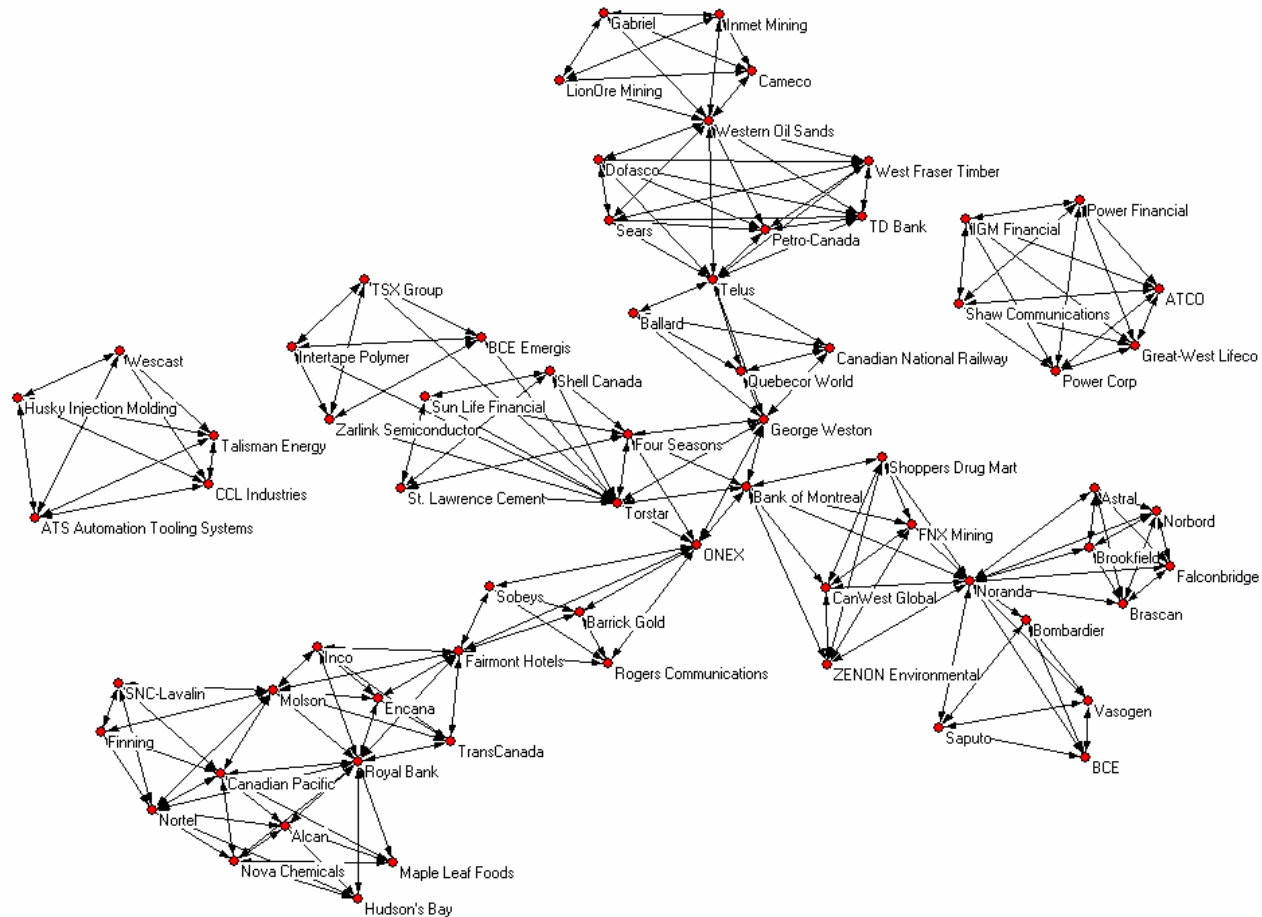


Canada's Corporate Elite

The Gatekeepers of Good Governance



Clarkson Centre for Business Ethics and Board Effectiveness
December 2004

Powerful advocates have pushed for **corporate governance reform**

A New Appetite for Governance Monitoring



Moody's.com

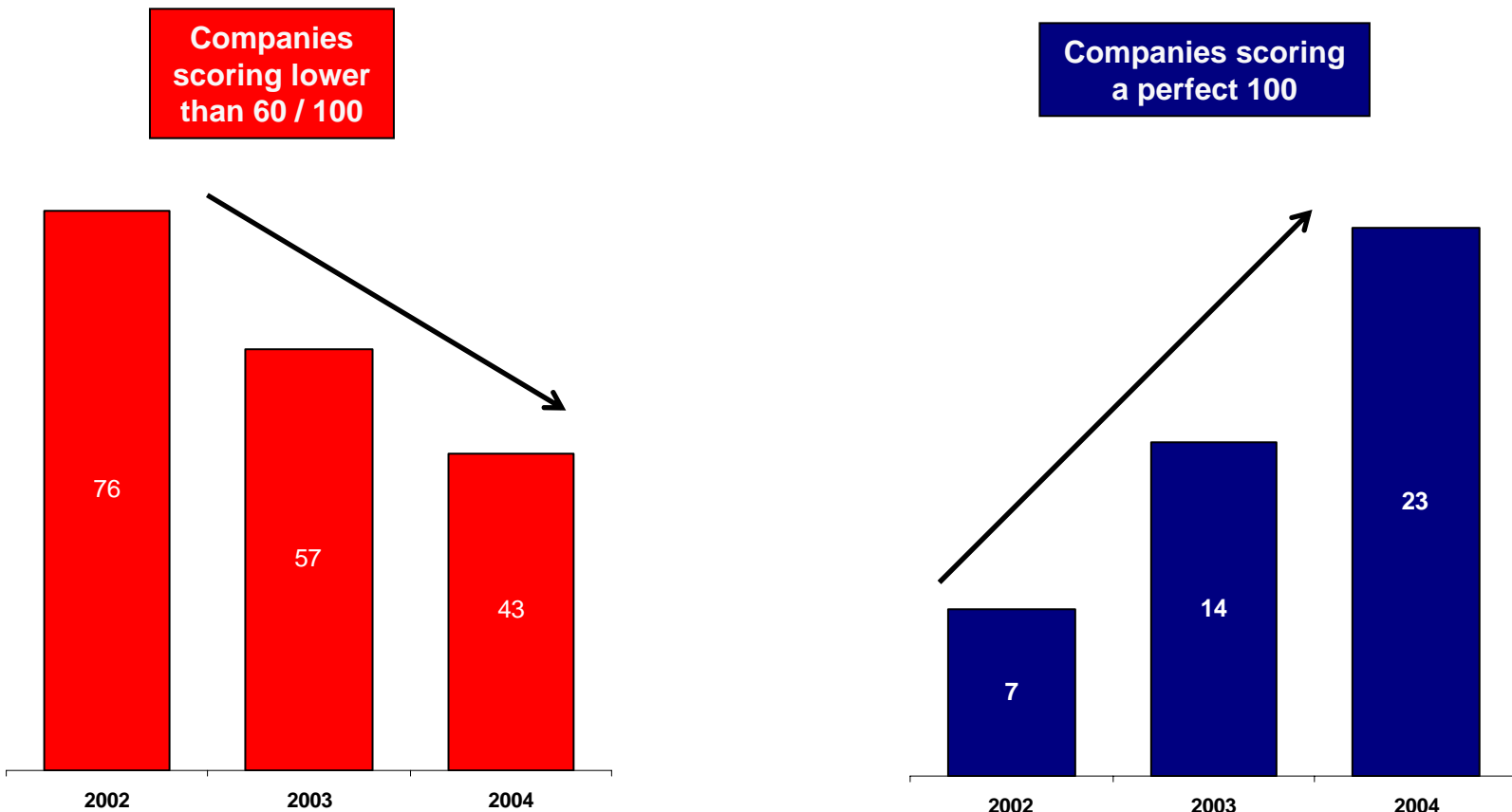
REPORT ON BUSINESS



A New Appetite for Regulatory Change



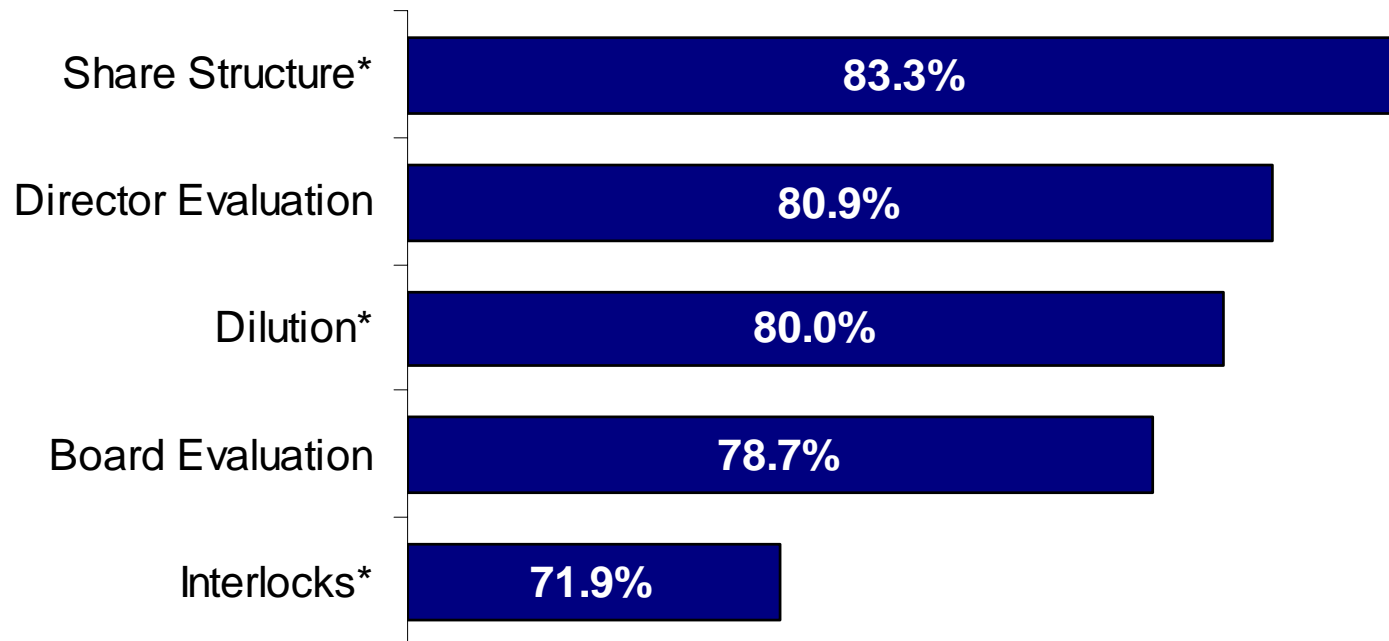
The result has been a significant improvement in governance practices in the S&P/TSX Composite Index over the past two years.



Based on the Rotman Board Shareholder Confidence Index Scores
All findings in this report are based on the S&P/TSX Composite Index

However, many boards remain below best governance practices.

% of Companies with sub-par governance practices in 2003 that remain sub-par in 2004



- * *Share Structure* – A deduction is made if more than 50% of a company's voting power is controlled by less than 50% of outstanding shares.
- * *Dilution* – Companies receive deductions for dilution when the number of outstanding options is greater than 10% of the number of outstanding shares
- * *Interlocks* – If the same two directors sit on more than one board together, there is a director interlock between the involved companies. Deductions are made if a company has more than one interlock.

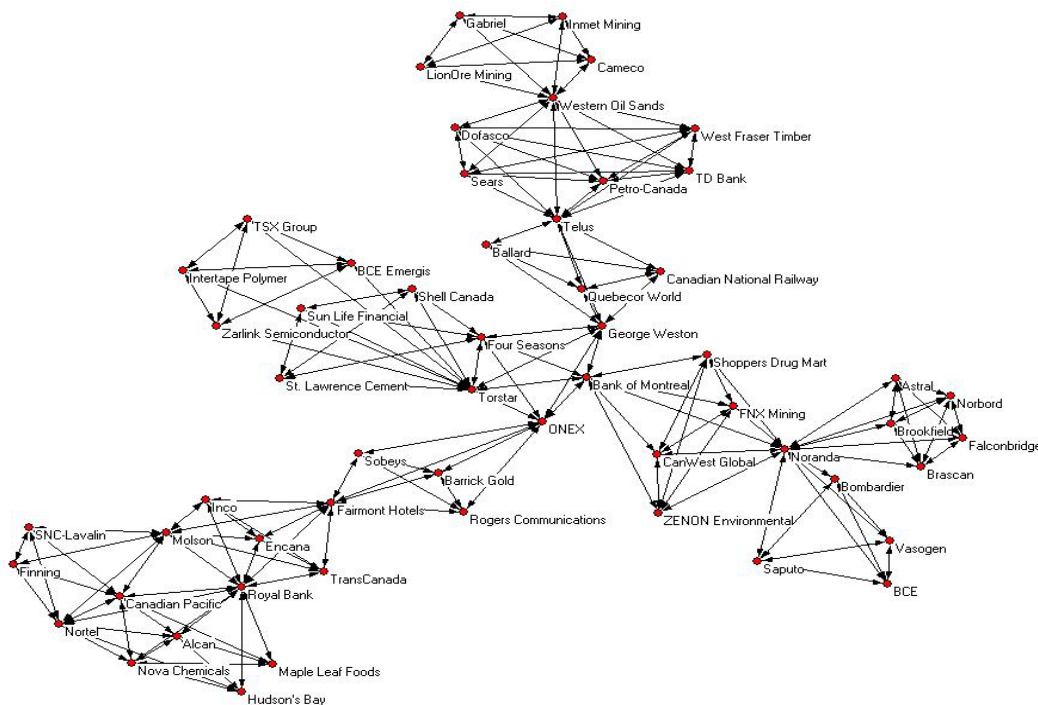
Because we have seen positive change and stagnation in governance practices, we wonder “***What are the factors that facilitate and block governance reform?***”

Two factors affecting corporate governance reform are the ***network of elite corporate directors*** and ***corporate ownership structure***.

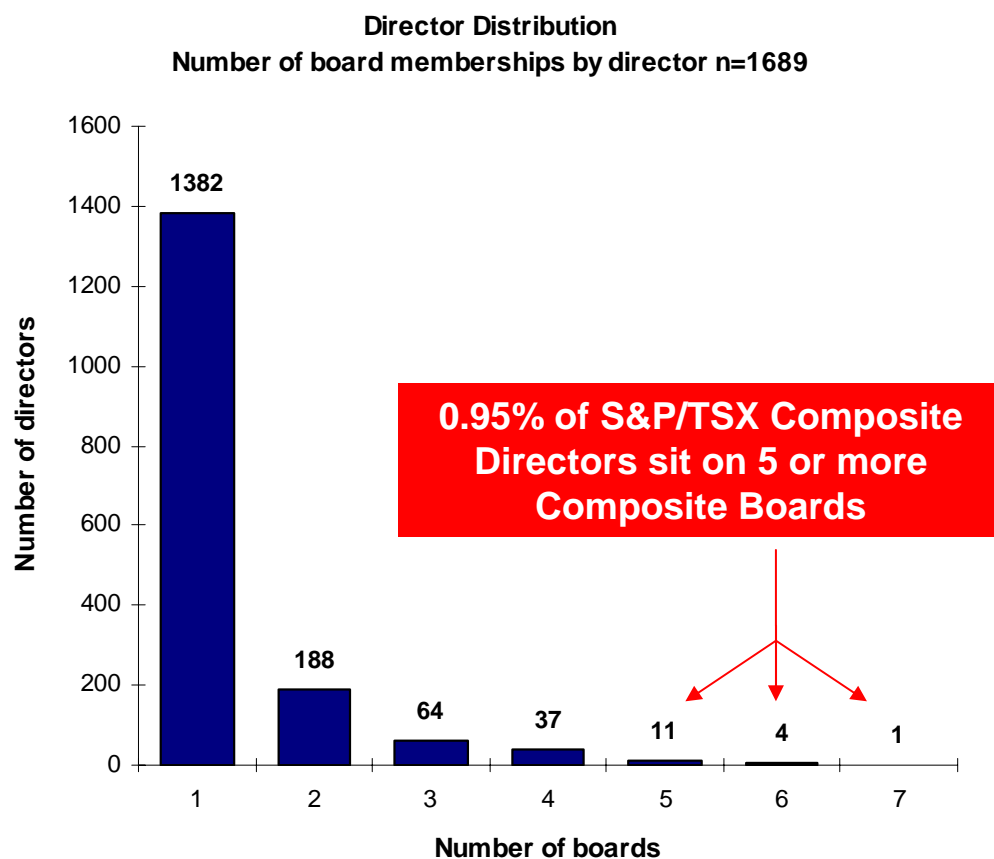
Canada's most *influential* directors are the **Corporate Elite**, who drive corporate governance reform in Canada.

The Influence of the Elite is driven by three key factors:

1. They represent a **large number of companies**
2. They represent half of the **market cap** of the S&P/TSX Composite
3. They are **interconnected**

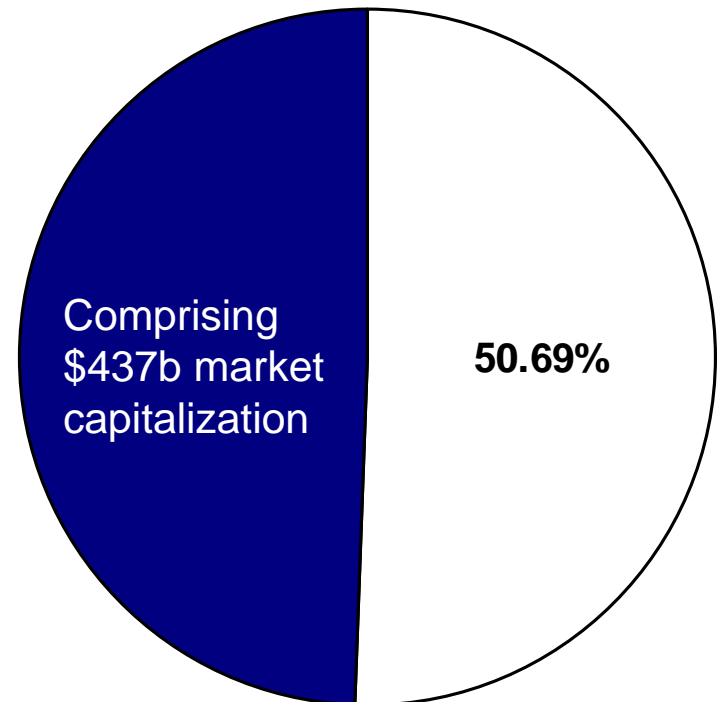
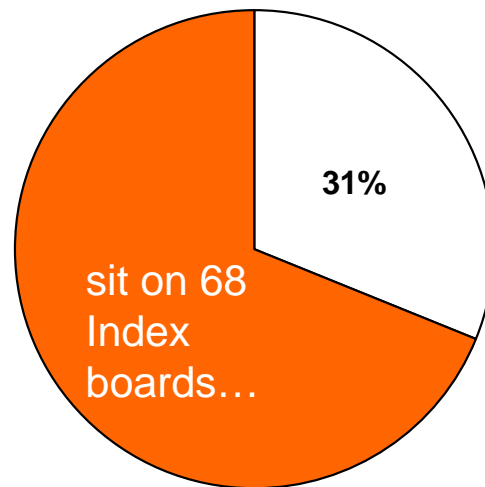


Of the 1689 directors sitting on boards comprising the S&P/TSX Composite Index a small number of directors are extremely sought-after and willing directors.



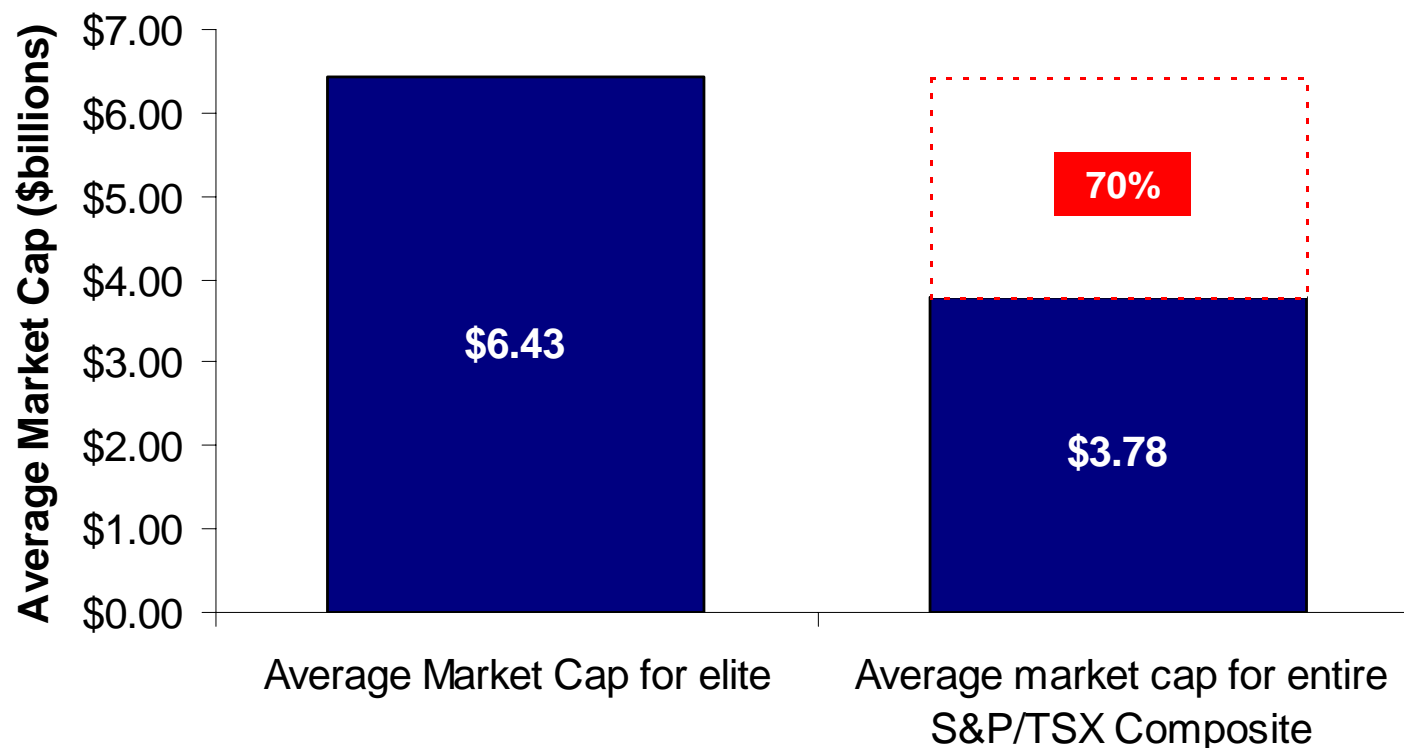
Director	Number of Boards
MacNeill, Brian F.	7
Cockwell, Jack L.	6
Mazankowski, Rt. Hon. D.F.	6
McKenna, Hon. F.J.	6
O'Brien, David P.	6
Baillie, A. Charles	5
Bérard, André	5
Cleghorn, John E.	5
Fortier, L. Yves	5
Godsoe, Peter C.	5
Hushovd, Oyvind	5
Lanthier, J. Spencer	5
Newall, J.M. Edward	5
Osborne, Ronald W.	5
Prichard, J. Robert S.	5
Tapp, Lawrence G.	5

Collectively, this small group of 16 directors have disproportional influence in Canadian board rooms. They are the **Elite 16**.



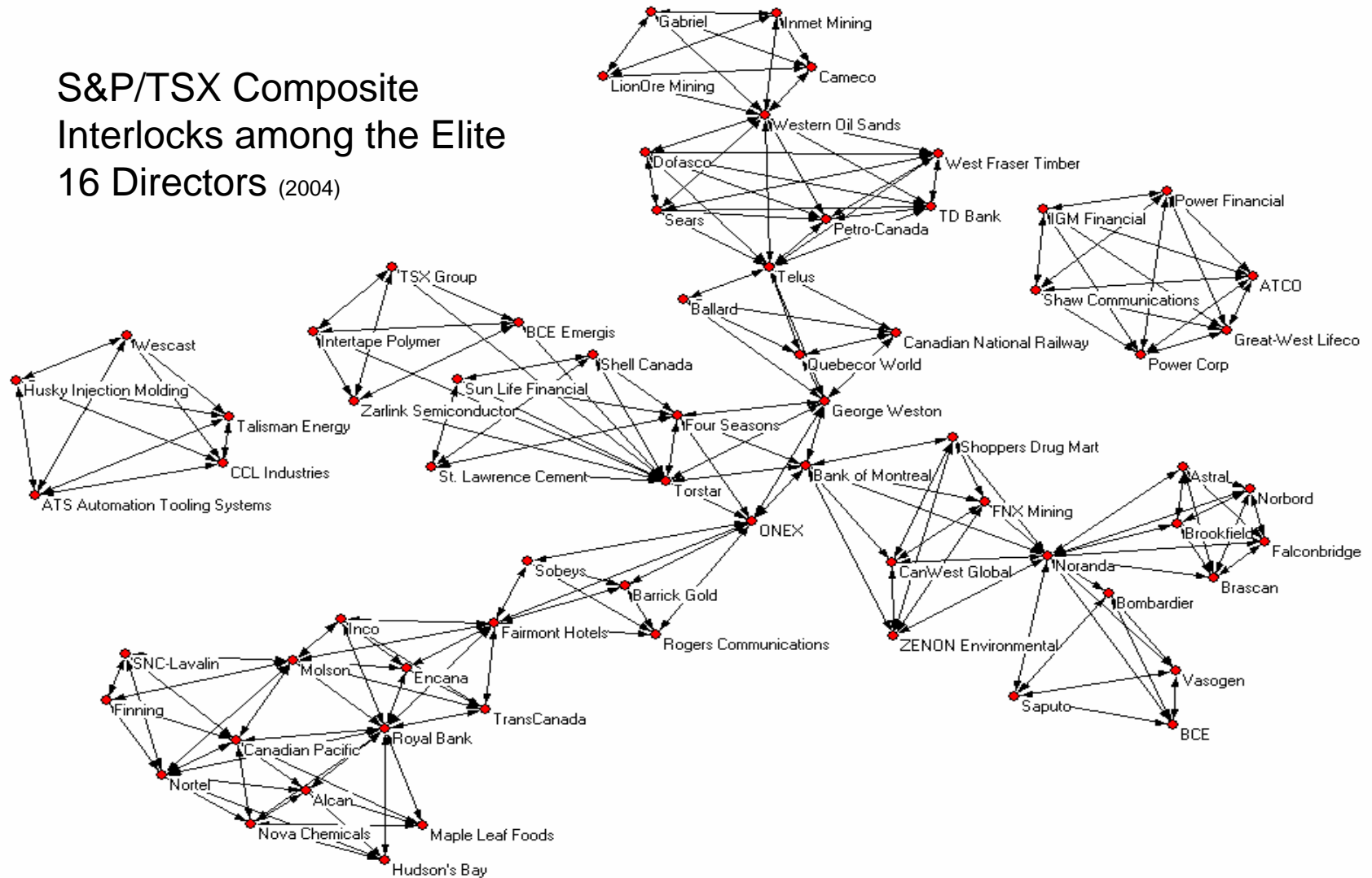
Members of the *Elite 16* sit on the boards of the largest Canadian corporations

Difference in Average Market Cap



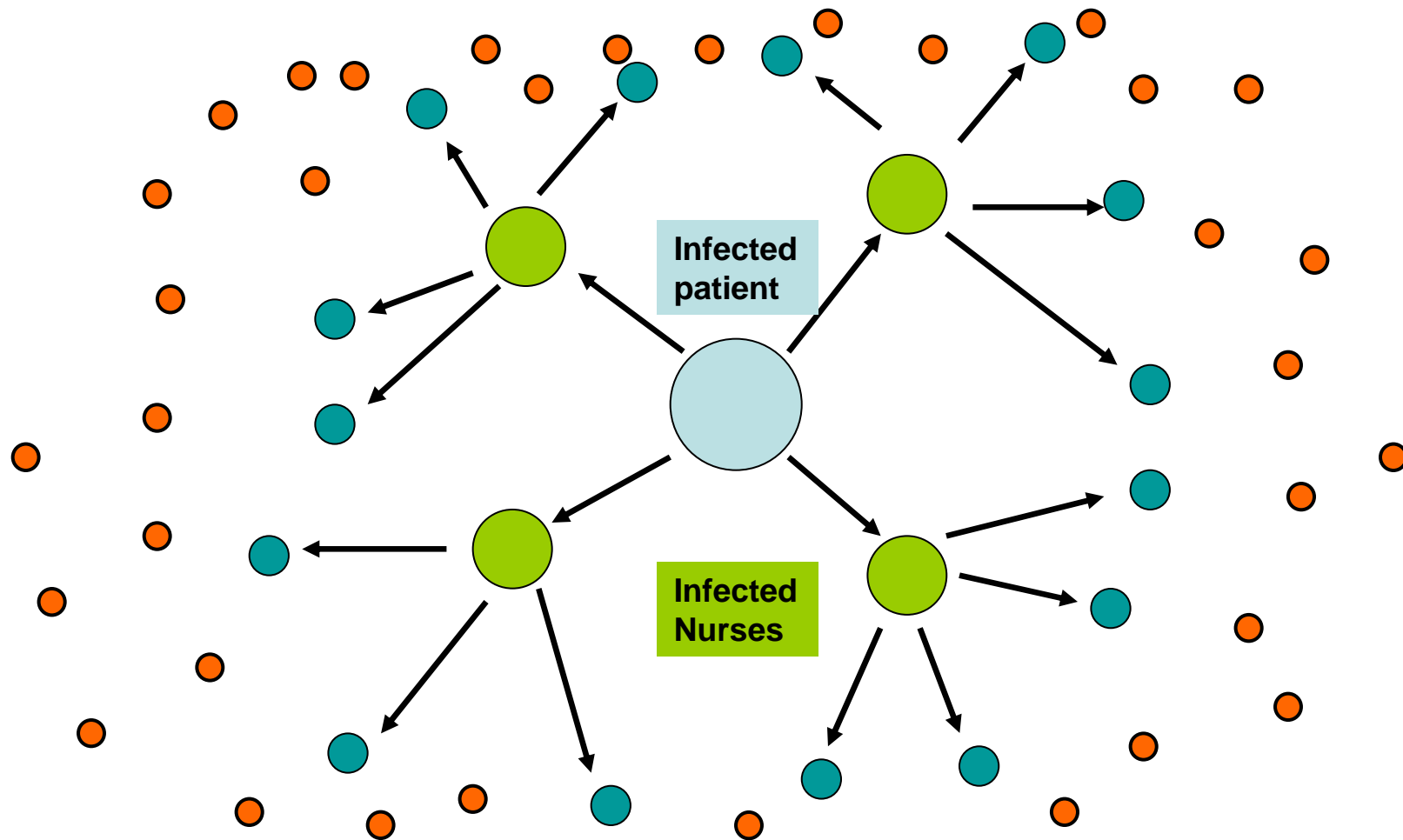
The **Elite 16** sit on many of these boards together. Their shared board appointments form the **Elite Network** – a **dense web of interlocks and influence.**

S&P/TSX Composite
Interlocks among the Elite
16 Directors (2004)

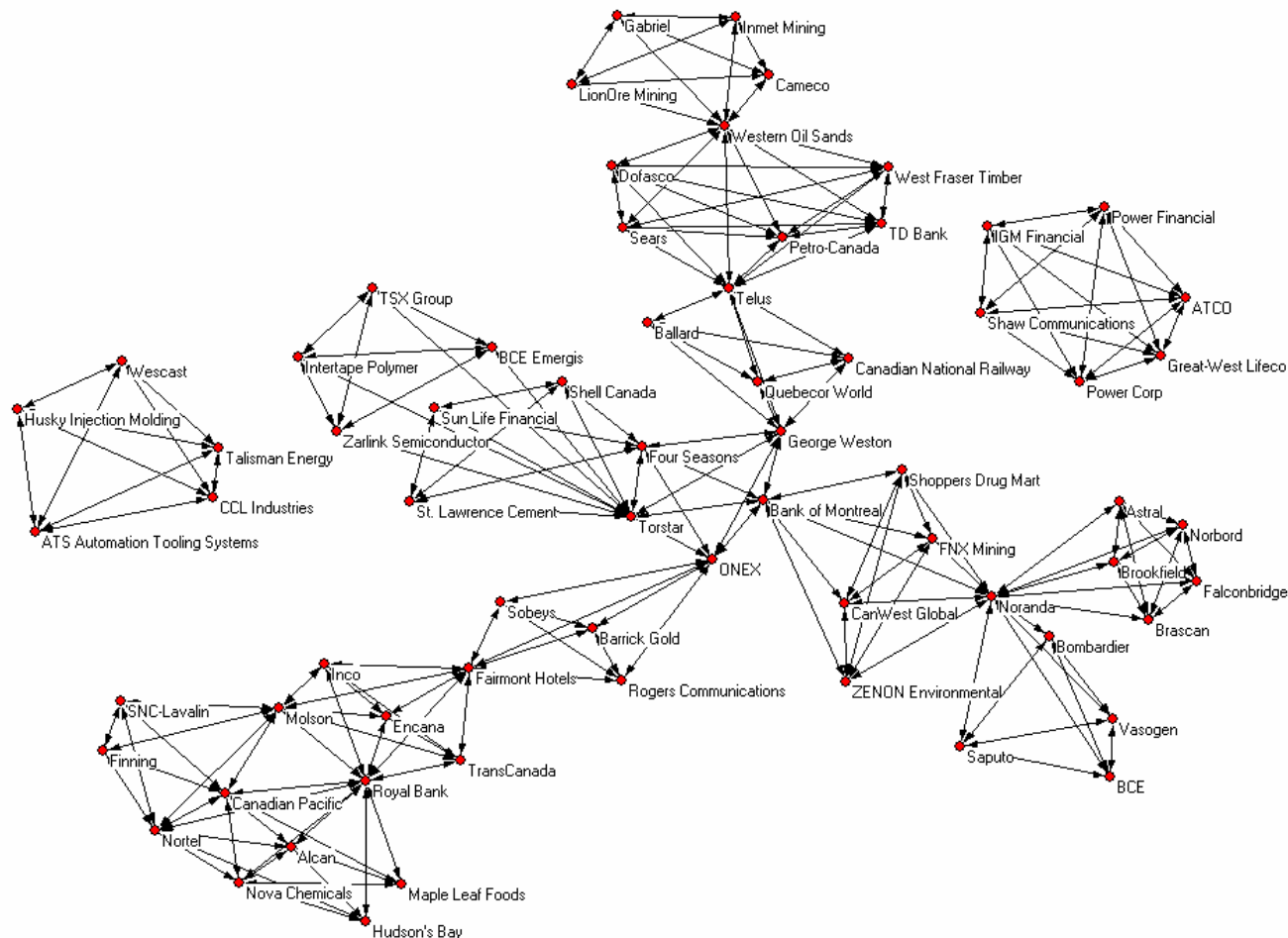


Networks are diffusion conduits

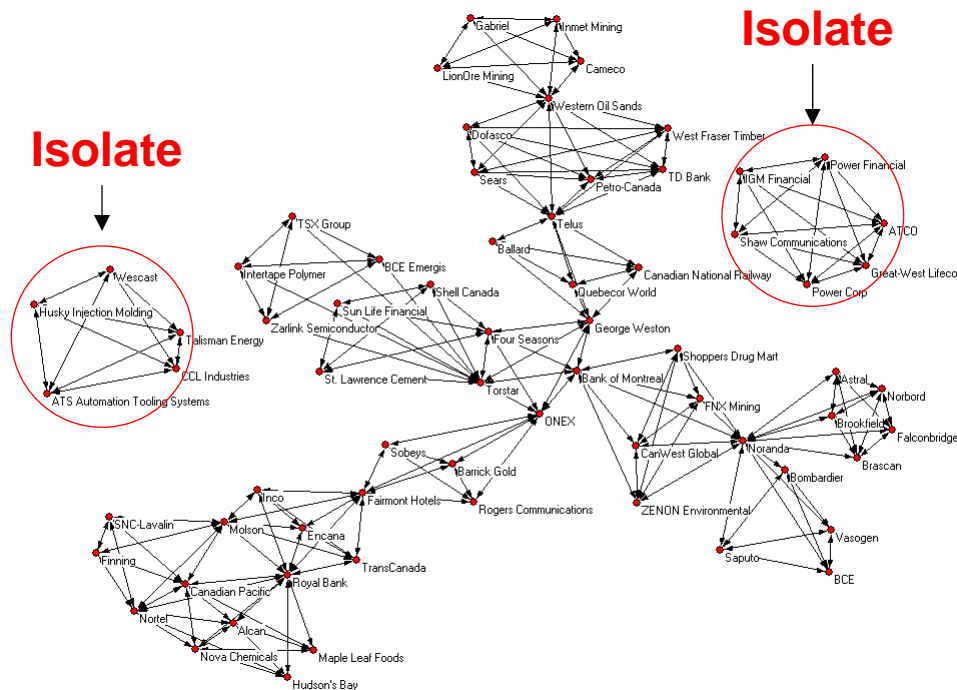
In Toronto, the spread of SARS began with a single infected patient, and continued as hospital workers came in contact with their families and people in other hospitals.



Similarly, Gerald Davis's research at the U of Michigan shows that practices "[appear] to spread through shared directors like a virus." (Strategic Organizations, 2003)

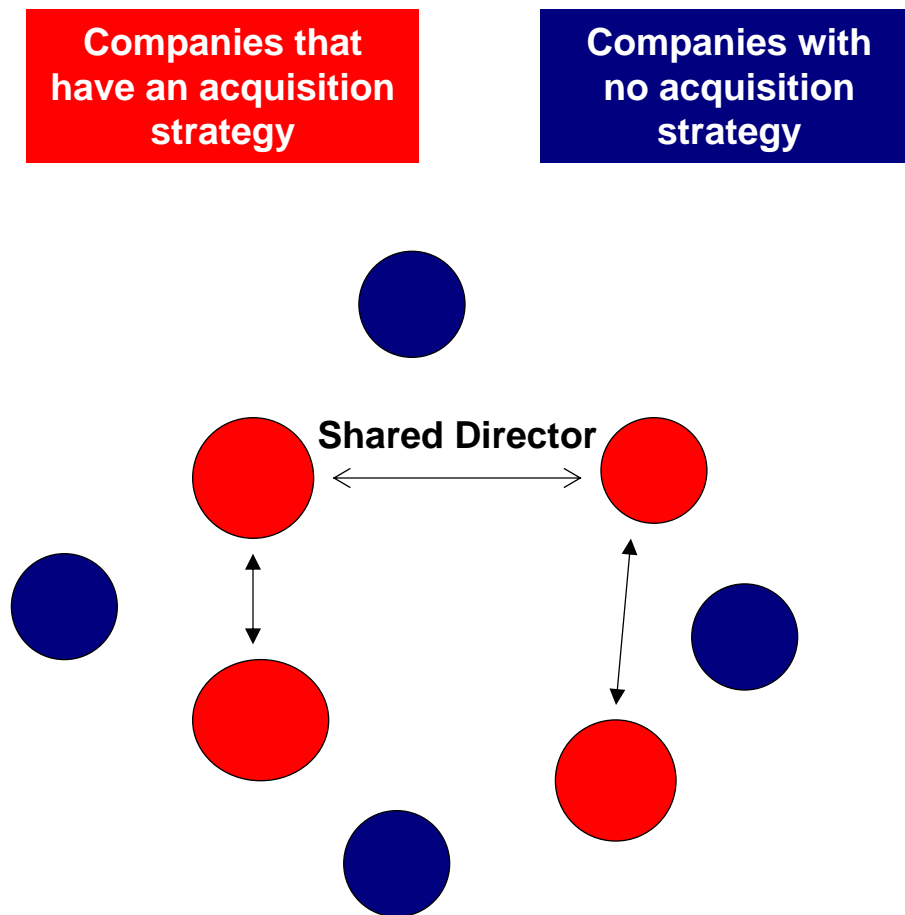


Aside from two of the **Elite 16** who are fully isolated, the flow of information through the **Elite Network** meets no obstruction.



Research has shown that influence and information travel between companies through shared directors.

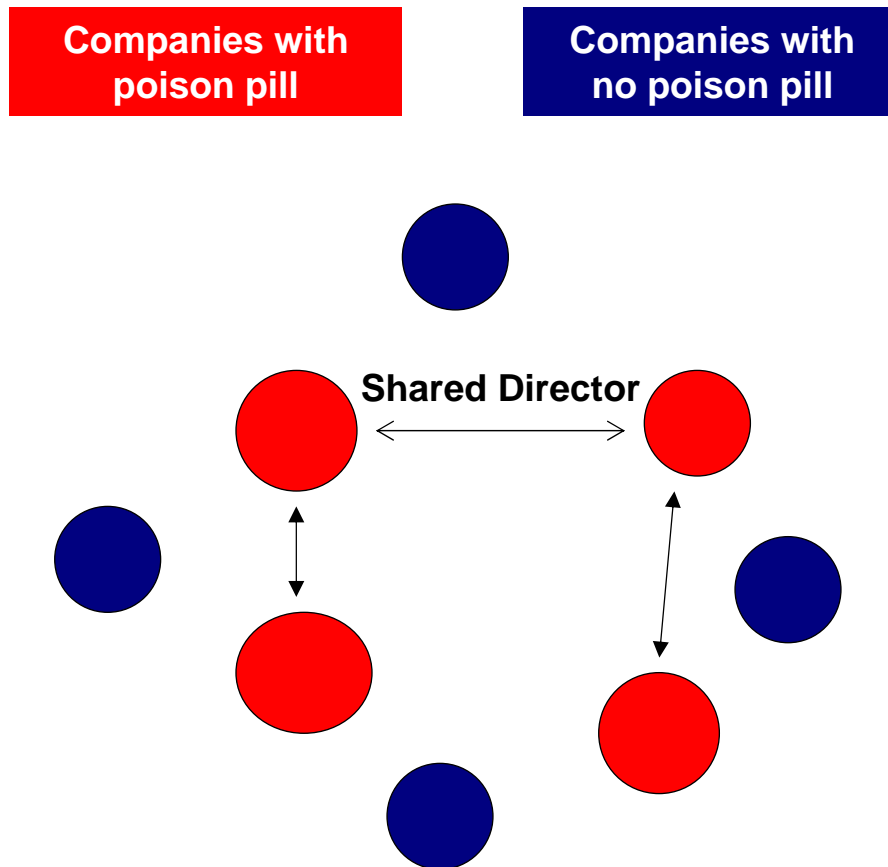
Acquisition strategies diffuse across director interlock networks.



Firms are more likely to adopt an acquisition strategy if they share a director with a company that has an acquisition strategy in place

(Haunschild and Beckman, 1998, Administrative Science Quarterly).

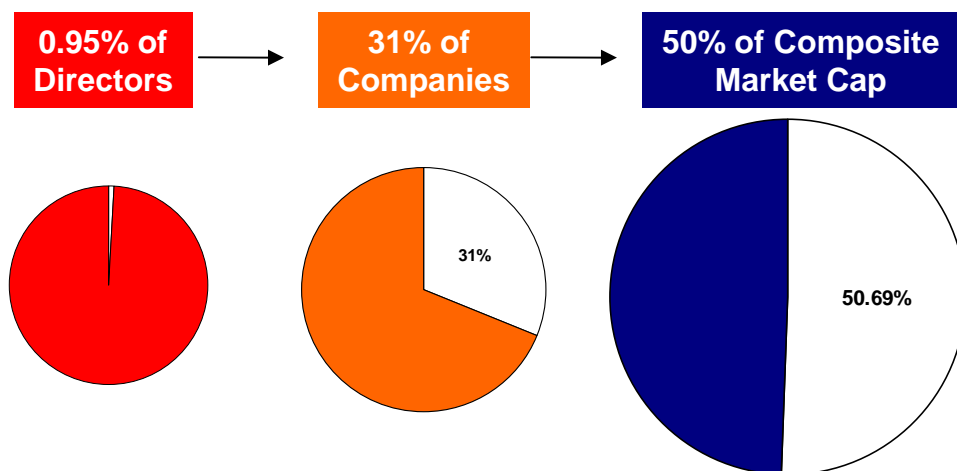
Anti-takeover defense strategies diffuse across director interlock networks.



Firms are more likely to adopt poison pills if they share a director with a company that has a poison pill in place

(Davis, 1991, Administrative Science Quarterly)

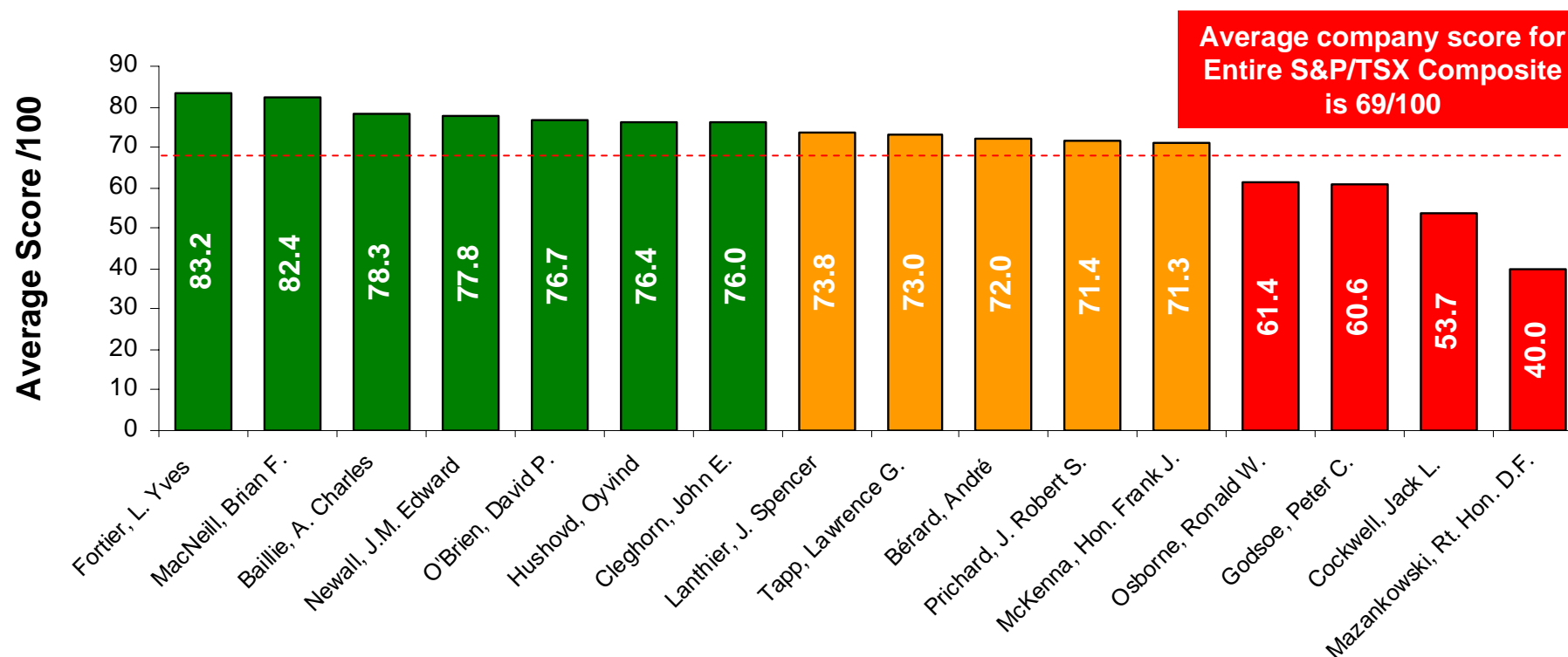
Similarly, the **Elite 16** as a group are at the core of the network that makes up the S&P/TSX Composite



The companies represented by the **Elite 16** are crucial to the reform of corporate governance in Canada

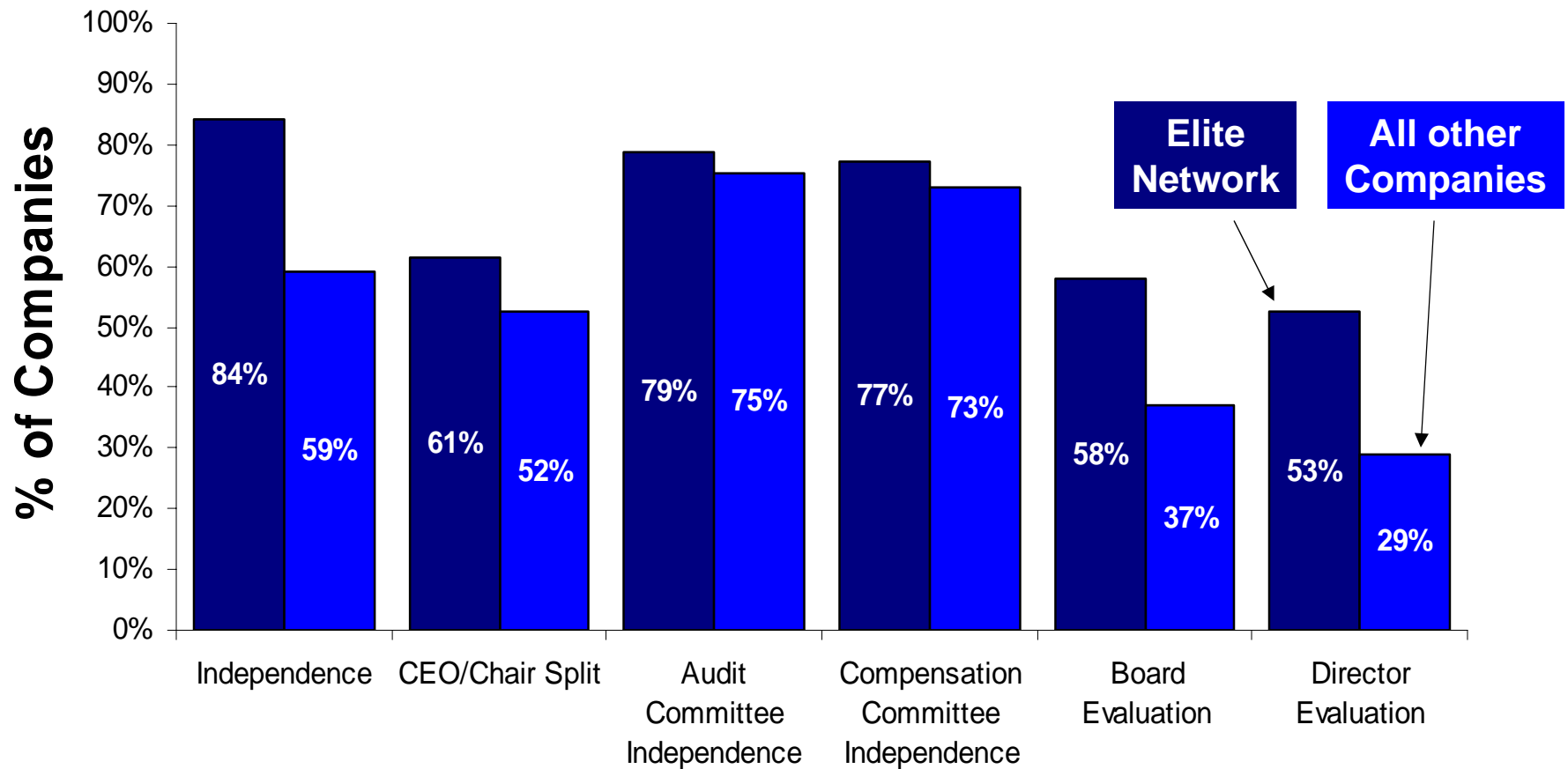
Generally, the **Elite 16** have demonstrated a strong commitment to excellent corporate governance practices.

Average Scores of Directors with 5+ Boards



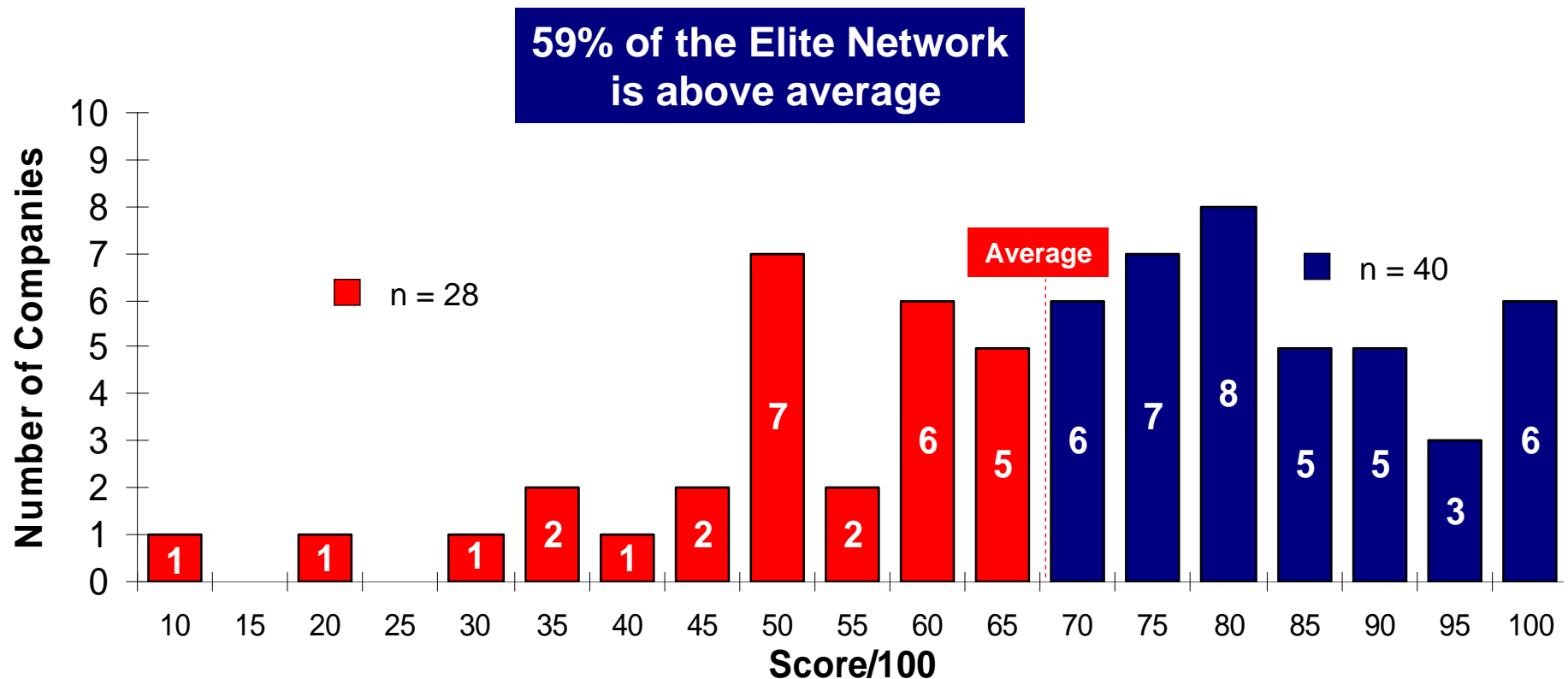
The effect of this commitment has been positive and significant

% of Companies with Best Practices



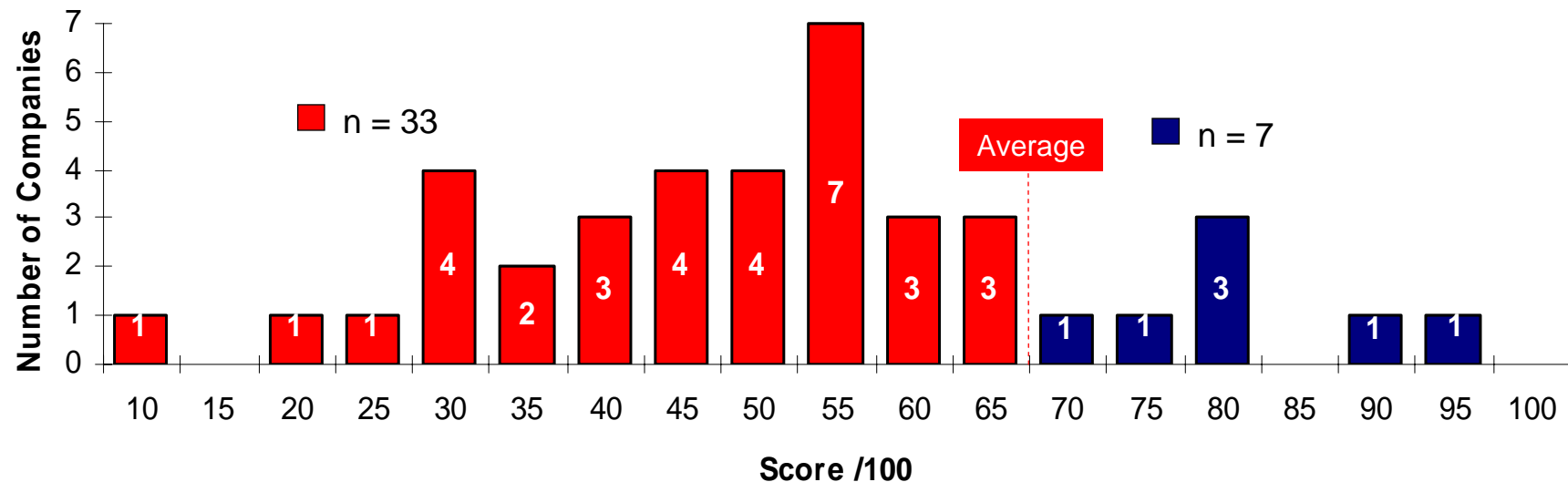
Most of the companies in the **Elite Network** demonstrate governance practices above and beyond those of the rest of the S&P/TSX Composite.

2004 Governance Scores - Elite Network



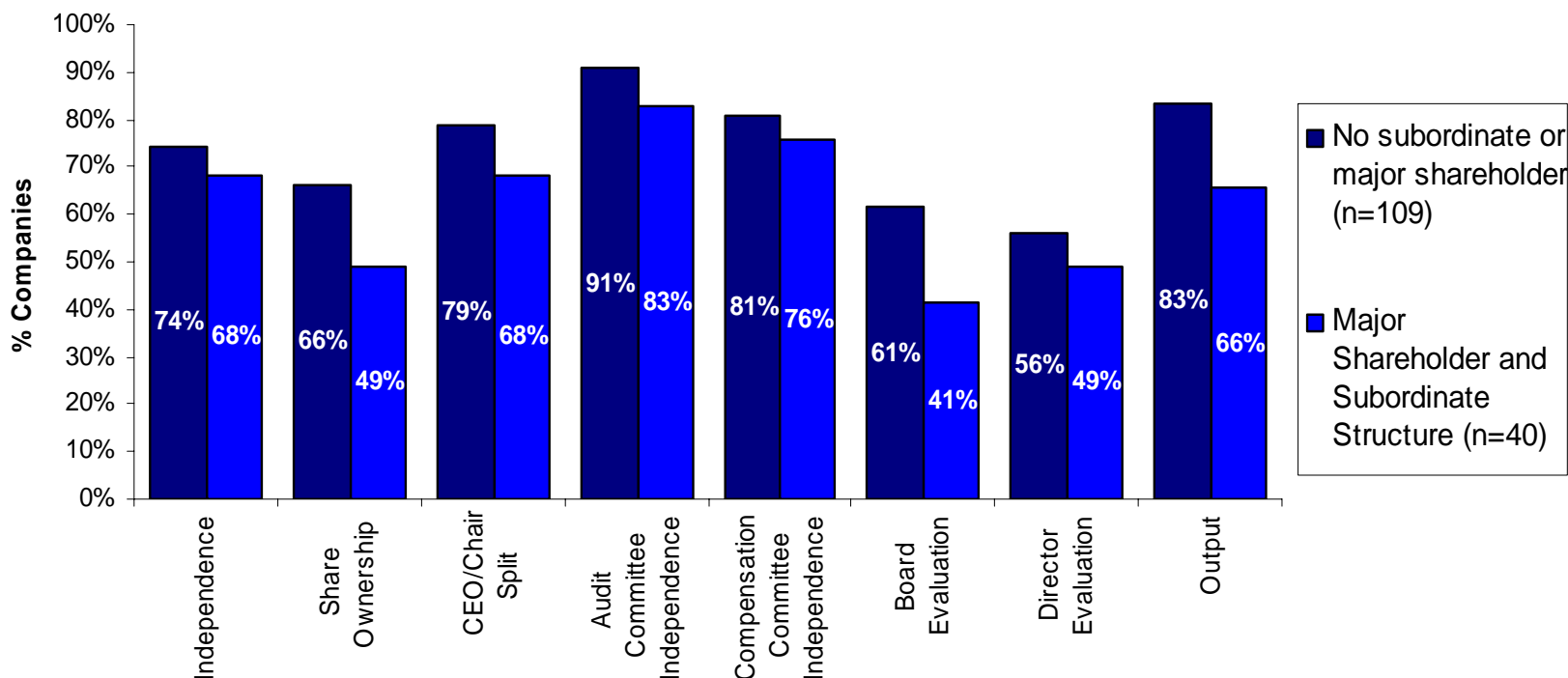
Despite the influence of the **Elite Network**, companies with an *imbalance of voting power* are resistant to improvements in corporate governance.

2004 Governance Scores - Companies with both a Major Shareholder and Subordinate Structure



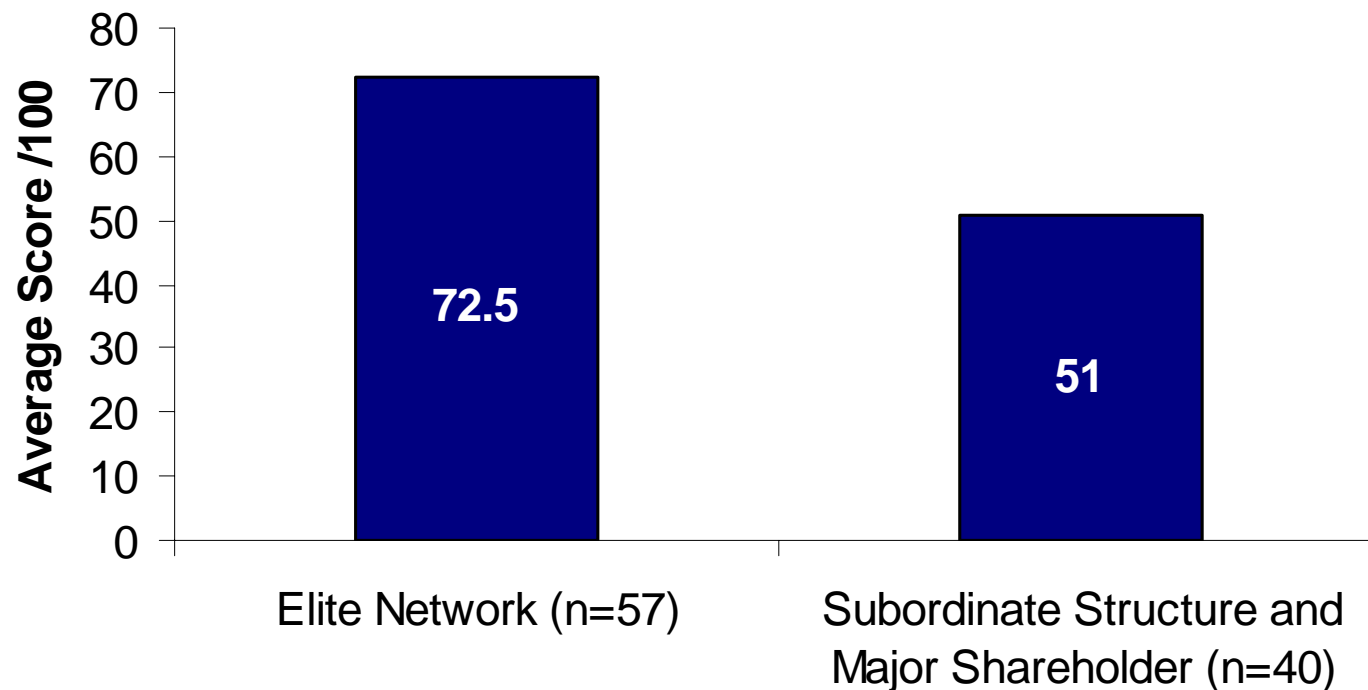
Companies that have a subordinate share structure and a major shareholder are far less likely to demonstrate good governance than widely-held companies (no major shareholder) where every share gets one vote.

% of Companies with Best Practices (2004) - Major Shareholder and Subordinate Share Structure



Control over these companies needs to move from the hands of controlling individuals into those of the board of directors, including the **Elite 16**, before governance reform will reach every company

Average Governance Scores



As the pressure increases on Canadian companies to improve governance practices, the **Elite 16** must be the innovators that drive widely-held companies to remain at the forefront of change.

Corporate Elite

Ownership Structure

