**CORPORATE GOVERNANCE
IN THE TELECOMMUNICATIONS INDUSTRY**

By

Yeongtae Jeon

A THESIS

Submitted to
KDI School of International Policy and Management
in partial fulfillment of the requirements
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Department of Strategy and International Management

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ABSTRACT

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Technological, regulatory, and economic forces have been changing the telecommunications industry. Korea Telecom, the leading telecommunications company in Korea, is experiencing privatization, deregulation, and market opening which is resulting in the weakening of its monopolistic position.

This paper aims to analyze the governance structure of telecommunications companies by reviewing the existing literature and conducting case studies of telcos in different stages of privatization. This study analyzes several telecommunications companies, such as AT&T and BT – the leading telcos with diffuse ownership – and Deutsche Telekom and France Telecom – those still regulated by their respective government.

The key findings obtained through the case studies are as follows:

First, this study did not find a significant relationship between firm performance and the composition of the board. Second, in the face of rapidly deregulating environment, the telcos have begun to give emphasis on the form of executive compensation by increasing the variable portion of the compensation. Finally, the market for corporate control is becoming an important mechanism for resolving owner-manager conflicts after privatization and deregulation.

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INTRODUCTION

1.1 Background

Technological, regulatory, and economic forces have been changing the telecommunications industry. Of the three, technology is the trigger of the changes.

It is the near-exponential increases in capacity made possible by the latest optical-fiber technology that are re-shaping telecommunications industries everywhere. The time is not far off when all the world's current voice traffic could be carried on a single pair of fibers the width of a human hair. Even today, that pair of fibers can carry all of North America's long-distance traffic.

Another crucial element of the new technology is the move from the proprietary circuit-switched networks that carry the voice traffic, to a connectionless architecture, based on Internet protocols (IP), that can route packets of data to their destinations at high speed. IP technology is not only ideal for the growing convergence between voice, data and video; it is also indifferent to distance and quickly expandable.

Relentless technological change is driving down many of the elements in the cost of a telephone call. Already, the cost of carrying an additional call is often so tiny that it might as well be free. As technological progress continues, telecommunications operators (hereafter telcos) are losing the benefit of economies of scale.

There was a time when the telecom industry was a natural monopoly. Most governments liked it that way because they owned the monopoly and siphoned off some of the profits. Even now, most homes are served by only one wire, so customers

cannot switch telephone services in the way they can change their hairdresser. But as new technologies reduce the costs of entry, competition is spreading. Enthusiastically in some countries and gingerly in most, governments have begun to accept that competition offers the best way to ensure that changing technology is fully translated into lower tariffs.

One of the features of the telecommunication industry trends is rapid privatization which is accompanied by deregulation. The flagship telcos of each country have experienced different paths of privatization and developed various governance structures. In privatizing government-owned enterprises, ownership and governance is a key issue.

The contemporary governance debate increasingly focuses on what systems of governance best promote economic efficiency and generate “shareholder value”. An efficient corporate governance system would ensure that a firm is managed to increase its value to the shareholders and help achieve the socially efficient resource allocation.

1.2 Purpose of the Study

This paper aims to assess the governance structure of selected international telcos and derive implications for Korea Telecom.

The proliferation of deregulation across many industries and abroad provides an opportunity for compiling cases on the evolution of governance structures and their adaptation to environmental shocks. Comparative-static analysis suggests that systems of management incentives and monitoring are likely to change after an industry is deregulated.

1.3 Organization of the Thesis

Chapter 2 reviews the existing literature on corporate governance; namely, the role of board of directors; the relationship between firm performance and director compensation; and agency problem in the external market for corporate control.

Chapter 3 analyzes the governance structure of seven telcos and evaluates Korea Telecom's governance structure. Since the telcos are in different stages of privatization and deregulation, analysis of their respective governance structure could lead to a better understanding of corporate governance issues in the telecommunications industry.

Chapter 4 summarizes the key findings of the study and develops some recommendations for Korea Telecom.

LITERATURE REVIEW ON CORPORATE GOVERNANCE

2.1 Separation of Ownership and Management

2.1.1 Agency Problem

The definition of governance as the interaction between owners and managers in controlling and directing a company is commonly accepted and used. A broader definition would include "stakeholders" in addition to owners.

The separation of ownership and control in the modern corporation, an issue brought to the fore so effectively by Berle and Means fifty years ago, retains a central position in writings about the economic theory of a firm. The problem is stated succinctly by Berle and Means:

> The separation of ownership from control produces a condition where the interests of owner and of ultimate manager may, and often do, diverge, and where many of the checks which formerly operated to limit the use of power disappear….
>
> In creating these new relationships, the quasi-public corporation may fairly be said to work a revolution. It… has divided ownership into nominal ownership and the power formerly joined to it. Thereby the corporation has changed the nature of profit-seeking enterprise. (Berle and Means, 1968)

Berle and Means contend that managers do not have the same interest and motivation as the owners to make full and efficient use of the corporate assets. Consequently the owners had to introduce other means to ensure an alignment of owners' and managers' interests. Jensen and Meckling(1976) extended the argument by assessing the agency cost of this alignment. They define the shareholder relationship as one of agency

With management control, professional managers can maximize their own welfare, which may not be in the best interest of shareholders. For example, they may seek to benefit from the private consumption of corporate wealth or even make selfish investment decisions to protect their own job security rather than maximizing the return to shareholders. This moral-hazard problem arises when there is information asymmetry between the shareholders and managers.

The potential conflict of interest between agents (managers) and principals (shareholders) incurs monitoring cost when shareholders try to set up a monitoring and bonding mechanism to prevent such abuse of corporate resources by the managers. Loss to their shareholders due to the incompleteness of the monitoring system will have to be borne by the shareholders as “agency costs”(Jensen and Meckling 1976)

2.1.2 Deregulation and Agency Cost

Deregulation increases the importance of the managerial function in the firm. Incentives to develop low-cost methods of production are muted under price and entry regulation. Price regulation and insulation from product-market competition also discourage firms from developing innovative pricing and distribution strategies. Regulation inhibits mergers and acquisition, either by explicitly discouraging the transactions or by limiting their potential gains. Removal of the profitability "safety net" provided by regulation introduces substantial downside risk: firms that make bad or unlucky decisions face extinction via bankruptcy or takeover. Managerial discretion increases under deregulation, as does the sensitivity of firm value to the quality of managerial decisions.

In addition to increasing the importance of the managerial function, deregulation increases the costs of observing managerial performance. Deregulation induces instability into the business environment. Greater instability makes it harder to distinguish the effects of management decisions on firm performance from the effects of other factors. By simultaneously increasing the role of managers and making their performance less observable, deregulation changes the nature and the severity of potential agency problems in firms. (Kole and Lehn 1997)

A successful corporate governance system must accomplish the tasks of coordination and motivation. The decisions and actions of the interested parties, i.e. shareholders, management, and creditors and potential investors in the financial market, need to be coordinated to protect the shareholders' interests and efficiently advance other corporate goals. An efficient corporate governance system would ensure that a firm is managed to increase its value to the shareholders, subject to legal and contractual constrains, and help achieve the socially efficient resource allocation given that financial and product markets relevant to the firm are properly functioning as well.

With those tasks in mind, I will review some previous studies on the following aspects of corporate governance in the following sections

- Internal corporate governance which concerns the means to protect the rights of stakeholders; the role and responsibility of the board of directors and its composition, the relation between firm performance and director remuneration

- External corporate governance by the market for corporate control which concerns the relationship between the firm and potential investors in the stock market. I will cover studies on the agent problems in the external corporate governance.

2.2 Board of Directors and its Composition

2.2.1 Role and Responsibility

Boards of directors are a crucial part of the corporate structure. They are the link between the people who provide capital(shareholders) and the people who use that capital to create value(managers). The board's primary role is to monitor management on behalf of the shareholders. This generally means that boards are the overlap between the small, powerful group that runs the company and a huge, diffuse, and relatively powerless group that simply wishes to see the company run well.

Together with guiding corporate strategy, the board is chiefly responsible for monitoring managerial performance and achieving an adequate return for shareholders, while preventing conflicts of interest and balancing competing demands on the corporation. In order for boards to effectively fulfil their responsibilities they must have some degree of independence from management. Another important board responsibility is to implement systems designed to ensure that the corporation obeys applicable laws, including tax, competition, labor, environmental, equal opportunity, health and safety laws. In addition, boards are expected to take due regard of, and deal fairly with, other stakeholder interests including those of employees, creditors, customers, suppliers and local communities.

The board should fulfil certain key functions, including:

1. Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital

expenditures, acquisitions and divestitures.

2. Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning.

3. Reviewing key executive and board remuneration, and ensuring a formal and transparent board nomination process.

4. Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions.

5. Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for monitoring risk, financial control, and compliance with the law.

6. Monitoring the effectiveness of the governance practices under which it operates and making changes as needed.

7. Overseeing the process of disclosure and communications. (OECD principles of corporate governance 1999)

A critical issue in carrying out a board's function is whether directors who are also members of the top management can be relied on to monitor and control what is effectively their own management performance. Exponents of the stewardship theory argue that power lies with the shareholders to choose the structure of their company's board and the members of it, with independent external auditors appointed to report to the shareholders on the truth and fairness of the reports.

Agency theory, on the other hand, points to many examples of the abuse of power stemming from the domination of boards by the incumbent management, who have treated the company as though it were their personal property, and apparently acted in their own interests rather than those of the owners. Hence the argument that boards should have non-executive, outside directors who are genuinely independent of the business.

2.2.2 Composition of the Board

Board structures and procedures vary both within and among countries, due to political histories, laws and regulations, cultures, and paths of economic development. Some countries have two-tier boards that separate the supervisory function and the management function into different bodies. Such systems typically have a “supervisory board” composed of non-executive board members and a “management board” composed entirely of executives. Other countries have “unitary” boards, which bring together executive and non-executive board members.

The experience of two-tier boards is principally in Continental Europe, and it is in Germany and the Netherlands that the idea has received its fullest development in the form of the mandatory “dualist” structures for certain kinds of company. The distinctive feature of these systems is that the shareholders have an opportunity to influence the composition of a body which has as its function the exercise of general and relatively continuous control and supervision over the activities of those managing the company’s affairs. The members of the supervisory body have the opportunity of scrutinizing the management of the company on behalf of the shareholders in a way the shareholders themselves, particularly small shareholders,

normally cannot.

One trend that has characterized unitary boards has been the rise of the "independent" outside director. In order to be independent, a director must have no connection to the company other than the seat on the board. This excludes not just full-time employees of the company, but also family members of employees and the company's lawyer, banker, and consultant.

Independent board members can contribute significantly to the decision-making of the board. They can bring an objective view to the evaluation of the performance of the board and management. In addition, they can play an important role in areas where the interests of management, the company and shareholders may diverge such as executive remuneration, succession planning, changes of corporate control, take-over defenses, large acquisitions and the audit function.

Boards should consider assigning a sufficient number of non-executive board members capable of exercising independent judgement to tasks where there is a potential for conflict of interest. Examples of such key responsibilities are financial reporting, nomination and executive and board remuneration. While the responsibility for financial reporting, remuneration and nomination are those of the board as a whole, independent non-executive board members can provide additional assurance to market participants that their interests are defended. Boards may also consider establishing specific committees to consider questions where there is a potential for conflict of interest. These committees may require a minimum number or be composed entirely of non-executive members. A previous study documents that CEOs should be the only insider on the board (Jensen 1993)

A recent research, on the other hand, observed no relationship between firm

performance and board composition (Mehran 1995). This lack of correlation has been interpreted by previous researchers as implying that boards are forsaking their obligations to shareholders. Directors, however, can design more efficient compensation packages that include equity-based compensation. Contracts that link executives' compensation to the outcome of their actions reduce the effort and expertise required of directors for effective oversight.

2.3 Firm Performance and Director Compensation

2.3.1 Relationship between Firm Performance and Director Compensation

Researchers have addressed the agency costs generated by the separation of ownership and control. Jensen and Meckling(1976) argued that ownership structure, executive compensation structure, and board composition are determined by each other and by the nature of a firm's business (business risk, nature of real assets, cash flow pattern, and firm size). They suggested that these variables also influence a firm's performance. Many devices have been suggested to improve the alignment of managers' incentives with the interests of shareholders, including such devices as high corporate leverage, more effective monitoring by the board of directors, and managerial pay.

Managerial pay has come under increasing scrutiny in the popular press. On one side of the debate are critics who suggest that chief executive officer (CEO) pay is not related to performance and is frequently 'excessive'. Suggestions have ranged from capping CEO pay to making pay a prescribed multiple of the lowest worker's salary. On the other side of the debate are proponents of moderate reform of the current

executive compensation system.

Pay for performance is just as important with directors as it is with managers. As with managerial pay, the important question in director pay is not “how much” but “how”. The assumption of risk should be rewarded. If directors are prepared to link their own wealth to the performance of the company, then they should be paid more.

Top managers, like most individuals, are portrayed as being risk-averse. This implies that managers will want their compensation structured so that they bear less personal risk. Given a certain level of compensation, managers should prefer fixed cash compensation over equity-based compensation. The latter, of course, is tied to the firm’s stock return and is to some degree beyond managers’ control. This preference is reinforced because the value of a manager’s human capital will also vary with the firm’s stock performance. In order to reduce their compensation risk, managers may engage in activities which reduce the firm’s risk (Jensen and Meckling, 1976). These activities in turn can adversely affect shareholders’ wealth.

Shareholders, on the other hand, are considered risk-neutral because they can diversify firm-specific risk simply by holding a diversified portfolio. Moreover, shareholders will anticipate that managers will attempt to avoid risks in ways that can reduce firm value. While there are several ways to reduce this conflict over risk, previous research suggests that tying managers’ compensation to firm performance motivates them to make more value-maximizing decisions. Some studies suggest that one specific way to tie pay to performance is by making a greater percentage of a manager’s compensation equity-based, such as through incentive stock options. Other researchers have formally shown that incentive-compensation plans motivate managers to take on more risk. For these reasons, shareholders should prefer, holding

the level of compensation constant, that managers' pay packages contain more equity-based forms of compensation.

Shareholders do not set executive compensation. They elect directors, who have the exclusive right under corporate law to manage the corporation. Among the most important of directors' tasks is to set the level and structure of the compensation of top executives, which raises the issue of how the composition of the board affects the structure of executive compensation. There is a growing body of evidence that outside directors are more independent of top management and thus better represent the interest of shareholders than do inside directors.

Mehran(1995) examined the relationship between the composition of the board and the structure of executive compensation. The study focused on the structure rather than the level of compensation and it investigated executive compensation in the context of the firm's ownership structure and the composition of this board of directors. Mehran(1995) documented his findings on compensation structure as follows: (1) firms with more outside directors have a higher percentage of their executive compensation in equity-based form; (2) the percentage of executive compensation that is equity-based is inversely related to their percentage of equity holdings; and (3) firms in which a higher percentage of the shares are held by outside blockholders use less equity-based compensation. His findings on firm performance, as proxied by Tobin's Q and by return on assets, are as follows: (1) firm performance is positively related to the percentage of executive compensation that is equity-based; and (2) firm performance is positively related to the percentage of equity held by managers. These findings support tying executive compensation more closely to firm performance (as measured by stock price or other indicators); they also suggest that the form, rather than the level, of compensation is what motivates managers to

increase firm value. The results on firm performance indicate that both Tobin's Q and return on assets are positively related to both the percentage of executives' total compensation that is equity-based and the percentage of shares held by top managers. Thus compensation does affect CEO incentives in ways that have a measurable impact on corporate efficiency (Mehran 1995). However, the study is exploratory in that executive compensation, ownership structure, and board composition are ultimately part of a simultaneous system that determines the corporation's value and the allocation of that value among various claimants. As a result, the association are not necessarily causal ones. Nevertheless, empirical regularities in the structure of executive compensation help understand the role of director remuneration.

Regarding the relationship between firm performance and outside directors' equity holdings, studies have different arguments. In contrast with the finding of Morck, Shleifer, and Vishny(1988), Mehran(1995) found no significant relationship between firm performance and outside directors' equity holdings. Unless a substantial component of outside directors' compensation is tied to the firm's performance (e.g., through stock options), their capital risk may not be large enough to motivate them monitor the management team.

2.3.2 Deregulation and Executive Compensation

CEO pay has been examined empirically by previous studies and all found a positive relation between pay and performance for samples of publicly-held corporations. Jensen and Murphy(1990) examined the link between changes in

shareholder wealth and CEO pay and found a significant positive relation between pay and performance. However, they find only a $3.25 change in CEO wealth per $1,000 change in shareholder wealth. They attribute this small sensitivity to public and private political forces influencing the managerial compensation market, noting that managerial compensation is highly visible and attracts 'implicit regulation' that truncates the upper tail of managerial compensation. They suggest that to align managerial incentives with shareholders' interests, caps on managerial salaries should be eliminated and the sensitivity of compensation to performance should be enhanced to reward the better performing managers.

Hubbard and Palia(1995) examined CEO pay in the banking industry and the effect of deregulating the market for corporate control markets. They find (1) higher levels of pay in competitive corporate control markets, (2) a stronger pay-performance relation in deregulated markets, and (3) CEO turnover increases substantially after deregulation. While such results must be interpreted with caution, they are consistent with the idea that restricting pay levels of chief executive officers reduces the effectiveness of a well-functioning managerial labor market and its associated pay structure in attracting talented managers to challenging careers.

2.4 Role of External Market for Corporate Control

The takeover process itself, however, has been considered as a mechanism for resolving owner-manager conflicts. Given the difficulty individual shareholders have in replacing inefficient managers, poorly performing firms may be valued below their potential in the marketplace. These firms become attractive targets for bidders who can correct inefficiencies. These forces the pre-takeover management of the target

firms to renegotiate for employment with either its old firm or a new one. Fama (1980) suggests that the need to "settle up" discipline managers. The threat of takeover should improve this process.

A previous research found that internally precipitated complete turnover of the top management team, which should be successful monitoring by board, is more likely to occur in firms that under-perform in troubled industries than in healthy industries. In addition, internally caused complete turnover is less prevalent in firms run by founders or "one-man" management teams. In contrast, hostile takeovers, which they associated with the board's failure to discipline managers, are predictable based on poor performance of the whole industry, and are disproportionately targeted at firms with "one-man" management teams. Finally, to the extent that they are disciplinary, friendly acquisitions seem to be encouraged by corporate boards that are faced with poor performance relative to a healthy industry (Morck, Shleifer, and Vishny 1989).

However, to the extent that internal control devices are cheaper to operate and are more conductive to long-term planning by incumbent management than are hostile takeovers, the replacement of the oversight function of the board by the external market for corporate control might be deemed a third-best situation.

Agency Problem in the Case of Tender Offer

Employment of agents has been shown to allow impediments to shareholder wealth maximization because the best interest of agents may differ from the best interest of shareholders (Jensen and Meckling, 1976). Resolution of these differences may generate agency costs. The potential for this conflict is exceedingly high in the

case tender offer. Managers of target firms may be faced with a conflict of interest between their fiduciary responsibilities and their own potential wealth changes. Managers who believe that a tender offer is in the best interest of their shareholders may, nevertheless, find themselves unemployed if the bid is successful. For these reasons, tender offers provide an ideal vehicle for the analysis of agency conflicts.

The finding of Walkling and Long (1984) is that the existence or absence of bid resistance is found to be directly related to the personal wealth changes of the target firm's managers.

ANALYSIS OF TELECOM COMPANIES' GOVERNANCE STRUCTURE

3.1 Introduction

Governance structures vary due to political histories, laws and regulations, cultures, and paths of economic development. Some countries have two-tier boards that separate the supervisory function and the management function into different bodies. Other countries have "unitary" boards, which bring together executive and non-executive board members. When evaluating governance model relevance, one should take into account the capital market structure, government regulations, and structure of shareholding.

One of the features of the telecommunication industry trends is rapid privatization accompanied by deregulation. The flagship telcos of each country have experienced different paths of privatization and developed unique governance structure respectively.

This chapter examines the composition of the board of directors, the compensation scheme, and other governance matters of seven telcos. After that, I will evaluate the governance structure of Korea Telecom. The seven telcos are AT&T Corp. (hereafter AT&T), British Telecom PLC (hereafter British Telecom), Deutsche Telekom AG (hereafter Deutsche Telekom), France Telecom, Nippon Telegraph and Telephone Corporation (hereafter NTT), Telecom Italia SPA (hereafter Telecom Italia), and Telstra Corp LTD (hereafter Telstra). The government ownership of the selected telcos ranges from zero to seventy-four percent due to the difference in the privatization stage.

Board structures and size vary among the telcos. AT&T has a unitary board which bring together executive and non-employee board members. DT has, on the other hand, a two-tier board that separates the supervisory function and the management function into different bodies.

3.2 AT&T Corp.

3.2.1 Overview

AT&T is one of the worlds largest communications services providing voice, data and video telecommunications services to businesses large and small, consumers and government entities. The company provides billing, directory and calling card services to support its communications business. AT&T has established alliances & joint ventures in major foreign markets with prominent telecommunication companies. The number of employees is 107,800 and total assets amount to USD 59,550 mil on December 31, 1998.

AT&T has diffuse share ownership. The only entity with more than 5% of the issued and outstanding shares of AT&T common stock had 5.242% as of December 31, 1998. The directors and executive officers as a group have 2,030,636 shares, which is about 0.13% of total shares.

AT&T has a unitary board with majority of non-employee directors. Its compensation scheme puts emphasis on aligning directors’ interests with shareholders by increasing the variable portion of the remuneration and using long-term incentive plans.

3.2.2 Composition of Board

AT&T's board consist of eight non-employee directors and two executive ones. CEO is also the chairman of the board, which reflects US business culture. In 76 percent of the largest US companies, the chief executive is the chairman of the board. In England, by contrast, the figure is roughly reversed, with only one third of the largest companies having a joint CEO/Chairman.

3.2.3 Principal Board Committees

AT&T's three principal committees are as follows:

(1) Audit Committee meets with management to consider the adequacy of the internal controls and the objectivity of financial reporting. The committee consists of six non-employee directors.

(2) Compensation and Employee Benefits Committee administers management incentive compensation plans, including stock option plans, and keeps informed and advises the board regarding employee benefit plans. The committee consists of five non-employee directors.

(3) Governance and Nominating Committee, advises and makes recommendations to the board on all matters concerning directorship and corporate governance practices, including compensation of directors and the selection of candidates as nominees for election as directors, and it provides guidance with respect to matters of public policy. The committee consists of four non-employee directors and one employee director.

3.2.4 Directors' Compensation

AT&T's programs aim to provide executives with a competitive earnings opportunity, with earnings linked to the short-term and long-term performance of the company and the sustained performance of the individual.

The compensation principles are as follows: competitiveness, performance contingency, accountability to stakeholders, balance between short-term and long-term performance, and tax effectiveness.

The remuneration package for executive directors consists of three key elements: (1) Base salary, (2) Short-term incentives, i.e., annual bonus; and (3) Long-term incentives, i.e., performance shares, stock options, and restricted stock.

Base Salary

AT&T determines the salary ranges for each of the executive officer positions based upon the scope, level and strategic impact of the position, and on the pay levels of similarly positioned executive officers in comparable companies. Consistent with aligning compensation with shareholder interests and cost control, no salary increases were made for executive officers or other senior managers of the company in 1998.

Annual Bonus

The annual bonus for other executive officers is based on the company's financial and key non-financial results as measured against pre-set targets for (1) Earnings Per Share; (2) Revenue Growth; (3) Reduction in sales, general &administrative expense; (4) Customer value added, which measures the relative value that customers perceive

when AT&T's services are compared with those of competitors; and (5) People value added, which measures employee views regarding leadership and contributions to the diversity of the company.

Long Term Incentives: Performance Shares, Stock Options, and Restricted Stock

Long-term incentives provide a mechanism for aligning the economic interests of executive officers with those of shareholders. Grants of stock options and performance shares are made annually under the AT&T 1997 Long Term Incentive Program.

Performance Shares: Performance shares, which are awards of units equivalent in value to shares of AT&T common stock, are awarded annually in numbers based on surveys of competitive market grant levels for similar positions. Prior to 1997, payout of 0% to 150% of such performance shares was made in the form of cash and/or shares of AT&T common stock (with a required minimum of 50% in shares) at the end of a three-year performance period based on the company's return to equity ("RTE") performance compared with a target. In 1997, the company re-instituted a performance share program tied to three-year relative total shareholder return ("TSR") as measured against a peer group of industry competitors. TSR equals the sum of the appreciation in the price of AT&T common stock plus dividends paid over the period.

Stock Options: Stock options are granted annually to executive officers based on surveys of competitive grant levels for similar positions. Stock options are granted with an exercise price equal to or greater than the fair market value of AT&T common stock on the day of grant, and become exercisable after the expiration of a period of

time, typically between one and six years, and continue to be exercisable until ten years from the date granted. Such stock options provide incentive for the creation of shareholder value over the long term since the full benefit of the compensation package cannot be realized unless an appreciation in the price of AT&T common stock occurs over a specified number of years.

Restricted Stock: Restricted stock and restricted stock unit awards are granted occasionally to executive officers under the AT&T 1997 Long Term Incentive Program, primarily for purposes of retention. Restricted stock is subject to forfeiture and may not be disposed of by the recipient until certain restrictions established by the committee lapse. Recipients of restricted stock are not required to provide consideration other than the rendering of services or the payment of any minimum amount required by law.

Other Remuneration: Pensions and Insurance

Pensions: Effective December 31, 1996, AT&T terminated its pension plan for non-employee directors.

Insurance: AT&T provides non-employee directors with travel accident insurance when on company business. A non-employee director may purchase life insurance sponsored by AT&T.

Non-Employee Directors' Remuneration

In 1998, directors who were not employees received an annual cash retainer of $45,000 and stock units with a then-current market value of $45,000, which were deferred automatically and credited to a portion of a deferred compensation account, pursuant to AT&T's deferred compensation plan for non-employee directors. The chairpersons of the Audit Committee, Compensation and Employee Benefits Committee, and Finance Committee each received an additional annual retainer of $7,500. The chairperson of the Governance and Nominating Committee received an additional annual retainer of $5,000. No fees are paid for attendance at regularly scheduled board and committee meetings. Directors received a fee of $1,500 for each special board or committee meeting attended. Directors may elect to defer the receipt of all or part of their cash retainer and other compensation into the AT&T shares portion or the cash portion of the deferred compensation account.

Director Share Ownership Targets

Effective December 1997, the board adopted share ownership targets equal to five times the total value of the annual cash retainer and annual stock unit amounts. Although directors generally have five years to attain the ownership goal, nine of the non-employee directors have already met their target. Directors who are employees of AT&T receive no compensation for serving as directors, but also have ownership targets.

3.3 British Telecom PLC

3.3.1 Overview

British Telecommunications PLC supplies inland and international telecommunication services within the United Kingdom and overseas. Its main products and services include local, long-distance and international calls; telephone lines, equipment and private circuits for homes and businesses; providing and managing private networks; and supplying mobile communications services. The number of employees is 124,700 and total assets amount to GBP 23,285 mil on 31 Mar., 1998.

British Telecom has diffuse share ownership. The interests of directors and their families in the company's shares are 275,650 shares, which is about 0.0043% of total ordinary shares.

British Telecom has a unitary board with majority of non-executive directors and separates CEO and Chairman position. Its compensation scheme has similar features to that of AT&T, which is a result of competing for qualified executives in the global, and particularly, US markets. Its compensation scheme also aims to align directors' interests with shareholders by increasing the variable portion of the remuneration and using long-term remuneration.

3.3.2 Composition of Board

BT aims to have the board comprise approximately two-thirds non-executive directors. Among the eleven members, seven non-executive directors are independent

of the management of BT either being free from any business or other relationship which could materially interfere with the exercise of their judgement or not previously involved in the management of BT. CEO does not hold the position of chairman of the board.

3.3.3 Principal Board Committees

British Telecom's three principal committees are as follows:

(1) Nominating committee consists of chairman, deputy chairman and four other non-executive directors, (2) Audit Committee consisting solely of non-executive directors, and (3) Remuneration Committee consists solely of independent non-executive directors.

3.3.4 Directors' Compensation

British Telecom's executive remuneration policy is to reward employees competitively taking into account performance, market value and competitive pressures in the communications and information technology sectors.

The remuneration package for executive directors comprises basic salary, annual bonus, long-term remuneration, share option scheme and pensions.

Basic Salary

Salaries are reviewed (although not necessarily increased) annually. Salaries are

increased only where the committee believes that market adjustments are appropriate to reflect performance, increased responsibilities and/or market pressures.

Annual Bonus

The annual bonus plan is designed to focus on annual objectives and to reward senior executives appropriately for the results achieved against these objectives. Targets are set at the start of the financial year based on key corporate objectives – such as revenue growth, profitability, quality of service, customer satisfaction and people management. Specific weights are attached to each objective on the basis of the BT Corporate Scorecard. Bonus awards for executive directors for the year under review ranged from 41% to 65% of salary.

Long-Term Incentives

BT Long Term Remuneration Plan: The BT Long Term Remuneration Plan (‘LTRP’) was designed to ensure that British Telecom’s remuneration package remains competitive, to encourage personal investment in British Telecom shares, to foster community of interest with shareholders, to encourage key executives to stay with British Telecom and to link reward and long-term corporate performance more effectively. Under the plan, shares are awarded to participants conditionally on the company meeting a pre-determined corporate performance measure and, normally, the participants still being employed by the British Telecom Group at the end of a five-year period. The performance measure is British Telecom’s total shareholder return (‘TSR’) relative to the FT-SE 100.

BT Performance Share Plan: Under the PSP, shares are conditionally awarded to participants on the basis that they will only be entitled to these shares in full at the end of a three-year period if the company has met a pre-determined corporate performance measure and the participants are still employed by the British Telecom Group. The performance measure is the same as for the LTRP.

Other Remuneration: BT Share Option Scheme and Pensions

BT Share Option Scheme: The BT Share Option Scheme for senior executives was not renewed after its expiry in January 1995. The last options were granted in December 1994.

Pensions: For executive directors and other senior executives the policy is to provide pension benefits of one thirtieth of final salary for each year of service with a two-thirds surviving spouse's pension. Pensions are based on salary alone – bonuses, other benefits and long-term incentives are excluded.

Non-Executive Directors' Remuneration

The Board has delegated the determination of remuneration for non-executive directors to the Chairman and Chief Executive. The basic fee for non-executive directors, which includes membership of one committee, is £25,000 per year.

3.4 Deutsche Telekom AG

3.4.1 Overview

Deutsche Telekom, the former German state owned telecommunications company which is publicly traded since 1996, operates and maintains telephone networks and is involved in the mobile telecommunications market. The company is the largest provider of telecommunications services in Europe and the third largest in the world. In addition to telephone services, Telekom is involved in satellite operations, cable TV transmission (via its wide-frequency network), video conferencing, audiovisual & textual data transmission and multimedia & online services. The number of employees is 203,374 and total assets amount to DEM 155,078 mil on 31 Dec 1998.

The Federal Republic held an approximate 48.2% direct stake in Deutsche Telekom and an indirect investment through KfW interest of approximately 23.8% at March 31, 1999.[1]

Deutsche Telekom's board has typical features of two-tier board. This system has "supervisory board" composed of non-executive board members and "management board" composed entirely of executives. Half of the supervisory board represent the employees.

[1] As part of the legislative process relating to the enactment of Postreform II, the responsible legislative committee stated in its statement of legislative intent that the Federal Republic would *de facto* retain a majority shareholding in Deutsche Telekom for a number of years because the sale of Shares by the Federal Republic is, in principle, prohibited through December 31, 1999. Until December 31, 1997, the regulatory function was exercised by the Post Ministry. Thereafter, the new regulatory authority, which is administered by the Economics Ministry, took over this function.

3.4.2 Composition of Board

As required by the German Stock Corporation Act, Deutsche Telekom has a two-tier board system consisting of a Board of Management and a Supervisory Board. The board of management is responsible for managing Deutsche Telekom and representing Deutsche Telekom in its dealings with third parties, while the supervisory board appoints and removes the members of the board of management and oversees the management of Deutsche Telekom. Under the German Stock Corporation Act, the supervisory board is not permitted to make management decisions. Pursuant to the Articles of Association of Deutsche Telekom and the By-laws (*Geschäftsordnung*) of the board of management, the board of management must obtain the consent of the supervisory board for certain actions, including acquisitions or dispositions of real property having a value of more than DM 50 million, acquisitions or dispositions of equity investments, the appointment of members of the supervisory board or other bodies having supervisory functions of direct or indirect subsidiaries with a share capital of more than DM 5 million or an annual turnover of more than DM 50 million, and actions concerning the corporate structure or the strategy of Deutsche Telekom. In addition, under the German Stock Corporation Act, the supervisory board is authorized to subject other actions of the board of management to its consent. As a result of the Law Amending the German Stock Corporation Act (*KonTraG*), the supervisory board now has extended monitoring functions. The German Stock Corporation Act prohibits simultaneous membership on the management board and the supervisory board of a company.

Supervisory Board: In accordance with Deutsche Telekom's Articles of Incorporation, the supervisory board of Deutsche Telekom consists of twenty members, ten of whom represent the shareholders and ten of whom represent the

employees. Members of the supervisory board may be elected for a term of up to five years. The supervisory board members representing the shareholders are elected at a general meeting of the shareholders. The supervisory board elects a chairman and a deputy chairman from among its members; in the event that a majority of two thirds of the members of the supervisory board is not achieved, the shareholder representatives elect the Chairman and the employee representatives elect the Deputy Chairman.

As a result of a change in certain legal requirements with respect to the supervisory boards of German companies, Dr. Klaus Götte left the supervisory board with effect from April 30, 1998. This supervisory board position was filled by Michel Bon (from June 4, 1998), the Chairman and Chief Executive Officer of France Telecom, in connection with an exchange of directors with France Telecom.

Board of Management: Pursuant to Deutsche Telekom's Articles of Incorporation, the supervisory board determines the size of the board of management, subject to the requirement that the board of management must have at least two members. The supervisory board may appoint a Chairman of the board of management as well as a Deputy Chairman. The members of the board of management are appointed by the supervisory board for a term of up to five years.

3.4.3. Principal Board Committees

DT's five principal committees are as follows:

(1) a mediation committee, (2) a personnel committee, (3) a committee for extraordinary matters and (4) a presiding committee. All committees have an equal

number of shareholder representatives and employee representatives. The chairman of the supervisory board is the chairman of the mediation committee and the presiding committee where he has the deciding vote in case of a tie. In the other committees, the chairman does not have the deciding vote in case of a tie. The chairman of the personnel committee is a representative of the employees.

3.4.4 Directors' Compensation

In addition to reimbursement of actual out-of-pocket expenses, members of the supervisory board receive a fee of DM 250 as compensation in respect of imputed out-of-pocket expenses and an annual payment, the amount of which will be determined by the shareholders' meeting on May 27, 1999. The proposed annual compensation for 1998 is DM 48,000 for the chairman, DM 36,000 for the deputy chairman and at DM 24,000 for each remaining member of the supervisory board. Remuneration was paid to members of the supervisory board of Deutsche Telekom in 1998 in the amount of DM 492,000, inclusive of meeting expenses of DM 36,000.

The remuneration of the board of management of Deutsche Telekom amounts to DM 9,174,787.46. The remuneration package for the board of management comprises guaranteed portion (base salary), variable portion (annual bonus). The variable portion is dependent upon a number of criteria, including the attainment of certain financial performance objectives and the achievement of certain individual performance objectives. For the year ended December 31, 1998, 36.3% of the total remuneration was paid pursuant to such bonus arrangement.

Stock Option

Subject to the approval of the supervisory board and the shareholders' meeting, a stock option program for the members of the board of management is to be introduced in the year 2000.

Other Remuneration

Pension: Pension accruals totaling DM 7,912,363 have been established for the board of management

3.5 France Telecom

3.5.1. Overview

France Telecom operates the French telecommunications system and manufactures and distributes telephone products, fax machines and mobile phones. It is also responsible for the construction and maintenance of telephone lines and telecommunications networks. France Telecom offers a wide range of services, to companies as well as to individual customers, including the public phone network, phone card vending machines, a large number of "Publifax" (public fax machines) and directory inquiries services. France Telecom is also active in the visual and audio communications sectors, through the production, transmission and broadcasting of programs. In 1997 France Telecom became publicly held and in the same year the company began the sale of its first mobile phones and it also signed contracts with both the Senegalese and Vietnamese governments concerning various different

business ventures. The number of employees is 165,042 and total assets amount to FRF 287,197 mil on 30 June, 1998.

The French State[2] held an approximate 63.6% direct stake in France Telecom at March 31, 1999. The members of the board of directors and of the executive committee collectively owned a total of approximately 23,200 shares, which is about 0.0023% of total shares.

France Telecom's board has mostly unitary board features, however, it distinguishes itself from that of British Telecom or AT&T with the presence of one-third of the board elected by the employees.

3.5.2 Composition of Board

FT Board consists of (1) four Members elected by the annual shareholders meeting; (2) ten Members appointed by decree of the French state; (3) seven Members elected by employees; (4) three Observers appointed by the board of directors. Michel Bon, Chairman and CEO, is the only executive officer in the board. There are nine executive officers, including CEO. Though one-third of the directors elected by employees, this structure does not assume equality between capital and labor since the chairman come from the shareholder side.

[2] In accordance with the legislation applicable to state-owned corporations, France Telecom and its subsidiaries are subject to the rules related to the economic and financial control of the French State. A representative of the French State appointed by the minister is entitled to attend all meetings of the board of directors as an observer.

3.5.3 Principal Board Committees

FT's two principal committees are as follows:

(1) Audit committee consists of directors appointed by decree of the French state, and (2) Compensation committee consists one director elected by shareholders and two directors appointed by decree of the French state.

3.5.4 Directors' Compensation

The total amount of remuneration allotted to the directors and members of the Executive Committee totaled FF 16.6 million in 1998. The directors representing the French State or who are France Telecom employees do not receive any remuneration for their term of office. Only expenses linked to their attendance at meetings are reimbursed. Directors appointed by the general meeting do not collect attendance fees.

3.6 Nippon Telegraph and Telephone Corporation

3.6.1 Overview

NTT is the largest provider of telecommunications services in Japan. Its business is providing nationwide telecommunications services. These services fall into six major classes: telephone services, telegraph services, leased circuit services, data communication facility services, sale of telecommunication equipment and other services.

The Government of Japan held an approximate 65.49% direct stake in NTT at

March 31, 1998.[3] The appointment of the Company's directors and corporate auditors is subject to approval by MPT. The members of the board of directors and officers collectively owned a total of approximately 409.44 shares, which is about 0.003% of total shares.

NTT was established under the Nippon Telegraph and Telephone Corporation Law (the "NTT Law") and is responsible for providing nationwide telephone services and for promoting research in telecommunications technologies and disseminating the results of such research. The number of employees is 226,000 and total assets amount to USD 131,459 mil on 31 Mar., 1998.

NTT's board size is the largest among the selected telcos' and the board consists mostly of executive directors.

3.6.2 Composition of Board

The Board of Directors currently consists of 36 members, of whom 35 are also executive officers of the Company as of June 26, 1998. Directors are elected for a two-year term.

[3] The Diet passed the Revision Law in June 1997. The Revision Law implements a plan proposed by the Ministry of Posts and Telecommunications, and accepted in principle by the Company, to reorganize the Company. Under the Revision Law, the Company will continue to exist but will operate primarily as a holding company with its businesses reorganized into three newly established companies, East-Nippon Telegraph and Telephone Corporation, West-Nippon Telegraph and Telephone Corporation and the Long Distance Company. The Revision Law continues to require the Government to own one-third or more, and restricts foreign ownership to less than 20%, of the total number of issued Shares.

3.6.3 Directors' Compensation

During fiscal year 1998, the aggregate amount of compensation paid by the Company to all Directors, executive officers and corporate auditors as a group was 1,228 million Yen.

3.7 Telecom Italia

3.7.1 Overview

Telecom Italia (formerly known as Societa Finanziaria Telefonica per Azioni-STET) provides telecommunications services and is Italy's leading manufacturer of telecommunications products. The company also manufactures specific electronic components, installs telecommunications systems & provides publishing, marketing & financial support services. In 1997, STET absorbed Telecom Italia and changed name to Telecom Italia. The number of employees is 126,097 and total assets amount to ITL 83,293,000 mil on 30 Jun., 1998.

The Government held an approximate 5.17% direct stake in Telecom Italia, and the stable shareholders[4] owned, in the aggregate, 8.11% of the shares at March 31, 1999. The members of the board of directors and executive officers collectively owned a total of approximately 29,957 shares, which is about 0.0006% of total shares.

[4] In connection with the privatization of Telecom Italia, the government entered into separate agreements with 14 stable shareholders, which agreed not to act in concert and which in the aggregate represented approximately 9.02% of the outstanding shares. The sale to the stable shareholders was intended to establish a degree of stability and continuity in the shareholding of the company following the privatization. The sale of the shares in the private sale was completed shortly after completion of the privatization. The stable shareholders, however, did not provide enough stability to the directors in the face of the hostile takeover offer from Olivetti.

Telecom Italia has a unitary board with "*voto di lista*" system which aimed at ensuring greater protection for minority shareholders.

3.7.2 Composition of Board

Telecom Italia's corporate governance bodies consists of Board of directors and General managers. Telecom Italia's board consists of thirteen members, including two directors appointed by the Italian government. Telecom Italia does not have joint Chairman/CEO. The general managers consist of three executive officers, which are responsible for the day-to-day administration of the operation within their respective spheres of competences.

3.7.3 Principal Board Committees

Telecom Italia's principal board committees are as follows:

(1) The Executive Committee consists of at least three and no more than four members, in addition to the chairman, the deputy chairman and the CEO. Pursuant to the Public Concessions, the director designated by the Ministry of Communication must be a member of the Executive Committee, if such committee exists.

(2) The Audit and Corporate Governance Committee has an advisory and investigative role in the areas of accounting, corporate governance and internal audit procedures. It is entrusted with periodically verifying compliance by Telecom Italia with current telecommunications and antitrust regulations.

3.7.4 Directors' Compensation

The total compensation paid in 1998 by Telecom Italia or by any of Telecom Italia subsidiaries to the members of the board of directors and to the executive officers was Lit. 26,162 million and the total compensation paid in 1998 to the members of the Board of Statutory Auditors was Lit. 998 million.

At the Shareholders' Meeting of December 15, 1998, Telecom Italia shareholders passed a resolution authorizing a capital increase of up to 74,000,000 Telecom Italia ordinary shares (approximately 1% of the share capital) over a five year period, for the implementation of a management stock option plan. To date the Board of Directors had neither issued specific guidelines as to the performance parameters for the distribution of the authorized stock options, nor identified the managers who will be the potential beneficiaries of the plan.

Provisions for Minor Shareholders: *Voto di Lista*

Pursuant to Telecom Italia's by-laws, the election of directors and statutory auditors, other than those appointed pursuant to the special powers described above or designated pursuant to the Public Concessions, is made through the "*voto di lista*" system. This system has been used for the first time to elect directors of Telecom Italia at the ordinary Shareholders' Meeting held at the end of October 1997. The "*voto di lista*" system is primarily aimed at ensuring that minority shareholders are represented on the board of directors and board of statutory auditors. For the board of directors, such requirement is not subject to amendment so long as the maximum limit on shareholding remains effective; for the board of statutory auditors, representation

of minority shareholders is mandatory. By the "*voto di lista*" system, the board of directors is elected on the basis of lists or slates of candidates presented by the shareholders or by the outgoing board of directors; candidates are listed by means of progressive numbers. Each shareholder may submit only one slate, and each candidate may appear only on one slate. Only those shareholders who alone or together with other shareholders hold a total number of shares representing at least 1% of the share capital entitled to vote at the shareholders' meeting may submit slates. Each person entitled to vote may vote for only one slate. Four-fifths of the directors to be elected are chosen from the slate that obtains a majority of the shareholders' vote in the progressive order in which they are listed on the slate. The remaining directors are chosen from the other slates; the votes obtained by the various slates are successively divided by one, two, three or four, depending on the number of directors to be chosen, and the quotients obtained are assigned progressively to candidates on each of these slates, in the order respectively specified on the slate. The quotients thus assigned to the candidates on the various slates are arranged in a single decreasing order. Those candidates who have obtained the highest quotients are elected to the board of directors. The election of the board of statutory auditors are governed by the same procedures used for the election of the board of directors as far as presentation, filing and publication of slates are concerned. If the board of statutory auditors is composed of three members one member of the board of statutory auditors must be taken from the minority slate that obtains the largest number of votes. Two members must be taken from such minority state if the board of statutory auditors is composed of more than three members.

3.7.5 Takeover Case: Telecom Italia and Olivetti

Telecom Italia, the world's 11th-largest telecommunications group, has undergone two years of extraordinary change and turbulence. Its chairman changed three times in 12 months and its top management has been in a state of intense turmoil. Little has gone right for it since its board promised shareholders better performance early last year. Increased competition is partly to blame, but Telecom Italia has lost its way because of managerial infighting, strategic confusion and an ineffective group of core shareholders.

Olivetti, the much smaller information technology and telecommunications group, launched, at the end of February, Europe's biggest post-war hostile takeover bid involving a highly leveraged offer totaling L102,000 billion – or $65billion – for its giant Italian rival.

Ever since Olivetti launched a hostile takeover bid for Telecom Italia in February, there has been speculation about a white knight coming to the rescue. On April 21st Telecom Italia's board backed a shareswapping merger with Deutsche Telekom that values the Italian group at $70 billion, a $5 billion more than Olivetti had been offering. If Telecom Italia and Deutsche Telekom get their way, they will create a telecoms monster with a market capitalization about $175 billion and 3000,000 employees. However, most can see little point in increase in scale that Deutsche Telekom and Telecom Italia will achieve

In fact, the two groups are hardly text-book candidates for value-creation through integration. Their fixed-line phone franchises do not overlap. Telecom Italia is strong in mobile phone services, and has expanded into Latin America. Deutsche Telekom is more interested in on-line access and eastern Europe.

True, some analysts point to the complementarities and cost-cutting potential. But, the deal carries risks, especially for Deutsche Telekom. It would distract the company from its own restructuring program, which has already led to 30,000 layoffs but needs to go much deeper. It will introduce management tensions: the plan is that the Mr. Sommer and Bernabé would together run the merged group, but both are famously strong-willed. Telecom Italia's Machiavellian corporate culture may clash with that of ex-civil-servants in Deutsche Telekom's middle management.

These are the features of the possible merge talk between Telecom Italia and Deutsche Telekom that suggest shareholder interests aren't its underlying force. Managers of Telecom Italia may be faced with a conflict of interest between their fiduciary responsibilities and their own potential losses. However, a messy compromise at a company that is so lacking in direction and so badly in need of restructuring would be the worst possible outcome.

As of March 31, 1999, the stable shareholders – institutional investors - owned, in the aggregate, 8.11% of the shares. All the stabel shareholders, except for Credit Suisse Group, tendered their shares in the Olivetti offer which close on May 21, 1999. On May 25, 1999, the majority of Telecom Italia board of directors tendered their resignation; as a result according to Telecom Italia's by-laws, the entire board of directors has to be renewed and a new Chief Executive Officer has to be appointed.

3.8 Telstra Corporation Limited

3.8.1 Overview

Telstra is a full service telecommunications carrier offering local, domestic, long distance and international services throughout Australia, as well as a wide range of other telecommunications services, including digital and analogue cellular mobile services, advanced business services, directory services, pay phones and operator assisted services. The number of employees is 66,760 and total assets amount to AUD 25,683 mil on 30 Jun., 1998.

The Commonwealth owns 66.7 per cent of the shares of the Telstra Entity. The Commonwealth, as holder of 66.7 per cent of the Shares in the Telstra entity, like any other majority shareholder in an Australian company, has the ability to control the company.[5] The interests of directors in the company's shares are 441,910 shares, which is about 0.0034% of total shares.

Telstra has a unitary board with majority of non-executive directors and separates CEO and Chairman. The government owns two-third of ordinary Telstra shares and regulates it with a variety of measures. Telstra's compensation scheme, however, has long-term incentive plan similar to that of British Telecom, a privatized utility.

[5] The Telstra Act precludes any reduction in the Commonwealth's voting rights, paid-up capital or rights to distributions of capital or profit, if any, below a two-thirds interest in Telstra without amending legislation. The Telstra Act deems the Commonwealth Auditor-General to have been appointed as the auditor of Telstra for the purposes of the Australian Corporations Law. The Telsta Act restricts foreign ownership to less than 20%, of the total number of issued Shares

3.8.2 Composition of Board

As at 26 August 1998 there were 11 Directors on the Board – 10 non-executive Directors, including the Chairman, and the Chief Executive Officer. The maximum number of Directors fixed by Telstra's Articles of Association, in the absence of a resolution of shareholders to the contrary, is 13. Telstra's adopted so-called staggered board. Apart from the Chief executive Officer, one third of the Directors are subject to re-election by rotation each year.

3.8.3 Principal Board Committees

Telstra's principal committees are as follows:

(1) Audit & Compliance Committee: The role of this committee is to provide oversight of the Group's compliance with external and internal obligations, review of the annual audit program, overseeing Telstra's risk management program and to provide advice to the Board on matters of due diligence, financial systems integrity and financial risks.

(2) Appointments, Nominations & Compensation Committee - The role of this committee is to oversee the composition of the Board, the performance of the Board and the appointment and the remuneration of the Chairman, Directors, Chief Executive Officer and senior executives.

3.8.4 Directors' Compensation

For the 1998 fiscal year, the aggregate amount of remuneration earned by the Directors and Executive Officers of Telstra as a group was A$7,677,165. This amount consists of:

• A$513,572 that has been set aside or accrued by Telstra during fiscal 1998 to provide pension and retirement benefits; and

• A$7,163,593 representing remuneration, other than amounts for pension and retirement benefits.

The remuneration package for executive directors comprises Basic salary and Management Incentive Plan (MIP) , and Long-Term Incentive plan (LTP)

Management Incentive Plan (MIP): The Management Incentive Plan (MIP) is an annual plan open to all executives in the Telstra Group. The amount at risk (target incentive) varies between 10% and 22% of the total remuneration package depending on the executive's role. The plan is based on performance against set targets for Corporate, Business Unit and individual measures. The measures include financial, customer service and individual measures that support the Telstra Group's key business objectives. Before any MIP is payable a certain threshold must be reached, according to the predefined measures. The plan also provides that payments are capped.

Long-Term Incentive plan (LTI): Selected senior executives who contribute significantly to the future long term profitability and success of the Telstra Group also participate in a Long Term Incentive Plan (LTI). At target, the LTI comprises 16% to 19% of the total remuneration package depending on the executive's level. Any

payment made under this plan depends on the achievement of return on investment targets over a three year period. The plan, which began in 1994, also includes an annual payment based on the dividend declared in respect of earnings.

Non-Executive Directors' Remuneration

Remuneration of non-executive directors is determined by the board within the parameters approved by shareholders from time to time. The maximum aggregate amount of non-executive directors' remuneration provided for at present is A$750,000. This remuneration is for all services provided by the directors as directors including service on committees. Directors are also entitled to be reimbursed for reasonable travelling, accommodation and other expenses incurred in travelling to or from meetings of the board or committees or when otherwise engaged on the business of the company in accordance with board policy.

3.9 Korea Telecom Corp.

3.9.1 Overview

Korea Telecom is the largest and leading provider of telecommunications services offering nationwide local & long distance call services, overseas call services throughout Korea, as well as a wide range of other telecommunications services, including multimedia Services, satellite communications services, directory services, pay phones and operator assisted services. The number of employees is 56,887 and total assets amount to KRW 170,152 mil on 31 December, 1998.

The Government held an approximate 71.2% direct stake in Korea Telecom at December 31, 1998.[6] The interests of directors in the company's shares are 2,650 shares, which is about 0.000001% of total ordinary shares. CEO and vice president do not have shares at all. Neither do the outside directors.

Korea Telecom has a unitary board with majority of outside directors, pursuant to a special Act. Its executive compensation scheme lacks stock-based incentives, and is more or less short-term result oriented.

3.9.2 Composition of Board

Korea Telecom board's outside directors comprise more than half, which is subject to 'The Act on Privatization and Management Reform of Public Enterprises'. Korea Telecom Board consists of seven outside directors and six executive officers. The CEO does not hold the position of the chairman. However, majority outside directors does not automatically imply 'independence'. The line ministry is able to continue to influence indirectly as well as directly the management, for it is allowed to appoint outside directors. The line ministry used to and still considers Korea Telecom as means of policy implementation, which is not always compatible with shareholder value maximization. The majority share ownership is not automatically linked to the economic residual of the enterprise.

[6] The government held about 59% stake in Korea Telecom after Depository Receipt issue in 1999.

3.9.3 Principal Board Committees

Korea Telecom's five principal committees are as follows:

(1) Management committee, (2) Finance committee, (3) Investment committee, (4) Public interest committee, and (5) Marketing committee. These committees have an advisory role on matters in their respective area with the objective of overseeing the interests of shareholders and encouraging sound corporate governance, if such committee exists.

3.9.4 Directors' Compensation

The total amount of remuneration allotted to the directors totaled 1,170 million Won.

The remuneration package for executive directors comprises Basic salary and Annual bonus. Consistent with cost control, no salary increases were made for executive officers or other senior managers of the Company in 1999

Annual bonus: The annual bonus plan is designed to focus on annual objectives and to reward senior executives appropriately for the results achieved against these objectives. Targets are set at the start of the financial year based on key corporate objectives – such as EVA, revenue per employee, customer satisfaction and R&D. Different weight is assigned to each objective. Bonus awards ranges 0 to 200% of basic salary. 44% of the total remuneration was paid pursuant to such bonus arrangement.

Stock Option

The contract between the board and CEO has stock option clause, however, the board has neither proposed a stock option plan at the shareholder meeting, nor issued specific guidelines for the implementation of a management stock option plan yet

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Other Remuneration

Insurance: Korea Telecom provides directors with director liability insurance of which the purpose is to have the directors become risk-taking by providing safeguards against substantial legal liabilities through class action suits initiated by shareholders, the plaintiff's bar, an others. The legal liability incentives are more often consistent with minimizing downside risk rather than maximizing value (Jensen 1983). Other researchers have formally shown that incentive-compensation plans motivate managers to take on more risk. It is unlikely that such defensive a measure as the insurance could lead to proper decision control and decision management that create efficiency and value for the company.

Outside Directors' Remuneration

The outside directors received an annual cash retainer and expenses linked to their attendance at meetings are reimbursed.

Summary and Conclusion

This paper reviewed the existing literature on the issues on corporate governance: internal corporate governance structure and agency problems in external corporate governance. The existing literature suggests that firm performance has a positive correlation with the percentage of executive compensation that is equity based and the percentage of equity held by managers. These findings support tying executive compensation more closely to firm performance.

The case studies of seven telecom operators provideded a better understanding of governance change.

First, the board structure has little relation with firm performance in the telecommunications industry, which was suggested by Mehran (1995). This finding is in a sense insignificant partly due to the small sample. However, the finding should be interpreted with caution, and the distorting force of price regulation by the government should be taken into consideration.

Second, The proliferation of deregulation in telecommunications industry has changed the systems of management incentives. The telcos have begun to emphasize the variable portion of the executive compensation, and especially the increase in long-term incentives. Among the seven telcos, companies with diffuse share ownership employ equity-based incentive system in order to reduce agency cost and align executives' interests with those of shareholders. The telcos under stricter regulation, on the contrary, often lack equity-based or long-term incentive plans and could be vulnerable to managers' short-termism without proper monitoring

mechanism.

Finally, the takeover case of Telecom Italia provided an example of the agency problem in the market for corporate control. Even though the Olivetti offer was not in the best interests of Telecom Italia shareholders, the merger plan between Deutsche Telekom and Telecom Italia was rather a value-destruction than shareholder value maximization one. After failing to achieve Deutsche Telekom–Telecom Italia combination, the entire board of directors were renewed and a new CEO was appointed. With rapid privatization and deregulation, the market for corporate control becomes a mechanism for resolving owner-manager conflicts.

Korea Telecom's corporate governance continues to evolve as the company moves from a government-owned business enterprise to a major publicly-listed company with a wide shareholder base. While the government plans to privatize Korea Telecom, it owns more than 50 percent of the shares of Korea Telecom and the company still remains subject to various ministerial and other controls to which other publicly-listed companies are not subject. Nevertheless, within these constraints, the board should continue to strive to achieve best corporate governance practice.

In general, public enterprises take much time to change fundamentally from the old regime that was based upon the view that public enterprises are instruments of the government in its pursuit of public policies. And the government lacks systematic incentive to monitor the management of the public enterprises.

Korea Telecom's current remuneration package for the directors does not provide enough incentive to pursue long-term shareholder value maximization. I suggest that Korea Telecom should design long-term incentive plans and apply it to executive directors. A future compensation scheme should give outsider directors share

ownership targets in order to align independent directors' interests with those of shareholders who receive the economic residual of the enterprise. In introducing long-term incentives, I would recommend the expanded use of stock options deeper in the organization.

APPENDIX

APPENDIX

Basic Figures of Selected Telcos

1998 fiscal year

	Revenue (million)	Assets (million)	Net Income (million)	Number of Employees	Net Income /Assets
AT&T (USD)	53,223	59,550	5,245	107,800	8.81%
BT (GBP)	15,640	23,285	1,706	124,900	7.33%
DT (DEM)	69,861	155,078	4,388	203,374	2.83%
FT (FRF)	161,678	287,197	15,085	165,042	5.25%
NTT (Yen)	9,450,000	17,353,000	214,000	230,000	1.23%
Telecom Italia(ITL)	46,550,000	87,614,000	5,252,000	126,097	5.99%
Telstra (AUD)	16,819	25,683	3,004	66,760	11.70%
KT (KRW)	8,773,912	17,015,197	258,319	56,887	1.52%

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