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**The effect of ownership concentration on management behavior
in Belgian banks: a case study**

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ABSTRACT

This thesis identifies two completely different ownership structures in Belgian banks: on one side, there is the concentrated ownership structure with a number of reference shareholders, while on the other side, the ownership is really dispersed and no shareholder has a significantly large stake and ability to influence management's decisions. Dexia and KBC followed the first model, while Fortis has evolved towards the second one around the year 2000. The mitigating impact that reference shareholders could have had on the – in hindsight – wrong decisions of Belgian banks' top-managers is found to be very limited. I therefore conclude that the dispersed ownership structure of Fortis was not an important factor in its collapse. Nevertheless, a concentrated ownership structure has been found out to help in case of financial distress, mainly because governments will be more inclined to participate to bailouts when a sound rescue strategy, elaborated with the help of a stable ownership structure, is present.

Key Words: corporate governance, ownership concentration, banking, financial crisis

INTRODUCTION

In 2008, Belgium's largest bank, Fortis (now BNP Paribas Fortis), had to be bailed out by the Belgian government. During the same crisis, Dexia (now Belfius) and KBC also needed strong government support and cash injections. Today, the lawsuits resulting from these events are far from over and seven members of Fortis' top management are accused of having misinformed shareholders. The Fortis case is very sensitive in Belgium because – due to its history that goes back to the 19th century – the bank was deeply anchored in the country's economy. Furthermore, its stock was known for being safe and paying regular dividends, which made it popular among the small Belgian investors. Hence, many small investors, who were shareholders, lost significant parts of their savings due to the 2008 events. *Ex post*, the bank's management made two errors according to Limbos and Phillips (2010): over-investing in CDOs and acquiring Dutch bank ABN Amro. All of this was accompanied by “[a] financial communication [that] was poor and vague” (Limbos and Phillips, 2010).

In 1999, the year of Fortis' creation, the bank experienced a critical change in control, as it moved from having only one important and controlling shareholder (Société Générale de Belgique) to a much dispersed ownership structure.¹ In this thesis, I assess how this change in power affected the company, and whether it is a reason for the 2008 issues. Two other larger Belgian banks, KBC and Dexia, were characterized during the period of interest by a concentrated ownership structure, and therefore will be used as comparisons in this study.

¹ Fortis Bank was created in 1999 by a merger of five banks, of which the biggest was Société Générale de Banque. When I refer to Fortis Bank before 1999, it is actually Société Générale de Banque that is meant.

Due to the small number of companies analyzed and the focus on Fortis, this thesis has the format of a case-study. I collect evidence from three different types of sources: (i) scientific articles on corporate governance, especially concerning ownership concentration, shareholder activism and agency theory; (ii) economic newspapers and books; and (iii) interviews. In order to provide a view as broad and objective as possible, I interview persons who represent both shareholders and management.² For reasons of confidentiality, the names of the interviewed persons are not disclosed, but short profiles can be found in Appendix 1.

This research leads us to distinguish two completely different ownership structures in Belgian banks: on one side, we find the concentrated ownership structure with a number of reference shareholders, while on the other side, the ownership is really dispersed and no shareholder has a significantly large stake and ability to influence management's decisions. Dexia and KBC are found to follow the first model, while Fortis evolved towards the second one around the years 2000. Because reference shareholders may have a stronger incentive to monitor management, they could influence its behavior and decision-taking.

The mitigating impact that reference shareholders could have had on the – in hindsight – wrong decisions of Belgian banks' top-managers is found to be very limited. I therefore conclude that the dispersed ownership structure of Fortis was not an important factor in its collapse. Nevertheless, a concentrated ownership structure has been found out to help in case of financial distress, mainly because governments will be more inclined to participate to

² I also tried to obtain interviews with regulators and supervisors, however due to reasons of professional secret and ongoing lawsuits, representatives of these groups could not satisfy my request.

bailouts when a sound rescue strategy, elaborated with the help of a stable ownership structure, is present.

During this research, I have found considerable inefficiency in the role of the supervisory boards, particularly in the case of Dexia. Despite the previous reforms on Belgian corporate governance, vital mistakes still occurred. The role of the non-executive directors is very important and, due to the complexity of the industry, non-executives should have a very deep financial knowledge and experience in order to be able to play their role adequately.

My findings are useful to practitioners in several ways. First, I conclude that for banks a concentrated ownership structure on itself is not at all an obstacle to serious management mistakes and corporate governance failures. Second, this ownership structure can be an indirect reason for a bailout if the bank finds itself in financial distress, as it will allow the firm to construct a stable long-term strategy that can be shown to regulators. Finally, this research shows that despite previous reforms on corporate governance, non-executive directors did not play the key role they should have had in a sound corporate governance framework. From an academic standpoint, this research offers a very specific view on the Belgian banking crisis by focusing on the importance and influence of two different ownership structures.

INSTITUTIONAL CONTEXT

A different corporate governance for banks?

Because banks operate differently than non-financial companies – for example by working with an extremely high leverage – and have a crucial role in an economy as financial intermediaries, they are subject to different regulations and government guarantees.

However, there are different opinions on the need for specific corporate governance regulation for banks (Magalhaes et al., 2010). Some believe this need exists, arguing that banks have a completely different business model, which results in dissimilar incentives and a different corporate governance framework. However, Caprio et al. (2007), for example, find that banks are subject to the same corporate control mechanisms as normal companies. Because of these opposite views on corporate governance in banking, I solely analyze articles specifically focused on banks.³

The Belgian financial sector

The banking sector has a crucial role in Belgium, representing 5.8% of the total economy and 60,000 jobs in 2012 (Febelfin, 2014). In 2013, banks lent €86 billion to public authorities, €186.9 billion to households and €117.8 billion to enterprises (Febelfin, 2014). One should therefore not be surprised that the country's economy is highly dependent on the health of its financial sector. In the past decades, the Belgian banking sector has been highly concentrated, with the top three banks representing as much as 80% of the country's banking assets in 2011 and a Herfindahl-Hirschman Index value of 0.27 (IMF, 2011).⁴ This index is particularly high when compared to other countries (Appendix 2) and reinforces the contamination effect in case one bank faces financial problems. Furthermore, the Belgian banking sector is very international. This goes in pair with the fact that Belgium, as a small country in the middle

³ Except for parts that describe general notions in corporate governance.

⁴ The Herfindahl-Hirschman Index (HHI) is a common measure of market concentration. It is obtained following way: $HHI = \sum(s_i^2)$ where s_i is the market share of every firm i in one specific market.

of Europe, has an economy that is highly reliant on foreign countries, as 80% of its GDP depends on exports.

The players

As of today, there are four important players in the Belgian banking sector: BNP Paribas Fortis, Belfius, KBC and ING Belgium (Appendix 3). These so-called universal banks offer a full range of financial services to both private individuals and companies. This includes retail banking, corporate banking, asset management or private banking. In the past decades, the sector changed significantly due to mergers and acquisitions and according to a recent report by Matthys and Thibeault (2013), it is not excluded that the Belgian banking sector will experience a new wave of consolidations in the years to come.

LITERATURE REVIEW

Ownership structure: the notion

Iannotta et al. (2007) state that the ownership structure of a company can be defined along two main dimensions: (i) a more quantitative dimension that takes into account the concentration of shareholders and (ii) a more qualitative dimension that accounts for the type of shareholders. In the former dimension, the possibilities to classify one specific shareholder are quite limited, as the only option is to set up certain thresholds according to the percentage of ownership of a shareholder. However, in the latter dimension, the possibilities are more diverse and the classification of a shareholder can be done according to a whole waiver of characteristics. One can think of categorizing shareholders according to their nature or objectives (e.g. governments, banks and insurance companies, pension funds, hedge funds,

family trusts, etc.), but some studies, for example Barry et al. (2008) or Kobeissi and Sun (2010), also take into account the shareholders' origin (local or foreign). The amount of studies taking into account the role of a company's ownership structure illustrates that it is a factor that should certainly not be underestimated when analyzing properties as corporate governance, performance or risk-taking.

Ownership structure and shareholder activism

Since its origins, the separation of ownership and control of companies has led to agency costs and possibilities of moral hazard in a company, which both come at the expense of the owners of the company: the shareholders. Therefore, one should not be surprised if these last ones engage in shareholder activism, meaning that they seek to actively monitor management when they feel that it does not fulfill certain financial or social objectives, or the way to reach these (e.g. the corporate governance structure of the company). Generally, the mechanisms of exit, voice and loyalty (Hirschman, 1970) are applied to shareholder activism. Thus, shareholders can either "vote with their feet" and exit the company, exercise their voice and try to change what they perceive as going wrong, or remain in the company without showing their dissatisfaction. As this last option cannot really be considered as an active solution, it is not taken into account in the majority of shareholder activism research. When it comes to the reasons behind shareholder activism, Hendry et al. (2007) find that although an important part of the performed studies assume that shareholder activism is driven by maximizing shareholder value, there is also evidence of what they call "a feeling of responsible ownership". Undoubtedly, we can state that the amount and reasons behind shareholder activism will be influenced by the two dimensions of ownership structure we previously

discussed, namely (i) the ownership stake, as large investors typically have more – financial – incentives to monitor management, and (ii) the type of shareholders. Besides this, we can also assume that the type of company in which they invest will influence the activism of shareholders. Following Westman (2010), this is the case for bank institutions, as the legal protection of bank depositors will not only encourage risk-taking by the bank, but also lower the incentives for shareholders to monitor management.

The influence of ownership concentration on control

According to Berle and Means (1932) the separation of ownership and control is the reason for conflicts of interest between management, which controls the company, and shareholders, which ultimately own the company. The corporate governance framework has the objective of solving these conflicts and allowing for incentive alignment between shareholders and managers by for example appointing independent directors, letting managers participate in equity, or establishing a two-tier board structure. However, a company is the scene for many actors, each having their own interests and incentives, and the corporate governance mechanisms that exist today have revealed being insufficient to align interests perfectly. Still following Berle and Means (1932), ownership concentration can be one of the solutions to this problem, where a more dispersed ownership will leave more space for managers to handle against the interests of shareholders. The logic is easy to follow: a shareholder owning a larger proportion of a company will have (i) more incentives to monitor as he has more financial interests at stake and (ii) lower costs (per share) of monitoring management. One could argue that if there is no such blockholder in a company, minority shareholders could still band together and monitor management. However, this does not take into account that

while only the shareholders that engage in monitoring borrow the costs of doing so, the non-active shareholders also benefit from their efforts. Therefore, this situation leads to a free-rider issue (see Grossman and Hart, 1980), where no shareholder may have sufficient incentives to monitor management. When assessing the practical side of this, we can refer to studies of Li (1994) and He and Sommer (2010), which find a negative relationship between ownership concentration and percentage of outside directors. This can be legitimated intuitively, as lower ownership concentration means higher agency costs and so greater need for outside monitoring.

The influence of ownership concentration on risk and performance

As far as the influence of ownership concentration on bank risk is concerned, a few studies have been performed, but there is lack of unanimity between them. Magalhaes et al. (2010) find that risk has a U-shaped relation with ownership concentration: from the moment that the main shareholder owns a 25% stake, bank risk taking increases with ownership concentration. Iannotta et al. (2007) obtain contradictory results, as they state that a concentrated ownership structure causes better loan quality, lower asset risk and lower insolvency risk.

Sullivan and Spong (1998) address an important issue when they state that bank risk is also dependent on the diversification of the owners' portfolios: when these are more diverse, their owners care less about the specific risk of one single investment. On the contrary, when these owners have a large part of their wealth in the same company, they will have a stronger incentive to monitor the firm and limit risk-taking.

Concerning the link between ownership concentration and performance, Thomsen and Pedersen (2000) establish the list of studies on the topic. A vast majority of these conclude that ownership concentration and profitability have a positive relationship.⁵ However, all of these studies were conducted on a sample of companies, and not specifically banks, so we should be cautious when generalizing their results. This need for caution is confirmed by the studies of Magalhaes et al. (2010) and Iannotta et al. (2007): the former one finds evidence of a cubic relationship (positive, negative and positive) between a bank's ownership concentration and its performance, while the latter one finds no significant relationship between these two variables. We can therefore deduct that there is no generally accepted conclusion on the link between bank profitability and ownership structure. This fact leaves all doors open for the examination of the present case study.

THE FORTIS CASE: BACKGROUND

From AG to Fortis Bank

Fortis Group was created in 1990 from a merger between Amev, a large Dutch insurer with limited banking activities, and AG Group, a large Belgian insurer (Fassin and Gosselin, 2011). Fortis' chairman, Maurice Lippens, strongly believed in the bancassurance model, and therefore pursued solid external growth by the acquisition of banks and insurance companies in the 1990's.⁶ In 1999, Fortis Bank – fully owned by Fortis Group – is created from the

⁵ See Short (1994), Lloyd et al. (1987) or Leech and Leahy (1991) for studies confirming the positive relationship between ownership concentration and performance, see Demsetz and Lehn (1985) for a study finding no relation between these two variables.

⁶ The bancassurance model is a business model that consists of combining banking activities with insurance activities in order to profit from synergies between these two industries.

merger of five banks, one of which was the Société Générale de Banque. The latter was part of the prestigious Société Générale de Belgique, the most important holding company Belgium ever had.⁷ These events had drastic implications on the shareholder structure of the group, as it evolved from a model with a number of controlling shareholders in 1997, to a model with only one minor shareholder in 2006. This is summarized in Table I.

CDOs, ABN Amro and the end of Fortis Bank

From 1999 onwards, Fortis was seen as the flagship of Belgian finance. Its chairman, Maurice Lippens, was even named Count by Albert II, the country's king (Delvaux and Michielsens, 1999). Unfortunately, things changed, mainly because of the combination of two causes: Fortis' exposure to the subprime crisis and the acquisition of ABN Amro (Limbos and Phillips, 2010).

Following the general trend among its peers, Fortis decided to acquire a team specialized in the construction of Collateralized Debt Obligations (CDOs) from French bank Société Générale in 2005. The aim was to increase the revenue coming from the merchant banking department by investing in this highly-profitable activity. One year later, in 2006, the bank increased the budget allocated to the construction of CDOs from €4.8 billion to €7.7 billion (Condijs et al., 2009). There is no mention of the corresponding risks in Fortis' 2006 financial statements. When the main credit rating agencies lowered their ratings for these securities late in 2007, Fortis became trapped with a considerable amount of them on its

⁷ It is important to note that the acquisition of the Société Générale de Banque by Fortis was not straightforward: after Fortis' first bid, the Dutch bank ABN Amro introduced a higher counteroffer, ultimately forcing Fortis to buy Société Générale de Banque at \$14.2 billion, representing a 16% premium compared to its original offer (The New York Times, 1998).

balance sheet. In the financial statements for that year, the bank reports a €2.8 billion impairment related to CDOs (Fortis Bank, 2008). This is surprising, given that on September 21 – just before the raise of additional equity – Fortis published a press release with an “update on the good risk management” of the bank, stating among others that “Approximately 95% of these MBS and ABS-portfolios are AAA and AA rated. The impact on Fortis’s full-year 2007 results is expected to be non-material (...).” The bank also states that “Fortis Investments [the asset management department of Fortis] is active in both CDO and CLO markets and manages around €9 billion in third-party closed-end funds. It is also active in CDOs within the sub-prime market, although there is no significant direct risk in its exposure.” (Fortis, 2007c).

Exposure to mortgage-related assets was not Fortis’ only concern: in October 2007, a syndicate composed of Royal Bank of Scotland, Banco Santander and Fortis itself bought Dutch ABN Amro for an amount of €71.1 billion, leading to the world’s biggest financial takeover. The three acquirers split ABN Amro between them, Fortis getting the bank’s Dutch and Belgian activities for which it paid €24 billion. From a strategic point of view, the deal was an excellent fit, as it would allow Fortis to establish a strong retail presence in the Netherlands. Furthermore, the parts that were taken over were the less risky ones (mainly retail and private banking) and would thus reduce the total risk of the Fortis group.⁸ The deal was approved at an Extraordinary General Meeting (August 6) by nearly 95% of Fortis’ voting shareholders. Ultimately, the bank financed this acquisition by (i) raising €13.4 billion

⁸ The most risky part, investment banking, was taken over by Royal Bank of Scotland, which ultimately led to very severe problems for that bank.

of equity; (ii) selling some of its assets; and (iii) cancelling the payment of the interim dividend of €1.3 billion. *Ex post*, critics argue that Fortis misinformed its shareholders by not mentioning correctly the risks that were related to the mortgage-related products. The price of the acquisition was also severely criticized, as ABN Amro was acquired for three times its book value (The Independent, 2009). Additionally, some people argue that a reason for this acquisition lays in the *hubris* of Fortis' management of (i) being asked by two well-renowned international banks to participate to their consortium; and (ii) having an opportunity to have its revenge on ABN Amro for the 16% premium it had to pay – because of that bank's counteroffer – for the Société Générale de Banque back in 1998 (see above).

According to Limbos and Phillips (2010) “the financial communication of the company was poor and vague”. On January 27, 2008, Fortis stated that (i) its solvability was far above the required 8% Tier 1 Capital requirements; (ii) it would maintain its dividend policy; (iii) all requirements concerning the solvability of the bank were met, even under very severe scenarios on the effect of the subprime crisis; and (iv) there was no need to issue share-diluting instruments (Fortis, 2008a). This was confirmed at the bank's annual general meeting in April, together with the promise of an interim dividend of €0.586 per share. Eventually, Fortis would have to breach these promises two months later as it wanted to “accelerate the execution of its solvency plan” by adding €8.5 billion to its solvency (Fortis 2008b). The bank did this by (i) a share offering; (ii) cancelling the interim dividend; and (iii) paying the 2008 dividend in shares instead of cash (Limbos and Phillips, 2010).

On September 26, 2008, the bank confirmed that there were no severe problems (Fortis, 2008c). Nevertheless, it had to be bailed by the Belgian, Dutch and Luxembourgian

governments three days later for a total amount of €11.2 billion. The Belgian State acquired nearly 100% of Fortis Bank, of which it sold 75% to French bank BNP Paribas in the beginning of October 2008, and the remaining 25% to the same bank at the end of 2013.

DESCRIPTION OF FINDINGS

Two different models

An analysis of the ownership structures of the three Belgian banks considered in 2006 shows two different models of ownership concentration (Table II). The first one is the model followed by KBC and Dexia, where there is a large number of reference shareholders, which own an important stake in the bank. The second model, followed by Fortis, is one where these reference shareholders are nearly absent and a large majority of the shares is on “free-float”. The bank ended up with this model because it took opportunity of the growth prospects that showed up through time, thus diluting its shareholder basis. Person C, who occupied top-positions within the Fortis Group, stressed that “This [the dilution of the shareholder structure] was a choice that has been made deliberately and which, considered afterwards, probably was the wrong one.” Interviewed persons that are related to KBC (Persons D and E) confirmed that it was also a deliberate choice of that bank to make the opposite choice of Fortis, by keeping a number of reference shareholders and therefore limiting the bank’s growth opportunities.

These two different models also impact how the company is run. The general tendency I deduct from the performed interviews is that when a bank has a diluted ownership structure, management has more freedom to make decisions. However, according to Person C, this is not necessarily an easier situation, as it is less complicated to explain your strategy and

performance to reference shareholders than to explain it to the – very specialized – analysts of investment funds which generally own a considerable number of the bank’s free-float shares. Furthermore, as person E mentioned, a bank with a high percentage of free-float is much more dependent on the short-term vision of the markets: “If we listened to the markets six to nine months ago, we had to have a real retail-strategy, the so-called Scandinavian model. This involves very little growth and a maximal payout ratio. Today, this is already completely different as the markets tell us that because of possible takeover threats, we should leave place for growth. Opinions can change very fast.” This market-dependence is a threat for industrial companies but it is even more for banks. Because of the high leverage that is typical in the industry, rumors of possible problems can lead to real and very serious problems, as was the case for Bear Stearns back in 2008.

The path to the crisis

I now discuss the possibility that the dispersed ownership structure that characterizes Fortis influenced the two factors that led to the bank’s fall: the acquisition of ABN Amro and the exposure to the subprime crisis.

As stated above, Fortis chose to grow in such a way that it abandoned its concentrated ownership structure. Doing so, it became the major financial player in Belgium from 1998 onwards. This ownership structure also helped the bank to take over ABN Amro in 2007, something which Person C thinks would not have been possible in a bank with reference shareholders, because these would probably have provided opposition against this transaction. However, according to the same person, this opposition would not have been related to the ABN Amro-deal itself, but to the fact that the reference shareholders wanted to

keep their large stake in the bank and would provide strong opposition against a strongly dilutive transaction. Everything should thus be placed in perspective and at that time, the acquisition of ABN Amro was seen as very positive as it was approved by nearly 95% of Fortis' shareholders (Fortis, 2007b). Therefore, we cannot conclude that the diluted ownership structure of Fortis was the reason for what can be considered *afterwards* as the wrong decision to acquire ABN Amro.

The second factor that led to the fall of Fortis was the important exposure to the subprime crisis. One could think that banks with reference shareholders would have had more opposition from them to engage in this risky activity. However, neither at Dexia nor at KBC did these shareholders show significant reluctance to their respective management concerning the investment in subprime credits. As Person D, representative of one of KBC's shareholders, states: "In the years before the crisis, banks had a very high return on capital. It will seem surprising, but we had to tell [KBC's] management to calm down, to be really careful and not to be too optimistic. However, it is very difficult for managers to resist to the huge pressure from the analysts. Considered afterwards, we probably did not provide enough opposition to this as reference shareholders. But it is very difficult to say to [KBC's] management that they should have a lower return when you are not aware of the risks that are being taken [due to unknown large off-balance sheet positions]."

The interviews suggest that opposition from hypothetical reference shareholders in the takeover of ABN Amro would merely have been due to their will of not getting diluted and not to specific aspects of the deal itself. Furthermore, a concentrated shareholder structure did not prevent KBC and Dexia to engage themselves in the CDO business and both banks

needed financial injections as well. Therefore, we can conclude that there is no significant association between the dispersed ownership structure of Fortis and the path taken by the bank, which ultimately led to its financial issues in 2008.

The role of supervisory boards⁹

Even if the two models described above have different impacts on the pursued strategies, they should not make any difference in the way corporate governance functions within the company. Shareholder representatives on the supervisory board, the non-executive directors, should theoretically act the same way when they represent a specific – reference – shareholder as when they represent the *community* of shareholders. Because of their concentrated ownership structures, it goes without saying that there were more non-executive directors directly representing specific shareholders on the supervisory board of KBC and Dexia than there were at Fortis. Previous managers of Fortis, as Persons C and F, did not have a very pronounced opinion about a difference in the behavior of a non-executive director in these two models.¹⁰ Nevertheless, according to persons related to KBC (Persons D and E), it really makes a difference and this is also what seems most likely. The main reason for this is that when a non-executive director directly represents a shareholder, he/she is financially linked to the company and therefore will pay more attention to its business and devote more

⁹ Belgian banks typically operate in a two-tier board structure, which separates the management board from the supervisory board. The former is responsible for the day-to-day management of the company, while the latter has the responsibility of supervising the management board and taking long-term and strategy-related decisions.

¹⁰ Person C stated that “In principle, it should not make any difference if you represent a shareholder or not [as non-executive director]. However, maybe I am naïve by believing this. A good non-executive director should react the same way when he represents someone or not” while Person F stated at first that “(...) it all depends on the personality and charisma of the person [= the non-executive director]” but re-considered his statement later in the conversation by saying that “when you own a large percentage of the company, you probably spend more time studying it.”

time to it. As person D states: “I usually spend 4 to 5 working days a month studying KBC. And these are not days of eight hours.”

The events in Belgium during the financial crisis show that supervisory boards did not always play the role that was expected from them. The case of Dexia, where some board members lacked the necessary financial competencies, is remarkable and probably the best example of this. As Person A states: “At Dexia, there were persons on the supervisory board that did not understand anything (...) I met [a person with a top-function on the supervisory board], who told me that they [the members of the board] did not understand anything of what was discussed. But it is normal, it was uncontrollable (...) persons which are in politics, which do other things and which are in 5 or 10 boards, how do you want them to understand?” Person B reinforced this idea by stating that “[at Dexia] there were the French directors and the Belgian directors. The former ones all came from very renowned universities, were counsellors of presidents and all had top-functions, while the latter ones did not understand anything and could not cope with all of this.” Concerning Fortis, Maurice Lippens, the bank’s former chairman, even went that far to admit in 2012 that he “was not a banker and only had superficial knowledge in the field of banking.” (Mediafin, 2013).

Supervisory boards certainly carry part of the responsibility for the risks their bank took. However, even leaving off-balance sheet items aside, banks are extremely complicated institutions to understand. After the performed interviews, I believe that if supervisory boards want to be effective in banks, they should be composed of a majority of persons that have (i) a very strong knowledge and experience in the financial sector; (ii) enough time to devote to study the bank’s business; and (iii) a continuous willingness to challenge management and

make sure that nothing is kept away from their supervision. This has been confirmed by recent proposals of reform on corporate governance by institutions as the Bank for International Settlements (BIS) or the OECD. The former one insists on the qualifications and training of board members as well as the need for them to – collectively – have the adequate knowledge and experience.¹¹ The latter one emphasizes the same matters, recognizing that “(...) it is often asserted that bank boards’ lack banking and financial experience.” (OECD, 2009).

Bailouts

The information collected leads me to believe that there was no difference between Belgian banks with a concentrated ownership structure and their counterparts with a dispersed ownership structure in the period that the foundations for the financial crisis were laid. I next examine the consequences of these different ownership structures in case the bank faces financial distress.

Fortis was the first Belgian bank hit by the subprime crisis and the Benelux governments reacted very quickly, injecting the necessary capital. Very soon thereafter, the Belgian government sold its stake in Fortis to French BNP Paribas. The approach was completely different for KBC, which was bailed out by the different Belgian governments by a €7 billion

¹¹ The BIS report states that “Board members should be and remain qualified, including through training, for their positions. They should have a clear understanding of their role in corporate governance and be able to exercise sound and objective judgment about the affairs of the bank.” and that “Independence can be enhanced by including a large enough number of qualified non-executive members on the board who are capable of exercising sound objective judgment.” (Bank for International Settlements, 2010).

injection.¹² This difference in treatment is criticized by the two former top-managers of Fortis I interviewed, Persons C and F, which argue that Fortis was not granted the opportunity to work itself out of the crisis. According to Person F, this could have been possible with government guarantees only, and the government went a bridge too far by directly selling the bank. According to Person C, Fortis did not benefit from the same treatment as KBC because of the strong lobbying and political connections of that bank's reference shareholders. The counter-argument is that having these reference shareholders, KBC was in a better bargaining position towards the different governments: recognizing its past errors, it managed to show a strong and – more importantly – stable strategy with unconditional support from its reference shareholders. This was different in the case of Fortis: according to person D, the absence of reference shareholders led to the fact that no shareholder wanted to support management and everyone was trying to leave the sinking ship as fast as possible. Therefore, Fortis could not present a stable story to governments, which was a major argument against financial support.

CONCLUSION

In this study I distinguish two completely different ownership structures in Belgian banks: on one side, we find the concentrated ownership structure with a number of reference shareholders, while on the other side, the ownership is really dispersed and no shareholder has a significantly large stake and ability to influence management's decisions. Dexia and

¹² KBC had to benefit three times from government injections in the period from October 2008 to May 2009. These injections were under the form of subordinated debt, which had to be paid back by KBC within a certain timeframe. Remarkable is that even if this financial aid was – practically seen – debt, KBC could count it as equity in its solvency capital requirements.

KBC followed the first model, while Fortis has evolved towards the second one around the year 2000.

The mitigating impact that reference shareholders could have had on the – in hindsight – wrong decisions of Belgian banks' top-managers is found to be very limited. I therefore conclude that the dispersed ownership structure of Fortis was not an important factor in its collapse. Nevertheless, a concentrated ownership structure has been found out to help in case of financial distress, mainly because governments will be more inclined to participate to bailouts when a sound rescue strategy, elaborated with the help of a stable ownership structure, is present.

The failure in corporate governance has been recognized by a considerable amount of institutions. Examples of this are the action plan launched by the OECD, the principles for enhancing corporate governance established by the BIS or the Walker Review in the United States and all of them insist on the need for stronger corporate governance.¹³ However, the current study leads me to doubt on the effectiveness of corporate governance reforms. Ironically, it was Fortis' chairman himself, Maurice Lippens, who proposed a reform of the Belgian corporate governance in 2004, the so-called Lippens-Code.¹⁴ At that time, Fortis was seen by many as an example in that field. Even though reforms in corporate governance are important and certainly necessary, the experience with the Lippens-Code shows that they are often insufficient.

¹³ The BIS proposals even recognize the importance of ownership structures: "It is nevertheless important that supervisors take steps to ensure that such ownership structures do not impede sound corporate governance. In particular, supervisors should have the ability to assess the fitness and propriety of significant bank owners as well as board members and senior managers." (Bank for International Settlements, 2010).

¹⁴ The Lippens-Code establishes an important number of corporate governance directives for Belgian companies.

During this research, I have found considerable inefficiency in the role of the supervisory boards, particularly in the case of Dexia. Despite the previous reforms on Belgian corporate governance, vital mistakes still occurred. The issue is therefore to assess if supervisory boards can really be effective and control management in a very complex industry as the banking sector. Logically, this issue is emphasized when the members of the supervisory boards (i) only spend little of their time performing a detailed scrutiny of the bank; (ii) lack the necessary financial competencies to understand what is going on in the bank; and (iii) over-trust management concerning the risk exposure of the bank.

I would therefore recommend banks' shareholders to be very selective when electing members of the supervisory board at the annual general meeting. Looking at this from the point of view of the bank's *stakeholders*: they should adopt a conservative attitude by not putting too much trust in the role of the supervisory boards, and simultaneously focus on the experience and integrity of the persons which have executive functions. After all, supervisory boards with very competent and experienced members have shown not to be an obstacle to severe mistakes.

Concerning the ownership structure of banks, I believe that a (nearly) 100% free-float structure is not ideal as it brings to much dependence on markets' opinions inside the company and these have shown too often to be short-term focused.¹⁵ An ownership structure with a number of shareholders owning a stake large enough to bring incentives to actively

¹⁵ However, on April 9th 2014, Laurence Fink, Chairman and CEO of Blackrock, sent a letter to a number of companies stating that "Many commentators lament the short-term demands of the capital markets. We share those concerns and believe it is part of our collective role as actors in the global capital markets to challenge that trend." (Blackrock, 2014). This could show that perceptions are changing and that markets want to attach more importance to long-term strategies.

monitor management seems more appropriate on the condition that the shareholders' representatives perform their role adequately. Of course, due to the fact that these shareholders would not want to get diluted, this would put limits on the growth possibilities that the bank has.

APPENDICES

Appendix 1: Interviewed persons

Person A: is a Belgian shareholder activist and is very present at a significant number of annual general meetings of Belgian companies.

Person B: has a top-position in a Belgian company that defends the rights of shareholders. He is very active in the Fortis case.

Person C: has a long career in the banking sector and reached top-positions within the Fortis-group.

Person D: represents one of the main shareholders of KBC and is a member of the bank's supervisory board.

Person E: occupies a top-position in the investor-relations department of KBC.

Person F: has a long career in the banking sector and reached top-positions within the Fortis-group.

Appendix 2: Herfindahl-Hirschman Index (HHI)

Belgium	0,27
France	0,13
Germany	0,04
Netherlands	0,18
UK	0,06
USA	0,04

Source: IMF (2011)

Appendix 3: The largest Belgian banks in terms of assets

Bank	Total Assets (€ Mn) as of mid-2012
BNPP Fortis	283.539,3
KBC Bank	168.618,1
Belfius	187.564,0
ING Belgium	151.771,5
AXA Bank Europe	38.759,3
Argenta	32.790,7

Source: IMF (2013)

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TABLES

Table I: the ownership structures of Fortis Group in 1997 and 2006 ¹⁶

<i>Year</i>	<i>Shareholder</i>	<i>% of shares</i>
1997	Stichting VSB Fonds and related companies	13.60%
	Société Générale de Belgique	9.69%
	Asphales	4.64%
	Asahi	3.41%
2006	Stichting VSB Fonds	4.99%

Sources: Fortis (1998) and Fortis (2007a)

Table II: ownership structures of the three main Belgian banks in 2006

KBC Group	KBC Ancora	20.90%
	Cera	6.40%
	MRBB ^a	11.70%
	Other core shareholders ^b	11.80%
	KBC Group Companies	4.30%
	Free-float	45%
Dexia Group	Caisse de dépôts et consignations	11.82%
	Arcofin	17.52%
	Municipal Holding	16.44%
	Ethias	6.36%
	CNP Assurances	1.98%
	Own shares	0.04%
	Employees	4.27%
	Free-float	41.57%
Fortis	Stichting VSB Fonds	4.99%
	Free-float	95.01%

a: MRBB is the investment branch of the Belgian farmers association (Boerenbond)

b: These are mainly a number of important Flemish families

Source : KBC (2007), Dexia (2007) and Fortis (2007a)

¹⁶ Fortis Group had a particular structure, as half of it was owned by Fortis Belgium and the other half was owned by Fortis Netherlands. The companies listed in Table 1 are shareholders of these entities, and thus theoretically only indirect shareholders of Fortis Group. Their ownership share was computed as if it was the final share in Fortis Group e.g. if a company had a 25% stake in Fortis Belgium, it is shown in Table 1 as having a 12.5% stake in Fortis Group.