

REGULATION AND EVOLUTION OF BOARDS OF DIRECTORS IN SWITZERLAND OVER 30 YEARS

An analysis of Swiss board of directors from 1988 to 2017 *

Boards of directors have been subject to unprecedented pressure to change and professionalise in recent decades. Boards have become smaller and more diverse, directors now hold fewer seats, and committees have been established. Many significant changes occurred before 2002 when the Swiss Code of Best Practice was introduced. The results show that even without strict regulations firms continuously modernize and professionalise their board of directors.

1. INTRODUCTION

In the aftermath of corporate failures, fraud, and accounting scandals in the United States (e.g. Enron) and worldwide (e.g. Parmalat) in the early 2000s, corporate governance standards, stock exchange guidelines, and, for example, the Sarbanes-Oxley Act (SOX) of 2002 were introduced to scrutinise the responsibilities of boards of directors, among other things. Reform proposals were aimed at promoting the professionalisation of boards, increasing board independence and diversity, and creating board committees. In addition, managerial networks potentially prone to collusion and the accumulation of directors' external appointments suspected of compromising their time commitment were more and more the subject of criticism [1].

Such reforms often assume that all boards face the same challenges and tasks, that there is one solution to these challenges, and, consequently, that there is one optimal type of board of directors ("one size fits all"). Moreover, this perspective assumes that boards on average are not adequately structured ("out of equilibrium") and that reforms would therefore improve overall board effectiveness. Because companies have no "good corporate governance", it will thus be in the nature of regulation to interfere in the corporate decision-making process and mandate a specific structure of corporate governance.

The structure and suitability of a board of directors is determined by firm-specific characteristics [2], specifically

(i) the institutional framework (legal rules and cultural factors) [3], (ii) the operational environment (e.g. company age, size, strategy, diversification, sales growth, industry affiliation) [4], and (iii) the ownership structure (which relates to the question of who the principals [and electors of board members] are in the principal-agent relationship, e.g. a family or smaller institutional investors) [5].

Besides these endogenous board determinants (i.e. company characteristics), researchers have found evidence that board compositions react to changes in the (exogenous) legal environment, such as the deregulation or regulation of industries [6], the introduction of corporate governance codes [7], stock exchange regulations and SOX [8]. However, these regulations often had negative effects on company performance because the board's role varies across companies (e.g. advising or monitoring role) and the optimal board structure depends on company characteristics [9]. These results suggest that negotiations between corporate insiders and outsiders lead on average to better corporate governance than external regulations. Furthermore, findings show that reforms based on "comply-or-explain" are advantageous compared with rule-based reforms [10].

2. EXOGENOUS FACTORS AFFECTING SWISS BOARDS OF DIRECTORS

2.1 Hard law. The Swiss Code of Obligations (CO) specifies the leeway companies have in structuring corporate governance and, in consequence, their board of directors. For example, the board may be authorised to create committees that prepare special board topics (e.g. auditing tasks). Swiss corporate law leaves substantial discretionary power to the company on how the board is structured and relies more on market-driven self-regulation [11]. Until recently, the law did not impose rules regarding board size, structure (e.g. CEO duality) or composition (e.g. quota for women or requirements for independent directors). Several attempts to improve corporate governance, notably transparency and shareholder protection, have been enacted in special laws such as the Stock



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Table 1: **IMPACT OF BOARD REFORMS DIRECTLY OR INDIRECTLY ON BOARD STRUCTURE**

Year	Important development or board reform	Impact on
1988	Nestlé allows foreigners to buy registered shares	Foreign board members (+)
1991	Revision of <i>Code of Obligations</i> allows delegation of daily business	Board size (–)
2002	<i>Swiss Code of Best Practice for Corporate Governance</i> (SCBP) recommends separation of leadership positions, more diverse board skills, and installation of board committees	Foreign and female board members (+) Number of committees (+)
2003	<i>Federal Commercial Register Circular</i> documents equal treatment of Swiss citizens with EU or EFTA citizens	Foreign board members (+)
2005	NYSE Corporate Governance Rules require installation of audit, nomination and compensation committees	Number of committees (+)
2006	Sarbanes-Oxley Act (SOX) requires audit committee	Number of committees (+)
2008	<i>Swiss Code of Best Practice for Corporate Governance</i> (SCBP) recommends the installation of compensation committees composed of independent directors <i>Code of Obligations</i> (CO) abolishes the requirement to have a majority of Swiss or EU/EFTA citizens on board of directors	Number of committees (+) Foreign board members (+)
2014	Ordinance against Excessive Compensation for Publicly Listed Companies (OaEC) requires the installation of compensation committees and setting a maximum number of third-party mandates that directors may hold. <i>Swiss Code of Best Practice for Corporate Governance</i> (SCBP) recommends diverse boards composed by both men and women as well as the separation of CEO and Chairman positions based on “comply or explain”	Number of committees (+) Multiple directorships (–) Female board members (+)

Exchange Act, the Merger Act, and the Takeover Ordinance. The electorate’s acceptance of the federal initiative against excessive compensation (“rip-off initiative”), its integration into the CO, and the ongoing discussion about its further revision will, however, reduce this leeway.

Industry-specific regulations also have an impact on corporate governance. The Banking Act (BA) and the Banking Ordinance (BO) and the Insurance Supervision Ordinance (ISO) require that banks and insurance companies, respectively, must separate the supervisory board from the management board (i. e. two-tiered board structure) (Art. 11 para. 2 BO, Art. 13 para. 1 ISO). Furthermore, the Financial Market Supervisory Authority (Finma) also publishes “circular letters” containing, among other things, detailed regulations on banks’ and insurers’ corporate governance. For

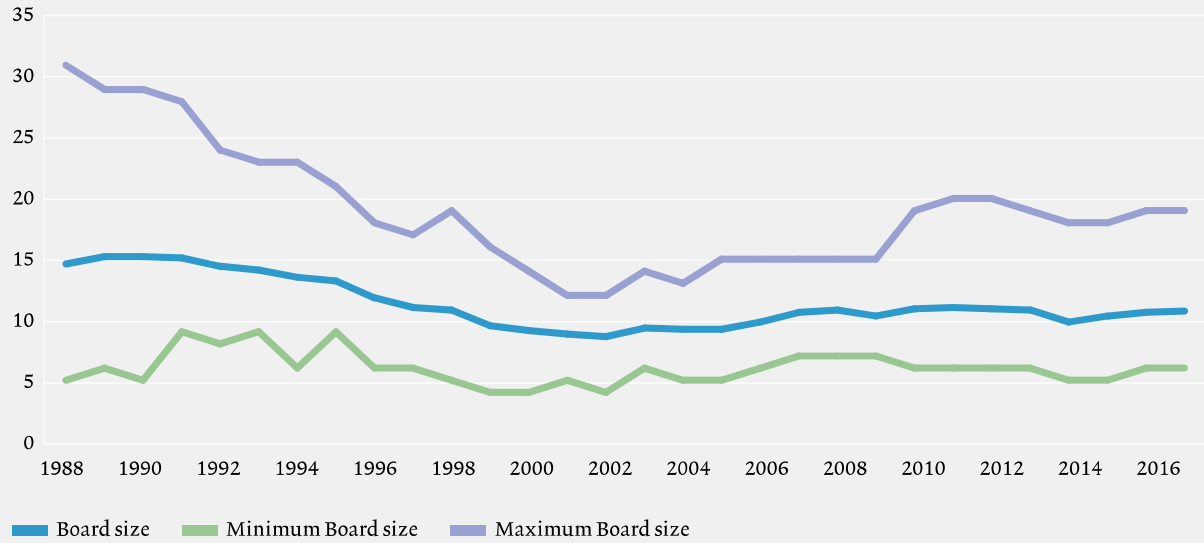
example, Finma Circular 2008/24 “Supervision and Internal Control – Banks” states that at least one third of a bank’s board of directors must consist of independent directors and that an audit committee should be formed. This circular also includes detailed definitions of independence (e. g., independent board members do not represent significant shareholders).

2.2 Best practices and transparency. Corporate governance codes that outline principles of “good governance” and how companies should be governed (best practices) have appeared increasingly since the 1990s (e. g. Cadbury report in the United Kingdom), especially since the Enron scandal in 2001. In 2002, two important instruments of self-regulation affected corporate governance in Switzerland. On the one hand,

Table 2: **EXPLANATORY POWER OF VARIOUS FACTORS AND YEAR OF FIRST SIGNIFICANT IMPACT**

	Log Board size	Foreign board members	Female board members	Log Multiple directorships	Log Number of committees
(Intercept)					
Time effects	22%	44%	33%	38%	53%
Industry effects	25%	8%	12%	3%	7%
NYSE listing	0%	13%	1%	5%	4%
Cultural effect	3%	3%	2%	1%	0%
Size effects	21%	0%	3%	1%	9%
Year of first significant effect (+/–)	1996 (–)	1997 (+)	2005 (+)	1996 (–)	1999 (+)

Figure 1: **BOARD SIZE (NUMBER OF DIRECTORS)**



the SIX Stock Exchange (SIX) introduced the Directive on Information Relating to Corporate Governance (DCG), which is based on the principle of “comply or explain”. Companies listed on the SIX are required to report and disclose information about their corporate governance. On the other hand, Economiesuisse published its Swiss Code of Best Practice for Corporate Governance (SCBP). The SCBP contains guidelines and non-binding rules that define best practices in corporate governance, notably concerning the board of directors.

Both instruments have been updated since their introduction. With corporate law leaving leeway to corporations, the interaction of the SCBP, stipulating best practices, and the DCG, requiring disclosure of practices, is arguably one of

the successes of Swiss corporate governance [12]. Changes in the legal environment (e.g. “rip-off initiative”), political pressure for more gender diversity on corporate boards, and the paradigm of corporate social responsibility as well as new national and international developments finally led to a new edition of the SCBP in 2014.

2.3 Foreign developments. Foreign developments in corporate governance have certainly had an influence on Swiss companies, as well. For instance, companies cross-listed on the New York Stock Exchange (NYSE) (e.g. ABB, Credit Suisse, Novartis) have had to comply with the extraterritorial SOX from 2006 onwards as “Foreign Private Issuers” and the

Figure 2: **DIVERSITY (FOREIGNERS AND WOMEN)**

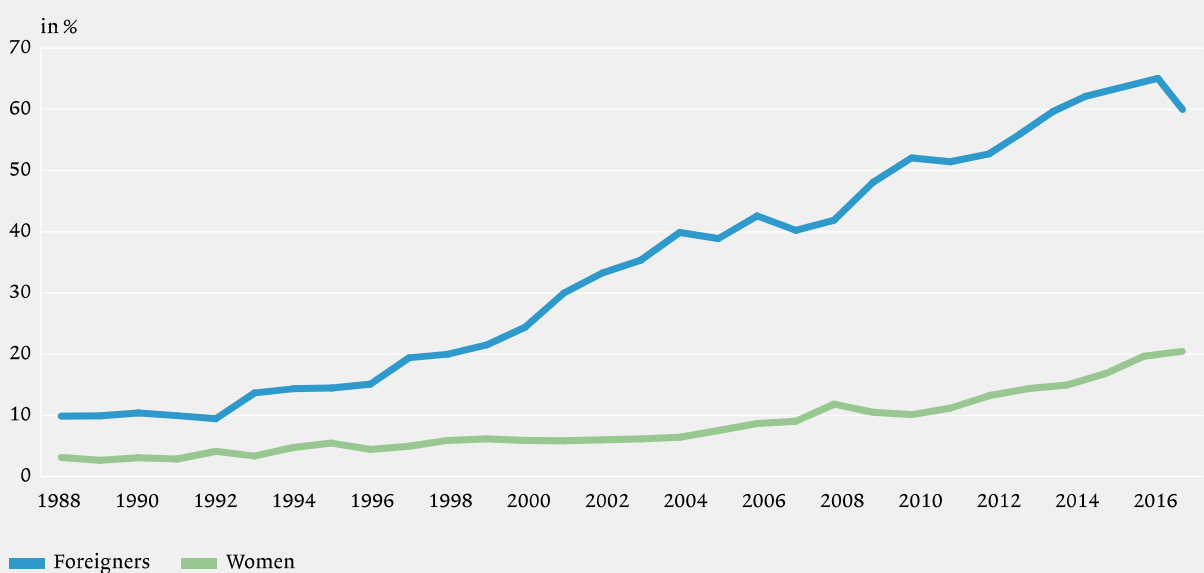
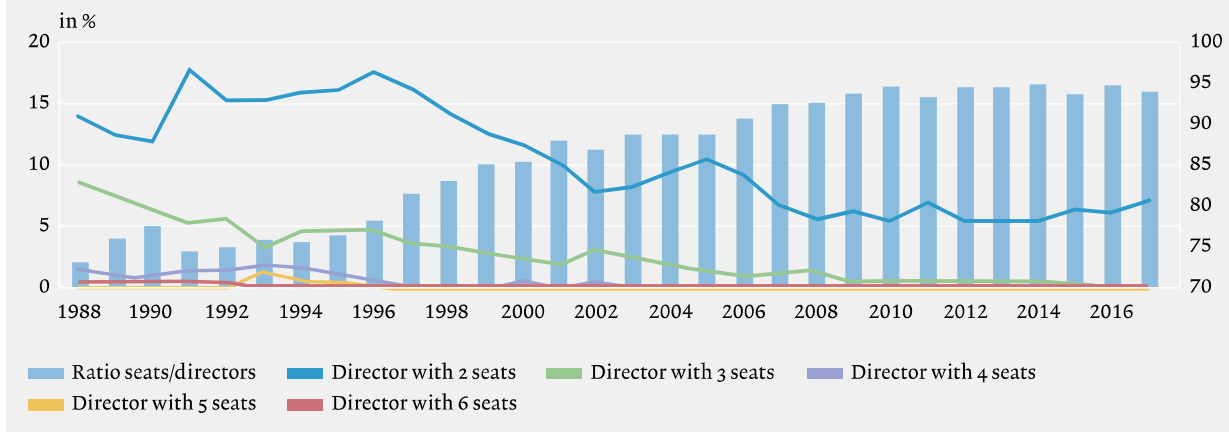


Figure 3: MULTIPLE DIRECTORSHIPS IN SMI COMPANIES

Number of directors and ratio to the number of available seats



NYSE listing rules since 2005. In addition, companies are certainly affected by foreign corporate governance codes and legislation in the places where they operate, where they have close cultural ties or where their shareholders or directors come from. This may concern the introduction of quotas for women, such as in 2011 in France, for instance. Spillover effects from extraterritorial legislation and developments in foreign law can thus have important influence on local boards. For example, the initiation of the Swiss Code of Best Practice in Corporate Governance (SCBP) was in part a consequence of the NYSE cross-listings of UBS and Novartis in 2000 [13].

2.4 Institutional investors and proxy advisors. Developments affecting shareholder rights, especially those concerning foreign institutional investors, had a significant effect on the composition of boards in the 1990s. Nestlé can be seen as a forerunner of this “revolution”, as it allowed foreigners to buy registered shares in 1988 [14]. By opening up access to registered shares and eventually introducing a single-class equity structure, the impact of foreign investors increased and thereby their influence in the election of the board of directors.

Furthermore, during the 2000s, Ethos, a proxy advisor and fund manager supported by state-owned pension funds, began to have an impact on Swiss boards. Their voting positions, often accompanied by media campaigns, affected corporate governance [15]. Later on, other proxy advisors, such as US-based Institutional Shareholder Service (ISS), Glass, Lewis & Co. (Glass Lewis) and Swiss-based zRating (Inrate AG), increased the pressure for Swiss corporate boards to modernise. These relatively recent actors became increasingly important by setting standards of good corporate governance outside the legal framework and partly on the basis of negotiations as representatives on behalf of their clients.

3. RESULTS

The author examines how board structures of Switzerland’s largest companies included in the Swiss Market Index (SMI) have evolved since the SMI was introduced in 1988. The SMI accounts for about 90% of the entire market capitalisa-

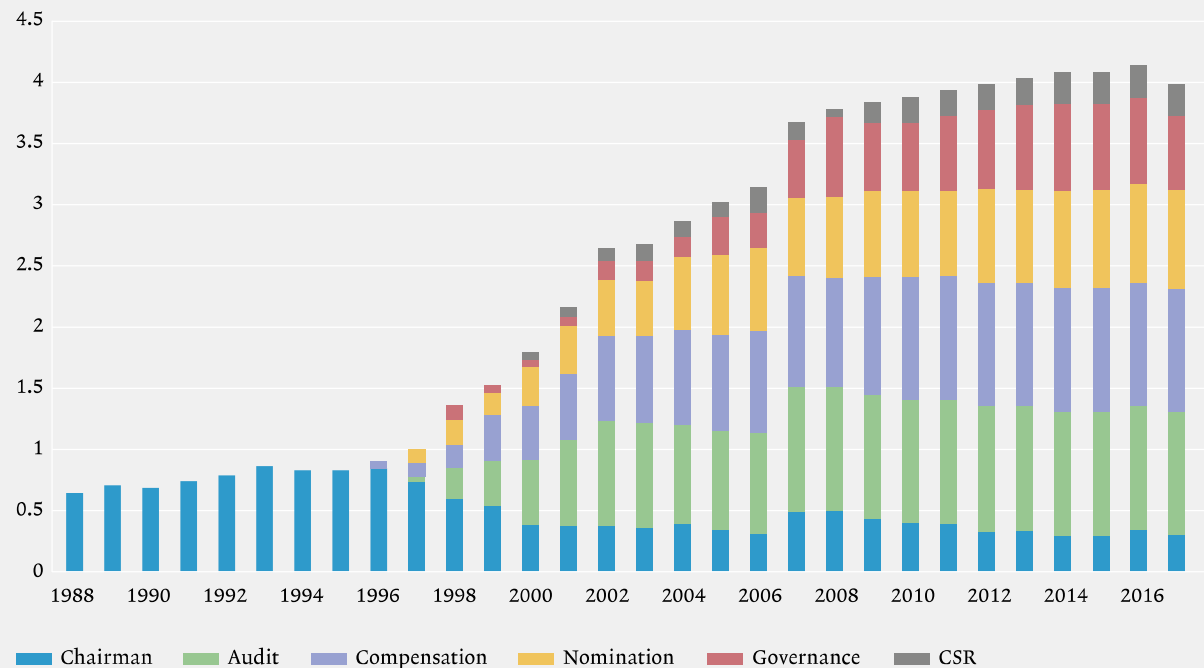
tion in Switzerland and includes the 20 largest listed companies. These firms maintained early on a high level of transparency, which made it possible to collect data from 1988 onwards. All information has been hand-collected from annual reports provided from the Swiss Economic Archives Basel or available online. The data covers 625 boards of directors consisting of 6,925 board members. Blue-chip firms also operate in an environment of similar external monitoring by financial analysts or rating agencies. This facilitates the analysis of the relationship of legal changes (see Table 1) and general developments in corporate governance with the structure of board of directors.

Table 2 shows coefficients of determination (R^2) representing the proportion of the variance for board size, foreign board members, female board members, multiple directorships, and number of committees. The results show that time effects are the main determinant of board structure, explaining between 22% (board size) and 53% (number of committees) of the variation. Industry effects are the second most important determinant, especially with respect to board size. The results indicate a strong relation between trends and board structure. In contrast, NYSE listing, the cultural effect (i.e. firms headquartered in the French-speaking region of Switzerland) and company size (within the SMI) seem to have had only a minor effect on board structure.

Furthermore, Table 2 shows the year of the first significant impact on board structure. The year indicated marks the year after which all year effects are significant (relative to 1988). Board sizes were significantly smaller starting in 1996, board diversity began to increase significantly in 1997 (foreigners) and 2005 (women), while multiple directorships were becoming less relevant in 1996, and board committees increasingly appeared as of 1999. The results show that board structures significantly changed before the introduction of the SCBP, and only board gender diversity followed later on.

3.1 Board size. Both theoretical considerations and empirical analyses suggest that oversized boards are less efficient

Figure 4: NUMBER OF BOARD COMMITTEES (ON AVERAGE)



and, therefore, harm company performance [16]. The board should be small enough for efficient decision-making and large enough to pool enough experience and knowledge from different fields.

Figure 1 shows that average board size decreased from 14.6 in 1988 to 10.7 in 2017. However, after reductions in board size during the 1990s, board size began to increase again in the 2000s. In 2002, several corporate governance reforms attempted to professionalise the board. The increase in average board size since then can certainly be attributed to higher demands in terms of responsibility and the recommendation to create specialised board committees.

3.2 Board diversity. Board diversity has also been one of the more controversial and widespread debates in corporate governance in recent years. In several European countries, politicians have demanded an increase in the number of women on boards and have introduced quotas [17]. Gender diversity should reflect gender equality and increase the breadth of perspectives within a board of directors. The introduction of quotas for women in Norway (2008, 40%), Germany (2016, 30%), and France (2017, 40%) and discussions about introducing a soft quota in Switzerland can be expected to have had an effect on board gender diversity in practice.

Until the end of 2007, Art. 708 CO stated that a majority of the board members must be Swiss citizens and domiciled in Switzerland [18]. Together with the recommendation of the SCBP in 2002 to consider board diversity in the composition of the board, it can therefore be expected that the fraction of foreigners on boards of directors has increased especially since 2008.

The aspect of diversity is depicted in Figure 2. Gender diversity has only become a relevant factor in the last ten years. Compared to 2007, the proportion of women on boards has more than doubled (2007: 9.8%/2017: 22.9%). Figure 2 shows that the fraction of foreigners on boards has increased even more strongly. Until 1993, only 10% of all board members were foreigners. This ratio increased to 65% in 2016.

3.3 Multiple directorships. Overly busy directors are also continuously criticised. On average, directors had 0.38 additional seats in other SMI companies. A high number, considering the fact that the SMI only represents the largest companies in Switzerland. The fact that Switzerland is a small country and the CO required a majority of Swiss nationals on boards are likely reasons for directors exercising a number of mandates simultaneously [19].

Figure 3 shows a remarkable shift occurring in the last 30 years. Board members today combine less board seats concurrently. In 1988, 24% of all board members had more than one seat in an SMI company, but this figure had dropped to 7% in 2017 (as indicated on the left axis). The decline was especially dramatic from 1996 to 2002. Again, the main changes occurred before the corporate governance reforms of 2002.

3.4 Board committees. Committees are recommended by the SCBP and legally legitimated by Swiss company law (Art. 716 a para 2 CO). Since the introduction of OaEC in 2014, listed companies have been required to have a compensation committee. Furthermore, there is an industry-specific regulation in the banking sector that requires banks of a certain size to create audit committees (Finma 2008/24). Also, NYSE Listing Rules require the formation of audit, nomination,

and compensation committees composed of independent directors with adequate professional skills (especially in matters that concern the audit committee).

As Figure 4 shows, boards created audit, compensation and nomination committees in the period from 1998 to 2002. Since 2010, all companies have had audit and compensation committees and three quarters have established a nomination committee. Half of all companies until the mid-90s had a “Chairman’s committee”. This committee is described as an interface between the board of directors and the management [20]. This committee therefore consists of executive directors. Hence, specialised board committees began appearing before 2002. However, the results for the period from 1988 to 2001 have to be considered with caution because committees only had to be fully disclosed as of 2002.

4. CONCLUSION

The last 30 years have been marked by enduring debates and reforms on corporate governance. The results in this study show that boards made significant changes and professionalised between 1988 and 2017. As Swiss company law remained fairly unchanged, these board changes have not been severely affected by hard law. Many significant changes occurred before 2002 when corporate governance as a topic be-

came popular and when the Swiss Code of Best Practice was introduced, which represents a milestone for corporate governance in Switzerland. Such soft law may have prevented hard law, which all companies would have to comply with. However, the results show that even without strict regulations and amendments in company law (hard law) or even without non-binding self-regulatory codes (soft law) on a country level, firms continuously modernise and professionalise their board of directors.

Spillover effects from other companies and countries as well as pressure exercised by shareholders and proxy advisors are the likely reasons for this. Furthermore, boards of directors may also have anticipated potential changes in board regulations by adapting their structures.

These findings are important, since research shows that the private negotiation process between corporate insiders and outsiders for specific corporate governance arrangements instead of an exogenously imposed structure may potentially lead to better results. In line with this, the equilibrium interpretation suggests that board structures on average are optimally chosen and value-maximising on the long run. Board reforms would, therefore, rather impair board effectiveness. ■

Footnotes: *An extended version of the article is available on SSRN, <https://papers.ssrn.com/abstract=3436395>. **1)** Böhren, Ø., Ström, R. Ø., Governance and politics: Regulating independence and diversity in the board room, in: *Journal of Business Finance & Accounting*, 2010/9–10, p. 1281–1308. **2)** Hermalin, B. E., Weisbach, M. S., Boards of directors as an endogenously determined institution: A survey of the economic literature, in: *Economic Policy Review*, 2003/1, p. 7–26. **3)** Volonté, C., Culture and corporate governance: the influence of language and religion in Switzerland, in: *Management International Review*, 2015/1, p. 77–118. **4)** Raheja, C. G., Determinants of board size and composition: a theory of corporate boards, in: *Journal of Financial and Quantitative Analysis*, 2005/2, p. 283–306; Boone, A. L., Field, L. C., Karpoff, J. M., Raheja, C. G., The determinants of corporate board size and composition: an empirical analysis, in: *Journal of Financial Economics*, 2007/1, p. 66–101; Coles, J. L., Daniel, N. D., Naveen, L., Boards: does one size fit all? in: *Journal of Financial Economics*, 2008/2, p. 29–356; Linck, J. S., Netter, J. M., Yang, T., The determinants of board structure, in: *Journal of Financial Economics*, 2008/2, p. 308–328; Lehn, K. M., Patro, S., Zhao, M., Determinants of the size and composition of US corporate boards: 1935–2000, in: *Financial Management*, 2009/4, p. 747–780; Pathan, S., Skully, M., Endogenously structured boards of directors in banks, in: *Journal of Banking & Finance*, 2010/7, p. 1590–1606; Volonté, C., Gantenbein, P., Directors’ human capital, firm strategy, and firm performance, in: *Journal of Management & Governance*, 2016/1, p. 115–145. **5)** Gantenbein, P., Volonté, C., Family Firms, Minority Investor Protection and Firm Performance, Working Paper, 2019. **6)** Kole, S. R., Lehn, K. M., Deregu-

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