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**Corporate Governance in France**

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*Résumé* : L'objectif de cet article est de proposer une présentation synthétique du système de gouvernance français

*Mots clés* : gouvernance des entreprises, France.

*Abstract* : The objective of this article is to shortly describe the French corporate governance system.

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In 2005, France ranks sixth in terms of gross domestic product (GDP) among world economies and thus seemingly has a competitive economic system. However, the central role historically played by the State, as well as the recurrent criticism of the typical recruitment process of the CEOs of the main French corporations generally carry the suspicion of its corporate governance system lacking sufficient discipline to guarantee the competitiveness of these corporations. In spite of this, a recent study (Fernandez *et al.*, 2006) on the Euro Stoxx 50 companies as of 2004 identifies 17 French companies and finds that the latter created significant value for their shareholders, offering them a 136 % return over the 1997-2004 period, largely outperforming their German counterparts. In addition, on the basis of stock index data supplied by Morgan Stanley Capital International, the annualized historical rate of return including dividends over the 1997-2006 period observed for the French market was 11.9 %, whereas the corresponding figures were 8.3 % and 8.8 % respectively for the US and the UK on a US dollar basis. It thus seems that the French corporate governance system has been able to adapt itself to the globalized competitive environment as is shown by the Davis Global Advisors ranking of 2002 or Standard and Poor's Transparency and Disclosure Study for Europe in 2003, which ranked France third, immediately following the United Kingdom and the United States. This highly positive assessment is probably due to the important reforms that have taken place for about twenty years, especially under the pressure from foreign institutional investors who hold nowadays a significant capital share in the principal French corporations.

### **National Corporate Law and Regulation**

The legal framework applying to French corporate governance is subordinated to the

European directives which emanate from the European Parliament. These directives are transposed with a certain degree of freedom into the national legislation of the member states. European policy with respect to corporate governance has been laid out in the Winter report, published in 2002, which aimed at modernizing corporate law and at tightening corporate governance standards. This report has established 10 priorities concerning the mandatory publication of an annual report on governance by publicly listed companies, a set of rules concerning shareholder rights, a strengthening of shareholder influence and of transparency with respect to CEO remuneration, as well as a better coordination of national corporate governance codes. The implementation of these priorities has led to an action plan formulating recommendations and adopting or reforming directives on issues such as the audit committee, the role of independent directors, the control and remuneration of CEOs, accounting and financial information, and even public takeover bids.

On a strictly French level, several texts of law have been adopted, hence modifying the general company law of 1966. They have either conferred a more official character on the recommendations already promoted by the voluntary codes of corporate governance “best practice” or transposed the European directives into French national law. Three recent texts hence call for special attention: (1) the law on new economic regulations of 2001 (*loi sur les nouvelles régulations économiques*); (2) the law on financial security of 2003 (*loi de sécurité financière*); and (3) the law on trust and modernization of the economy of 2005 (*loi pour la confiance et la modernisation de l'économie*).

The first law aimed at guiding France on the path towards sustainable growth by regulating the financial system, competition, and the corporation. Heavily influenced by the content of the existing codes of “best practice”, it had been conceived to guarantee a better balance of power between the different instances of control, by allowing for the separation of the functions of chairman of the board and CEO, by strengthening the control function of the

board, by assuring a higher level of transparency with respect to remuneration, and by increasing the rights of minority shareholders.

The law on financial security (2003) was designed as the French response to the crisis of trust in financial markets brought about by the various scandals (Enron, Vivendi ...). Beside strengthening the powers of the controlling authorities with the creation of the Financial Markets Authority (*Autorité des Marchés Financiers, AMF*) in an effort to achieve better investor protection, the law also aimed at improved legal controls, especially through the creation of the High Council of Legal Audit (*Haut Conseil du Commissariat aux Comptes*) that has received the mission to monitor the accounting profession. One of the objectives was to strengthen the role and independence of the auditors and to improve the quantity and the quality of the information supplied to shareholders, especially by forcing the chairman of the board to communicate on the organization and the work of the board and to reveal the internal control procedures.

Lastly, the 2005 law on the modernization of the economy has strengthened legal obligations with respect to information concerning CEO remuneration, particularly its components and the criteria of evaluation.

### **Corporate Governance Codes**

Various corporate governance codes have been drawn up by the employers' associations (MEDEF and AFEP) under the names of the Viénot 1 & 2 reports and the Bouton report. The Viénot 1 report (1995) was mainly concerned with the board of directors of publicly listed companies, wishing to clarify its mission and to make its work more effective. It recommended the suppression of cross directorships, a limitation of the number of board seats held, recourse to independent directors, and the creation of board committees.

The Viénot 2 report (1999) took on a more general perspective. It favoured an

approach granting companies the possibility to separate the functions of the chairman of the board and the CEO. This report gave precisions on the notion of director independence and called for strengthening the role of the independent directors as well as the information on management remuneration. It also made recommendations on financial information and communication and on the role of the general shareholder meetings.

Finally, the Bouton report (2002) was drawn up following the Enron crisis and aimed at a contribution to restore investor confidence. It suggested a certain number of improvements concerning the board of directors (stronger independence, a higher degree of formalization, better information, an improved evaluation), the board committees (audit, remuneration, and nominating committees), the independence of legal auditors, and financial information.

Overall, the main recommendations contained in the French corporate governance codes are very close to those published in other European countries, such as the Cadbury report in the UK. A comparative study mandated by the European Commission (Weil, Gotshal & Manges, 2002) concludes on the basis of an exhaustive content analysis of 35 European corporate governance codes on a high degree of convergence on such issues as accountability, minority shareholder protection, director independence, board committees and transparency.

Companies in France are free to adopt the above mentioned codes' principles. French listing requirements only impose an annual declaration by companies concerning "the conditions under which the board's deliberations are prepared and organized". In these declarations, an explicit reference to the governance codes is not mandatory, although it is strongly encouraged, and the Financial Markets Authority (AMF) actually considers the employers' associations' (MEDEF/AFEP) codes of "best practice" as a standard for the French capital market. As a matter of fact, it appears that the majority of listed companies making the above mentioned annual declaration do refer to at least one of the three above

mentioned governance codes. When they do, the AMF asks that they explain any divergence from the standards of “best practice” they contain. Hence, companies have discretion in adopting the governance codes, but in spite of a lack of any legal requirement, there is strong informal pressure in favour of voluntary compliance on a comply or explain basis.

### **Stock Market and Market for Corporate Control**

The stock market is generally cited as one of the principal corporate governance mechanisms. French companies are listed on Euronext, together with Belgian, Dutch and Portuguese corporations; this market is bound to be merged soon with the NYSE whose market capitalization is five times that of Euronext. The number of listed companies was about 1,300 by the end of 2005, which placed Euronext fifth among the big stock markets worldwide, behind the Americans (Nasdaq, NYSE), the London Stock Exchange, and Tokyo, but before Deutsche Börse. By the end of 2004, the Domestic Market Capitalization/GDP ratio, which is often retained as a measure of the stock market’s importance, was 70.7% for France against 127.4% for the United Kingdom. With 31.7 %, market concentration of 10 most capitalized companies appears to be superior to the American and Japanese stock exchanges but inferior to those of the UK and Germany.

**Table 1 : A Comparison of the Major Stock Exchanges (Source : World Federation of Exchanges – Annual Report and Statistics 2005)**

	Market Capitalization Billion \$ (2005)	Market Concentration of 10 most capitalized companies (2005)	New capital raised by shares Billion \$ (2005)	Number of Listed Companies (2005)	Market capitalization/GDP (2004)	New capital raised/GFCF (2004)	Share trading volume Billion \$ (2005)	Turnover velocity
Nasdaq	3604	28.8%	12.2	2832 (332 foreign firms)	30.1%	0.7%	10087	250.4%
NYSE	13310	18.6%	175	1818 (452 f.f.)	108.3%	6.6%	14125	99.1%
Deutsche Börse	1221	45%	4.8	648 (116 f.f.)	39.7%	0.5%	1915	149.4%
Euronext	2707	31.7%	65.9	966 (293 f.f.)	70.7%	6.7%	2906	112.8%
LSE	3058	40.9%	51.8	2757 (334 f.f.)	127.4%	8.7%	5678	110.1%
Tokyo	4573	18.1%	24.6	2323 (28 f.f.)	73.3%	2.2%	4482	115.3%

Note : GFCF Gross Fixed Capital Formation

The ratio New Capital Raised/GFCF approached 6.7% in 2004 and was very similar to the American percentage. In comparison, the same ratio was a low 0.5 % in Germany and 2.2% in Japan. In terms of Share Trading Volume, Euronext was at about 20% of the NYSE level. Turnover Velocity was 112.8% on Euronext against 99.1% on the NYSE. Overall, one may consider the discipline imposed by the financial market in France to be close to what can be observed in the US and the UK, even though, for the economy as a whole, the stock market remains less important.

The financial market also acts as a market for corporate control, where different management teams compete to eject underperforming incumbent managers, in particular through hostile public takeover bids. In fact, even if public takeover bids are not uncommon in France – a total of 234 can be observed between 2003 and 2005 – those that are hostile such as the recent Mittal Steel takeover of Arcelor are very small in number. The takeover market much remains a virtual governance mechanism, which may in great part be explained by the typical ownership structure of French firms.

### **Ownership structures**

Traditionally, as in most continental European countries, the ownership structures of French corporations remain concentrated, even though the number of individual shareholders has increased as a result of the privatization of major companies and has attained approximately 6 million people.

Table 2 gives the ownership structure of French corporations as of 2004. It shows the importance of foreign investors. The latter are to a major extent institutional investors, especially pension funds.

Table 2: The Ownership Structure of French Listed Companies (Source : Banque de France)

	1998	2004
Private households	10.9%	8.9%
Non financial companies	16.6%	19.4%
French institutional investors	26.3%	29.4%
Non residents	36%	37.9%

Others (the State included)	10.2%	4.6%
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The ownership structure of listed companies has gone through major changes for several years. Hence, we observe a strong decline of cross shareholdings which has allowed for a significant increase in the presence of institutional investors, especially non residents. The shareholdings directly controlled by households also have declined. When looking at the companies composing the CAC 40 stock index, the ownership stake controlled by foreign investors exceeded 46 % by the end of 2005. When compared to other leading nations, France appears to be the country with the most international corporate shareholder structure.

This strong presence of institutional investors does not mean however that the latter generally hold controlling capital stakes, since only 11.3 % of the companies as of the end of 2002 had an institutional investor as the main shareholder, whereas the proportion was over 40 % for the United States and the United Kingdom. In fact, Faccio and Lang (2002) and Sraer and Thesmar (2006) show that over 60 % of all listed companies remain under the control of the founding family. It is also worth mention that the State nowadays merely controls a marginal capital stake of about 2 % in French listed companies.

### **Board of Directors**

French law leaves corporations with the choice to either opt for a unitary or for a two-tier board system, the latter comprising a management board and a supervisory board. By the end of 2004, 76 % of the CAC 40 companies had chosen the unitary board. This percentage is confirmed by larger samples, and it seems that the two-tier board system has been on the decline in recent years. Among the CAC 40 companies having chosen the unitary board, 22 % had separated the functions of the chairman and the CEO by 2004. This percentage was similar for other companies, but it seems that this functional separation also was on the decline in recent years.



Table 3: Examples of the Board System Adopted by Major French Listed Companies (as of 05/31/2006)

Name	Market capitalization (Billion €)	Board system
Total	125,1	Unitary : CEO + Chairman
Sanofi - Aventis	99,5	Unitary : CEO + Chairman
EDF	77,6	Unitary : no separation
BNP Paribas	67,3	Unitary : CEO + Chairman
Société Générale	52,1	Unitary : no separation
Axa	50,8	Two-tier board
France Télécom	45,4	Unitary : no separation
L'Oréal	44,7	Unitary : CEO + Chairman
Crédit Agricole	43,6	Unitary : CEO + Chairman
Suez	38,1	Unitary : no separation
LVMH	37,6	Unitary : no separation
Vivendi	32,3	Two-tier board
Carrefour	31,9	Two-tier board
Gaz de France	26,9	Unitary : no separation
Renault	25,6	Unitary : CEO + Chairman

Concerning its composition, French law limits the number of internal directors (corporate employees) to a third of the board seats. The presence of independent directors has become commonplace on the boards of the CAC 40 companies, where they occupy 60 % of the board seats, and has become a widely accepted practice in most listed companies (with a mean value of 6 independent directors out of a total of 15). The legislation adopted in recent years has tended to reduce the number of board seats that can be held by one single person: by the end of 2004, 104 directors representing approximately a fourth of the CAC 40 board seats held more than one directorship, but there were only three who held up to five, henceforth the legal limit. However, the practice of cross-directorships remains a frequent phenomenon. 65 % of the before mentioned companies exchanged at least two directors. About one third of the boards include one of the company's bankers and an employee representative, and three fourths have at least one foreign director.

The principal three committees – the audit, remuneration, and nominating committees – are in place in most of the CAC 40 companies. They are mostly presided by an independent

director, but the presence of the chairman and the CEO during deliberations remains frequent (in half of the remuneration and nominating committees).

### Executive Compensation

French CEOs feature among the best paid in Europe. In 2005, the mean remuneration of the CAC 40 CEOs was 4.9 M€. Remunerations have tripled between 1998 and 2004, but have registered a 14 % decline in 2005. On the mean, the variable part of the remuneration package is close to 50 %. It has recently decreased due to the reduction of the part of stock options which only represented 38 % of total compensation in 2005, against 68 % in 2001. This decline in the proportion of stock options appears to be a world-wide phenomenon (cf. Towers Perrin, 2006). Several reasons may be advanced, such as the abuses that have been revealed, the changes in accounting methods, and the increasing success of restricted stocks and performance shares. It is nevertheless interesting to note that French companies' use of stock options remains comparatively rather strong. The criteria used to fix CEO pay are essentially peer remuneration levels, the position's responsibilities, and firm performance determined through accounting measures and/or stock-market indicators. A reference to the performance of companies in the same industry can be found in almost 30 % of the observations.

Table 4 : Use of Long-Term Incentive Awards, Stock Options, Restricted Stocks and Performance Shares in 2005 (Source : Towers Perrin, 2006)

	Use of LTI Awards (% of firms offering)	Use of Stock Options (% of firms offering)	Use of Restricted Stocks (% of firms offering)	Use of performance Shares (% of firms offering)
USA	95%	85%	35%	35%
Germany	85%	40%	5%	10%
France	95%	90%	5%	5%
Japan	35%	35%	0%	0%
UK	95%	80%	0%	60%

There are numerous legal requirements to reveal information on management pay

(individualized publicity of remuneration, distinction between fixed and variable components, mode of evaluation ...). No constraint however exists concerning the amount of admitted remuneration levels. The main employers' association, MEDEF, that is at the origin of the principal corporate governance codes, has merely given some general recommendations pleading for the respect of shareholder interests and emphasizing the necessity of social cohesion.

## **Conclusion**

During the last twenty years, the governance of French listed companies has undergone profound transformations, and its formal characteristics appear henceforth close to those of the Anglo-Saxon counterpart. However, even if foreign institutional investors have become its major actors, French capitalism still keeps a strong family character, and transactions on the market for corporate control are rarely hostile. One may add that minority shareholder activism is modest, even though their rights have been strengthened.

The overall evolution of French corporate governance towards Anglo-Saxon standards encounters some resistance, especially due to the characteristics of the market for managers of the main companies, which favour certain elite circles – in 2005, almost 15 % of the CEOs of French listed companies were graduates from Ecole Polytechnique and from Ecole Nationale d'Administration (ENA) –, and due to the employment market in general, often considered to be rather inflexible. The internationalization of ownership and of corporate boards will probably lead to a reform of these markets, and the growing pressure for accounting transparency, with the adoption of the new international financial reporting standards (IFRS), is probably bound to exert a continuing influence. Finally, the strong French tradition of State interventionism coupled with some recent statements by political leaders (at the occasion of certain operations concerning Danone or Arcelor ...) may lead to the assumption that the

State wishes to protect domestic corporations from foreign raiders. However, due to the substantial evolution of the legal context, especially at the European level, and, above all, to the fundamental changes of ownership structures, such State intervention mostly remains mere rhetoric. At present, the French government has lost much of its former impact on these issues, and the outcome of the recent Arcelor takeover struggle illustrates the loss of the institutional channels allowing for effective State intervention.

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