЯМО ДЪЩЕРНИ БАНКИ

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DIVERSITY ON CORPORATE BOARDS: PARENT BANKS VS. SUBSIDIARY BANKS

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Abstract

The aim of the article is to analyze good practices on the diversity of bank boards in the European Union. A comparative analysis was carried out covering the subsidiary banks in Bulgaria and their parent banks in the euro area on the ground of shareholder and stakeholder theory. Good practices were compared to the requirements of the Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions.

The data from the analysis outline a high level of board diversity for the underrepresented gender and the geographical provenance. The results identify good practices for parent banks as a consequence of the application of Directive 2013/36/EU (2016) and for the subsidiary banks - from the transition period toward market economy (1990's). The recommendations address the need for statutory approaches to determine the economic effects of board diversity.

Keywords: *stakeholder theory, shareholder theory, agency problem, cross-border banks, comparative analysis, good practices, corporate governance, Bulgaria, European Union*

JEL Codes: *F23, G18, G21, G34*

1. Background

The trend towards a board diversity emerged at the end of the 20th century as part of the measures to tackle another corporate crisis. In response to social expectations, government policies are being proposed to reform existing corporate governance practices. Initially, the basis of a board diversity are established social values and norms and, above all, race and gender equality, which were later expanded, taking into account other socio-demographic characteristics of board members (Borisova, 2017). Regardless

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of the results achieved in the fields of board diversity the public trust in the corporate governance is still low due to a lack of quantitative indicators to measure the economic effects of diversity.

Expectations for corporate reforms are related to a protection of stakeholders and a renaissance of trust (Filipova, 2016). An illustrative example of reform is the Sarbanes-Oxley Act (2002) in the United States, adopted in response to several cases of corporate scandals, which introduced mandatory requirements for board diversity, including membership of women, minorities, young and non-experienced directors. The core result of this reform is the increase in the number of directors without professional background.

In connection with the mitigation of the effects of the global financial crisis of 2016 in the member states of the European Union (EU), a reform is introduced to impose policies to diversity the boards regarding age, underrepresented gender, geographical provenance and educational and professional background. The main goal of the reform is to protect stakeholders and to improve the quality of decisions made. In the EU, the board diversity has been introduced through "hard law" - by Directive 2013/36/EU.

Board diversity is different from other good corporate governance practices on the following aspects:

- the diversity is based on a government action plan;
- the action plan enters into force through mandatory norms;
- the control over diversity is carried out by stock exchanges;
- the monitoring on diversity is exercised by auditors;
- the results of diversity are reported by competent supervisory authorities.

Along with the globalization process, the number of state policies for board diversity is increasing while expanding their scope (Madgerova & Kyurova, 2014). The statutes of companies start to resemble the constitutions of the states - they include unilateral declaration of equality and mutual expectations of trust, which are transformed into board diversity policies and practices. This also determines the growing attention to these issues by the scientists - pointing out some irrational results of diversity; the analysts are increasingly seeking economic justification for reforms.

2. Observations

The first benchmark data concerning the board diversity in the EU banks were published by the European Banking Authority for 2016 (European Banking Authority, 2016). In their opinion, most forms of board diversity are reported by cross-border banks, thus creating greater opportunity for comparative analysis of national policies and subsidiaries' practices.

Parent banks show better quantity results in the fields of board diversity, which can be explained by their status - they are listed on a stock exchange and are licensed in a euro area state, all of which call for stricter requirements for board diversity. An additional advantage for the introduction of good practice in board diversity is the dispersed ownership and a past dependence factor - the leading role of public opinion in disclosing information, including transparency on board composition.

Board diversity policies focus on team results rather than on individual qualities, as individuals are not able to influence the certain attributes such as age, gender, and geographical provenance. High scores are reported for educational and professional background, while in terms of geographical provenance, the diversity is relatively low. The achievements in gender diversity in the northern European countries are related to women only and, above all, to their board membership as non-executive directors. While it is easier to measure, the rationality of applying such practices is more difficult to explain, as public attention is now being reoriented to environmental performance rather than to gender equality and women's membership in the boards has a social echo rather than an economic effect.

A qualitative analysis of the data by parent banks from the EU highlights the following common disadvantages characterizing the board diversity:

- mandatory application of board diversity by laws and stock exchanges requirements;
- incorrect definition of diversity of underrepresented gender with women rights only and implementing the gender diversity through a quota principle;
- limited participation of non-residents in the boards of southern European states.

In summary, the good practices of diversity on parent bank boards have been based by the external environment and their dispersed ownership. These factors determine the opportunity through diversity boards to focus on protection of the interests of stakeholders, rather than on increasing the wealth of shareholders.

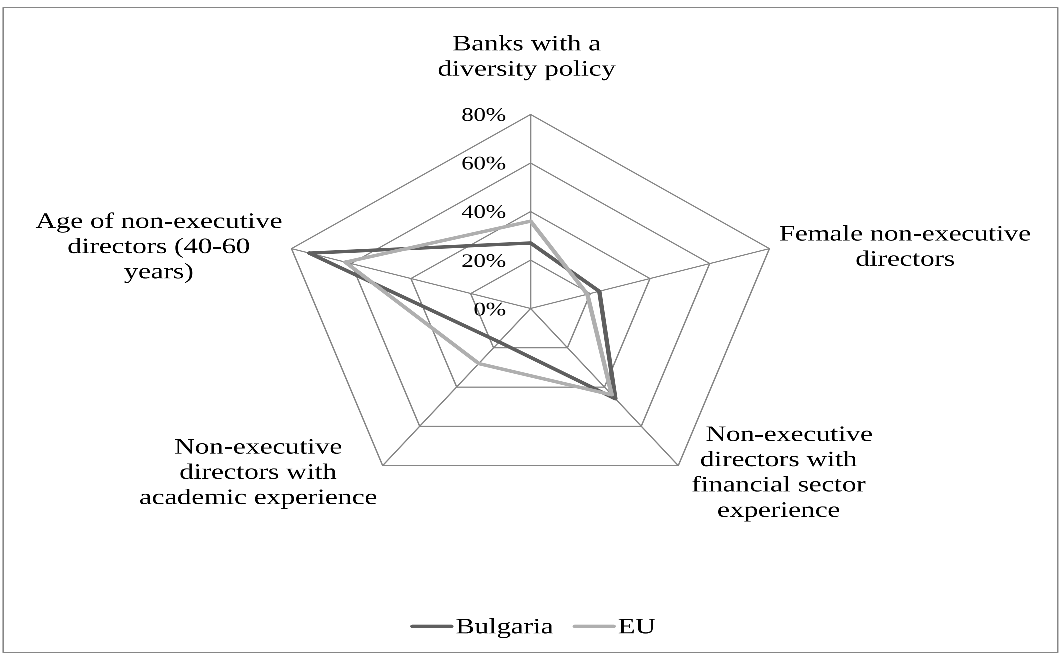
The overseas subsidiary banks are contrast to their parent banks: they are registered in a non-euro area state, without quotation on a stock exchange and have a concentrated ownership. However, they are of significant importance for the risk of the whole financial conglomerate, which largely determines the specificities of the board diversity practices (Tsvetanova, 2014). In most cases, foreign ownership exceeds 50% of subsidiary’s equity capital, which reduces the opportunities for diversity by geographical provenance for board members. Diversity is usually limited to the composition of management boards, whiles the members of supervisory boards, including the non-executive directors in case of one-tier system, are appointed by the majority shareholder. In order to protect ownership abroad, the directors are residents from the home state. This common practice is perceived as a diversity of geographical provenance, despite the fact that most board members are residents of one state only - from the home state[1]. On rare occasions, when

[1] European Banking Authority clarifies the “geographical provenance” as the area where a person has gained a cultural, educational or prior professional background. EBA report on the benchmarking of diversity practices (European Banking Authority, 2016, p. 9).

directors have an in-depth knowledge for local laws or have to act as claim addressees, the board members are residents of the host state.

Good practices in Bulgarian banks are a consequence of their level in the hierarchy of EU financial conglomerates[1]. The results of the comparative analysis of the board diversity reflect the formation and composition of the Bulgarian banking system - subordinated banks with predominantly overseas equity capital from a small number of euro zone states and with a concentrated ownership. Data on the diversity of board members before and after EU membership (2007) is relatively constant. Unlike the home state in the EU, in Bulgaria as a host country, the Directive 2013/36/EC and the legislative framework do not change the composition of the boards as there is no dynamics in the ownership of banks.

Figure no. 1 Comparison of the board diversity in parent banks from the EU and their subsidiary banks in Bulgaria



Source: European Banking Authority, 2016 and Bulgarian National Bank, 2017

[1] The leading example of Bulgarian practice is a subsidiary bank, a Dutch ownership that publishes full and detailed information about all kinds of board diversity for every board member. In this case, no account is taken of the fact that the published information is statutory requirement in the home state, in the Netherlands, whereas in the host state, Bulgaria, it is a voluntary act that is referred to as good practice for board diversity.

27% of the subsidiary banks in Bulgaria have implemented practices for board diversity (Figure 1), which is less than in their parent banks (36%). Most likely, the reason for this difference is the mandatory nature of board diversity in most euro area states. Banks in Bulgaria are ahead of their parent banks by the indicator "women-non executive directors", whose performance in the Bulgarian boards is traditionally high - 23%. For the diversity indicators "age of non-executive directors (40-60 years)" and "non-executive directors with academic experience", the results for Bulgarian boards are at a critically low level - respectively 74% and 17%, while for "non-executive directors with financial experience" is very similar for Bulgarian banks and parent banks in the EU - respectively 46 and 44%.

The diversity of geographical provenance in subsidiary banks aims to reduce the agency problem by nominating for board member a resident from the home state, and in parent banks - to reduce the likelihood of a new crisis by improving the quality of the decisions made. Diversity data on this indicator determine the leading position of subsidiary banks in Bulgaria as compared to their parent banks in the EU - 88% of the board members of the subsidiary banks are non-residents, while in the parent banks their share is 27%. However, it should be borne in mind that the idea of Directive 2013/36/EC is implementation of diversity by geographical provenance through a representation of a large number of states, while in Bulgarian banks the foreign members are from one state only - from the home state (foreign members are residents of 9 EU states, while the equity capital originates from 7 EU states). The coincidence between the home state of the directors and the home state of the equity capital in Bulgarian banks is high - over 95%, which do not comply with the good practices for board diversity.

The diversity of Bulgarian banks with regard to the underrepresented gender reveals a high percentage of women's membership in boards (16%), while its average level for EU is 11%. Due to the low dynamics of women participation in the boards prior to the membership of Bulgaria in the EU (2007) and after the entry into force of Directive 2013/36/EU (2016), it can be argued that a high level of gender diversity is a constant feature of the Bulgarian banking system.

The qualitative analysis of diversity for underrepresented gender highlights some features of Bulgarian bank system:

- there is a greater participation of women both in boards of banks with local capital and in case of banks with small market share;

- women are board members as representatives of foreign shareholders in banks with overseas equity capital;

- women are both a majority shareholder and a board chairman in banks with local equity capital[1];

[1] In 2015, there are two cases where a woman was appointed as a chairman of the board due to changes in bank's ownership, and to a large extent, due to the change of a majority shareholder

- boards with a wide variety of geographical provenance have a low level of women participation;
- in most cases, women are members of subsidiary boards and are accounted in the consolidated data of parent bank in the EU.

The subordination of Bulgarian banks in financial conglomerates of the EU determines the characteristics of another component of the board diversity - the educational background. Unlike parent banks, where more than 60% of directors have a degree outside the economics and business administration, in the subsidiary banks in Bulgaria more than 80% of the directors have a financial education and mostly are specialized in the fields of lending. The high percentage is relatively constant over time and is not a consequence of implementation of Directive 2013/36/EC. It is due to the provision of excess capital flows for lending in Bulgaria compared to the home state, which is a member state of the euro area, has lower country risk, lower interest rates and, accordingly, less profit than in Bulgaria. Interestingly, the directors representing the majority shareholders have a richest diversity in terms of education. The most serious diversity of professional background outside the economics is seen for directors of banks with local equity capital - engineers, diplomats, military officers, managers of health care systems, assurance managers, managers of pension funds, and experts of educational affairs.

3. Conclusions

The analysis carried out reveals different quantitative results on board diversity depending on the importance of individual subsidiary bank for the financial conglomerate. The subordinate status of the subsidiary banks in Bulgaria to EU financial conglomerates determines qualitative differences in the application of board diversity policies. For the banks in Bulgaria, the board diversity is not a consequence of EU membership (2007) and adoption of Directive 2013/36/EU (2016), but is rather a result of the introduction of market economy principles, privatisation programmes and good corporate governance practices in the 1990s (Nedeltchev, 2004).

The analysis shows that the results achieved of board diversity are aimed to meet the social expectations rather than to reach economic effects. At the same time, it is concluded that the diversity of team profile of board members is preferred option over the characteristics of individual member. We assume that diversity of geographical provenance in subsidiary banks has heterogeneous aims: protection of ownership abroad, generation and repatriation of profit, prevention of contagion risk and creation of management staff.

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and an increase in the share of majority shareholder rather than a consequence of the implementation of Directive 2013/36/EU.

The highest scores among all diversity indicators are reported in terms of underrepresented gender due to statutory requirements in a number of states. However, such policies undermine the idea of Directive 2013/36/EC for a voluntary application of board diversity. Another disadvantage is the focus on the participation of women in the boards through a legislative quota, while the meaning of Directive 2013/36/EU is to achieve diversity through the participation of the underrepresented gender, which is not necessarily just female. Our expectation is that an increase in the number of women in boards will lead to a greater diversity of educational and professional background outside the economics, as well as a reduction in the average age of bank board members.

The analysis shows that in the subsidiary banks in Bulgaria, the diversity of "geographical provenance" and "underrepresented gender" exceeds the average level in their EU parent banks. The good results are due to the subordinate position of the Bulgarian banks in the hierarchy of EU financial conglomerates rather than to the implementation of Directive 2013/36/EU. The level of the hierarchy defines the purpose of diversity: for parent banks, the diversity reduces the risk and meets the expectations of stakeholders to prevent another crisis while in subsidiary banks the diversity reduces the information asymmetry and responds to the shareholders' desire for wealth maximization.

The analysis of the board diversity of subsidiary banks in Bulgaria and their parent banks in the home state highlights:

- The factors from external environment for board diversity are legal norms and requirements of stock exchanges. The main disadvantage is that the board diversity is perceived as bipolar decision - for example, the underrepresented gender is misinterpreted with equal rights for women and geographical provenance is reduced to the dilemma of resident/non-resident board member. The survey of external factors is limited to a study of the regulatory framework and does not allow carrying out of a comparative analysis between states on the example of a cross-border bank. Differences in national laws lead to information asymmetry and the agency problem in an overseas subsidiary bank can be resolved through the board structure in the host state.
- Internal environment factors are a wider palette. These include activities in other states that lead to diversity in geographical provenance as well as in other sectors (e.g. insurance services and pension funds), which contributes to increasing diversity in educational and professional background.

4. Recommendations

Unlike the illustrative cases of diversity, such as the symbiosis between the survivor Robinson Crusoe and the native man Friday, the modern trend of board diversity puts corporate practices at the forefront. All stakeholders have started to speak on the same language for a sound banking system by using their own "dialect" like in the Babylon tower. Three years after the implementation of Directive 2013/36/EU, measures are taken that resemble the signal of Robinson Crusoe toward a passing ship. Attempts to impose common diversity views, regardless of established corporate practices, have a final outcome similar to broadcast a 3D movie towards a black-and-white TV sets.

For the sake of completeness in future analyses of board diversity, the following recommendations can be made:

- to be consider separately parent banks and their overseas subsidiary banks due to differences in external environment factors typical of euro area states - national laws and stock exchange requirements;
- to take into account only solo data of each subsidiary bank instead of the data currently used on a consolidated basis for a cross-border bank in order to eliminate the effect of subsidiary bank on the whole results;
- statutory to be introduce quantitative criteria for determining the economic effects of board diversity;
- to be examine the contribution for final results (number of proposals submitted at board meetings, level of risk acceptance and total remuneration) has each type of board diversity (age, underrepresented gender, geographical provenance and educational and professional background);
- to give less weight to the personal qualities over which the directors have no influence (age, gender and geographical provenance);
- to give priority attention to the personal qualities that are leading in the decision-making process (educational and professional background);
- to be perform a qualitative analysis of board minutes to determine whether there is an increase in the quality of the decisions made following a board diversity and whether the number of traditionally ‘yes’ voting members is decreased;
- to be reduce the number of interlocking directors in carrying out of an analysis for geographical provenance.

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