



## Corporate Governance and Leadership: First international forum. Paris. White paper

Patricia Charléty

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WHITE PAPER

# Corporate Governance and Leadership

1<sup>st</sup> International Forum, Paris



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## FOREWORD

### A Global Alliance of Schools of Management

#### COUNCIL ON BUSINESS AND SOCIETY

##### Values

The challenges are many. Business, society and the planet confronted with unprecedented change. The economic shift from West to East, re-occurring financial crisis, the acceleration in communication across frontiers and a growing scrutiny of business on both ethical and environmental levels present many risks but also great opportunity. Within this context, six of the world's leading schools – ESSEC Business School; Keio Business School; School of Management, Fudan University; Tuck School of Business at Dartmouth; the University of Mannheim, Business School; and FGV-EAESP, Brazil – came together under a shared commitment and belief in the power of academic excellence, global outlook, innovation, business excellence, social responsibility, humanism and transformational leadership, to form the Council On Business And Society.

##### Mission

The Council's mission is to create a multi-school process to study a series of critical issues facing business and society, organize international forums for dialogue and develop and disseminate educational materials and insights designed to foster continuing debate on the issues covered.

##### The 1<sup>st</sup> Annual International Forum 2012

#### Corporate Governance and Leadership in a Global World

November 16-17, 2012

Salons de la Maison des Arts et Métiers

Paris, France

The 1<sup>st</sup> Forum of the Council on Business and Society brought together leading academics, business leaders, students and policy-makers to form a multicultural, multi-level assembly of participants to cover the issues and insights around the theme of corporate governance and leadership. The output from this prestigious gathering supplies the basis for this White Paper that includes five chapters:

- AN OVERVIEW OF CORPORATE GOVERNANCE AND LEADERSHIP
- CORPORATE GOVERNANCE AND SOCIETY
- CORPORATE GOVERNANCE AND FINANCE
- GOVERNANCE AND THE BOARD
- GOVERNANCE, THE CEO AND LEADERSHIP

Each chapter includes analyses, recommendations for future developments, proposals for good practice, key subject Insights and Food for thought sections, as well as student survey contributions, focusing on both academic and operational matter for further reflection and transfer.



# Council on Business and Society Statements

## What is Corporate Governance?

Many economists, especially in the Anglo-Saxon world, define Corporate Governance as the sum of economic, legal and organizational mechanisms (or forces) ensuring that corporations return funds to their outside investors. All other stakeholders, including employees and creditors, have legal protection beyond the governance system.

Politicians, managers and also academics argue that Corporate Governance should not only be concerned about investors but also by creditors, employees, suppliers and consumers who all have a particular interest the way the company is run.

## Shareholders or Society?

The opposition between the two may actually be mainly (only?) apparent. Trust in the long run viability of a company favors investment financing by creditors. Consideration and involvement of employees in corporate decisions induce companies to invest their human capital and enables them to attract and keep talented people. Building a strong reputation among suppliers and consumers improves the terms of trade and helps companies step back from crisis. This all is convergent with long-term performance and shareholders' interests.

From the many contributions of the Council, **three focal points** emerge from the Forum White Paper in this respect:

**Sense of ownership:** Behaving as an owner means defending all shareholders' interests, in particular the constituency of small minority shareholders who are the least protected.

**Transparency:** Transparency contributes to trust, integrity and reputation.

**Long run view:** Mechanisms targeting turning towards the long term must be implemented to compensate for short-term pressure from the media, short-term reporting and crisis management, etc.

These focal points are implemented in different ways according to legal and cultural environments and the specificity of companies. They can take the form of appropriate rules for, among others, financial disclosure, CEO contracts, specific organizational forms, efficient selection of CEOs and directors, representation of employees on boards, engagement by long term investors and involvement of creditors to avoid excessive risk-taking.

## Leadership

How do Corporate Governance mechanisms designed to ensure managerial accountability to stakeholders at the same time serve to unleash entrepreneurial initiatives on the part of executives? CEOs and directors are obviously central for Corporate Governance. The CEO is the reference, must have a clear responsibility and lead by example. Being ultimately responsible before all stakeholders, the CEO is in a "very lonely" position, especially in times of crisis. In selecting the CEO, boards should consider both times of stability and times of crisis.

Drawing on the insights and studies of leading academics, business and society experts and business leaders, as well as student contributions, the following White Paper will include numerous testimonies, analyses and case studies to support the Council on Business and Society Statements.

Prof. Patricia Charléty, ESSEC Business School,  
Head of the Academic Committee



## EXECUTIVE SUMMARY

### A context of change, crisis and pressure

The interconnection of business and society has never been stronger, and the relationship between the two will continue to influence the global agenda in decades to come.

Societal attitudes to business determine the ability to create wealth, to create jobs, and to act as a positive force for change. But the financial crisis and a series of corporate scandals have led many to question the role and values of business.

Society's trust in corporations and their executives is dismally low, with the crisis in leadership fuelled by a relentless media cycle and a growing consumer influence through the global spread of information and viewpoints over the internet.

CEOs are scrutinized for their leadership and decision-making, boards are held accountable for the CEO's remuneration, and companies are questioned about their sustainable strategy and social impact.

### The hidden gift

But is this necessarily bad? The answer, despite the pressure this places on businesses and CEOs, must surely be no. For if the new world emerging through the current storm of change and crisis is one in which corporate governance builds not only business but also positively develops society while taking into account the environment, then such scrutiny can only be a wider form of positive governance in itself, there to remind businesses that they have a commitment to walking their talk.

### Corporate governance and leadership can find opportunity in the challenges it faces

The daily demands on their time to cope with volatility and shocks, compliance, and an over-emphasis on quarterly results gives companies little time for sustainable value creation, and yet research reveals that organizations that focus on long-term

performance perform better. For those companies who can successfully balance their short-term performance and long-term strategy, the 21<sup>st</sup> century will be filled with opportunity. Performance indicators such as employee satisfaction, innovation and brand health are fundamentals that will drive the performance of tomorrow's enterprise, and it is essential for businesses to engage with all stakeholders, not just with shareholders, to address the question of trust.

Equally, data shows that family-owned businesses have outperformed non-family companies over the last decade, which leads to the conclusion that boards should act and think like owners, thereby improving their effectiveness, their industry knowledge and their level of engagement.

It is also time to look more closely at internal governance mechanisms, and the actors who bring these mechanisms into play: only excellence in governance will restore the trust of society.

### The cultural perspective

This might hold true for developed markets in Europe and North America, but from an emerging economy perspective, the question is more likely to be *Does corporate governance matter?*

The debate over how companies are governed is as old as companies themselves. Corporate codes of governance, on the other hand, have developed more recently, many of them in the wake of various corporate scandals of the 1990s. With over 100 international codes and regulations that often focus on issues of shareholder rights, financial transparency, accuracy of disclosure, and accountability of the board, their interpretation varies from one country to another.

### Governance and leadership oriented towards the wider perspective

With the assertion that businesses have to make profit in order to create wealth, the way in which businesses are governed, and the relationships between management, the board, shareholders and outside stakeholders impacts on many of the challenges faced by society as a whole. The purpose of corporations therefore is more than just maximizing profits and wealth; the well-being of all stakeholders should be considered.

### Towards a governance mindset of collaboration, diversity and communication

The biggest test of corporate governance in any culture has been when things go wrong, such as bankruptcy or takeovers and the subsequent conflicts of interest between the board, workers, creditors and shareholders.

So how can businesses limit those conflicts of interest? Our suggestion is that governance should pursue an integrative approach, encouraging people to work more closely together - managers discussing with employees, shareholders collaborating with the board - to take into consideration all points of view, not just financial ones. Further, corporate boards will benefit from having a diversity of perspectives, which includes a higher percentage of female board members, and greater employee representation.

### Good governance is not about rules - it's about people

While most corporate governance conferences focus on shareholders and boards, few focus on the critical role of the CEO. The intense scrutiny of the media often overlooks the complexity of being a CEO, and how his or her decisions are impacted by the environment in which they operate. Context is very important for those decisions, and brings with it a better understanding of their leadership.

The idea of close cooperation is often met with skepticism, but this is in part a communication gap that influences public perception, and it is only through putting the human aspect back into the governance

equation that businesses can find a common language with society.

A good board can never compensate for a bad CEO but a good CEO can compensate for a bad board. In this light, effective leadership must anchor its behaviour in values that set example and provide stability in times of crisis, among them the essential three of integrity, transparency and accountability. The latter are critical for good governance and more effective capital markets, as well as providing investors with visibility on matters such as remuneration and giving investors, and moreover rating agencies, more information with which to make decisions.

Ultimately, when companies take the initiative be it on issues of diversity or transparency, it pre-empts activism among shareholders, and avoids the introduction of onerous legislation and rules.

### The business leaders of the future

Providing input to this White Paper, student respondents from across the world ranked environmental protection highest as the challenge in which business should be involved. There was also agreement that a company's board of directors should have the most influence over CEO decisions and, in addition, well over half the students agreed or strongly agreed that government legislation is essential to ensure a balance between business interests and society. These attitudes among future business leaders are consistent with movement in the last 10 years towards a greater interest in ethics and social responsibility. Indeed, it is the moral courage that our students will learn at business school that can encourage them to stand up and question behavior in order to positively shape the interconnection of business and society of the future.

# AN OVERVIEW OF CORPORATE GOVERNANCE AND LEADERSHIP

*"Ethics in business is extremely important; your reputation is all you have in life."*

*Sir Freddie Laker*

In a context of unprecedented change that has seen the economic shift of balance from West to East, financial crises and the impact of instant global communication, corporate governance and leadership have risen to the forefront in providing business and society with a compass setting offering clear direction towards stable haven.

Eroded trust, the pressures of short-term performance, limited resources and stretched productivity are only a few of the challenges ahead. We explore the wider context and provide an overview of developing not only business but also society in a positive way through making effective business decisions, strengthening the role of the leader and implementing effective governance.

Two analyses:

- What are the challenges for doing business in the 21<sup>st</sup> century?
- Governance and leadership at crossroads.



# 1. What are the challenges for doing business in the 21st century?

Mr. Eric Labaye, Director McKinsey & Co.

The last twenty years have seen unprecedented changes," insists Eric Labaye, Director of McKinsey & Co. and chairman of the McKinsey Global Institute. Since 1990, China has grown from 3 to 4% of world GDP to 14% today, the G7 has evolved into the G20 and the World Wide Web, which barely existed two decades ago, now connects billions of people around the world. Despite economic crisis, living standards have risen and hundreds of millions of people have been lifted out of poverty.

Eric Labaye draws from MGI (McKinsey Global Institute) research to look at the fundamental trends that are reshaping the global economy, as well as the key challenges for business and their implications for leadership and governance.

Eric Labaye identifies  
5 mega-trends affecting  
the global economy

- The great rebalancing of East and West
- Productivity challenges
- Interconnectivity and the global grid
- Resources and pricing the planet
- Increasing demands on governments

## The great rebalancing of East and West

The focus of economic power is shifting as 50% of GDP growth in the next decade will come from emerging markets with key drivers being demographics and urbanization.

## Productivity challenges

For developed countries, especially Europe, productivity has been declining, while an aging population is being supported by a proportionally smaller workforce. Indeed, a key issue is a mismatch in the skills of the labor force and the skills required by employers.

## Interconnectivity and the global grid

The world is connected by trade, capital and especially information flows. Moreover, interconnectivity has led to the creation of virtual communities and has changed the entire ecosystem of the global economy.

## Resources and pricing the planet

Over the past decade, commodity prices have increased dramatically and projections for the future show marked gaps between supply and demand in water, energy and food. In response to these gaps, strategies to deploy would include improving productivity and efficiency, as well as finding alternatives. In the words of Eric Labaye, "there is unlimited demand for limited resources."

## Increasing demands on governments

With aging populations, governments are facing increasing demands in areas such as health care and retirement as well as productivity challenges where new ways to increase output while lowering costs must be found. Confronted with these major trends, more than half of the CEOs surveyed by MGI say they are going to face a major business model transformation. For Eric Labaye, there are five key challenges and opportunities that lie ahead.

## How significant will the impact be on business?

The trends of the past 20 years are likely to last through at least the next decade. Key implications of these trends for businesses include:

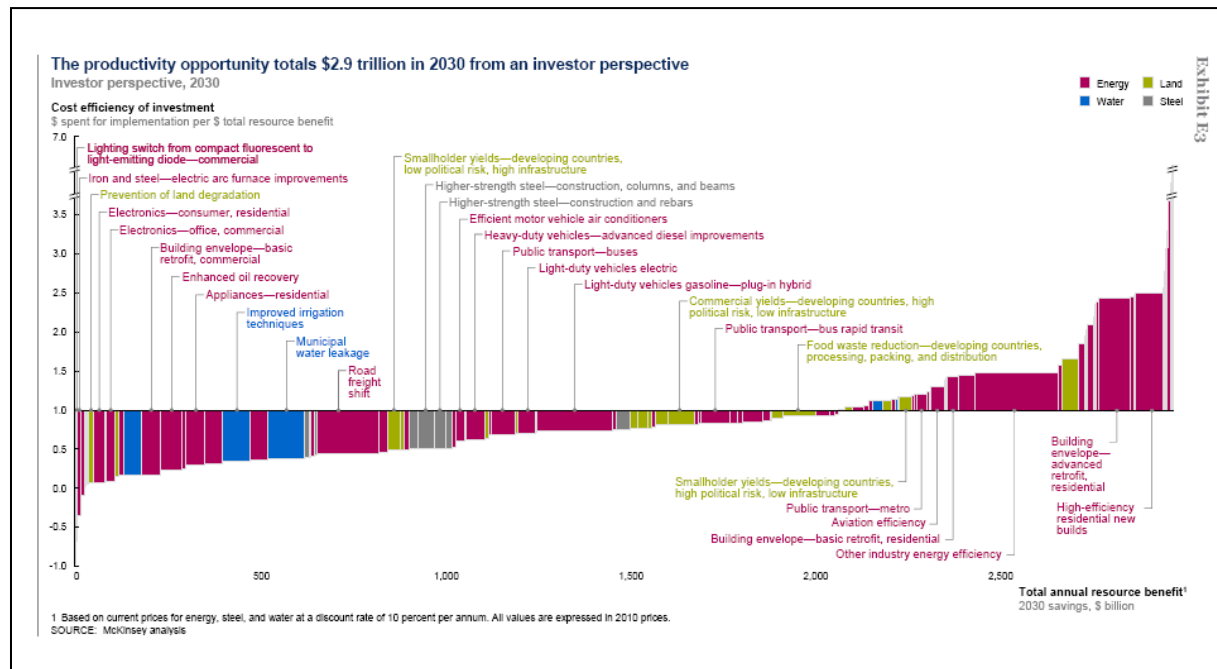
**Sources of growth in large companies:** Choosing which markets to enter, both in geographical and product category terms, is a company's most important strategic decision affecting growth. Moreover, there are many opportunities, and executives must decide which ones to pursue and how to execute their plan.

**New opportunities for innovators:** In order to compete in emerging markets, innovation is essential. However, innovation is changing, resulting in the need to learn from local markets and adapt accordingly, or use different business models employing new technologies such as cloud computing.

**Managing a global organization:** Leaders of global organizations face challenges attracting both the best talent and creating a collaborative culture as well as leading organizations that perform effectively both internally and with external suppliers and innovation chains. MGI surveys reveal that the organizational effectiveness of global companies is currently lower than that of local companies, which provides food for thought that being global is a penalizing factor.

**Being able to leverage data:** The amount of data available in the interconnected world has exploded offering a potential opportunity to generate significant financial value across business sectors. It is in businesses' interests to want to take advantage of this data but they require skilled individuals who can do so.

**Raising resource productivity:** As resources become more costly and constrained, companies - especially those that need resources for buildings (i.e. electricity) or transportation (i.e. gas) - must think differently in order to use these resources more efficiently.



## So what are the implications for leadership and governance?

Recognizing the issue of eroded trust in business - linked both to the financial crisis, and also the impact of globalization on society - Eric Labaye returns to the premise of the father of modern economics, Adam Smith, who argued that you couldn't have a successful business and not a prosperous society. Two hundred and fifty years later, the responsibility of

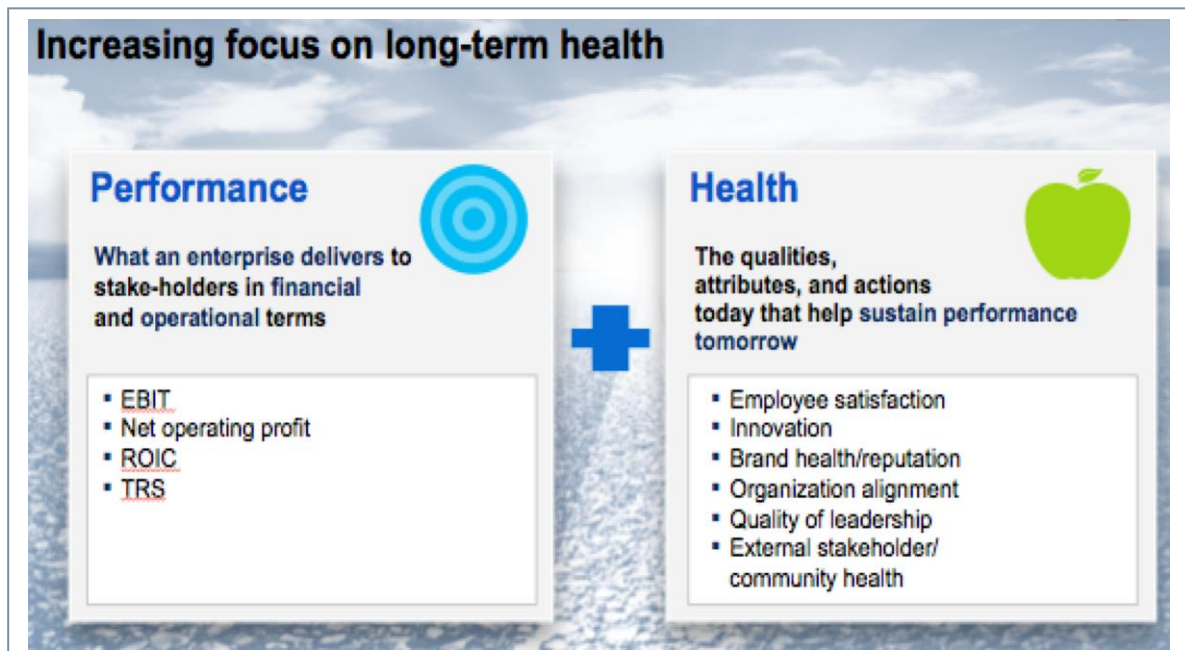


entrepreneurs remains to develop their business while also ensuring that society develops in a positive way.

The implications are fourfold: Firstly, Eric Labaye suggests that leadership will need to manage volatility, leading with both a telescope and a microscope. “We have mega trends that will shape the next 20 years, and at the same time there are many shocks - commodity prices, geopolitical events, and trade discussions - so taking a telescope view is important for leaders. But he acknowledges that the microscope view can take 150% of a CEO’s time, with a frequently occurring question that of how they can find enough time to think about the long term, skills and getting the right team.

Indeed, the balance between the two is a key challenge, with CEOs having to make your way through the volatility while still being able to deliver for the long term. Linked to this is the conclusion that there is an over emphasis on quarterly results, when stakeholders should in fact be taking a 10-year view.

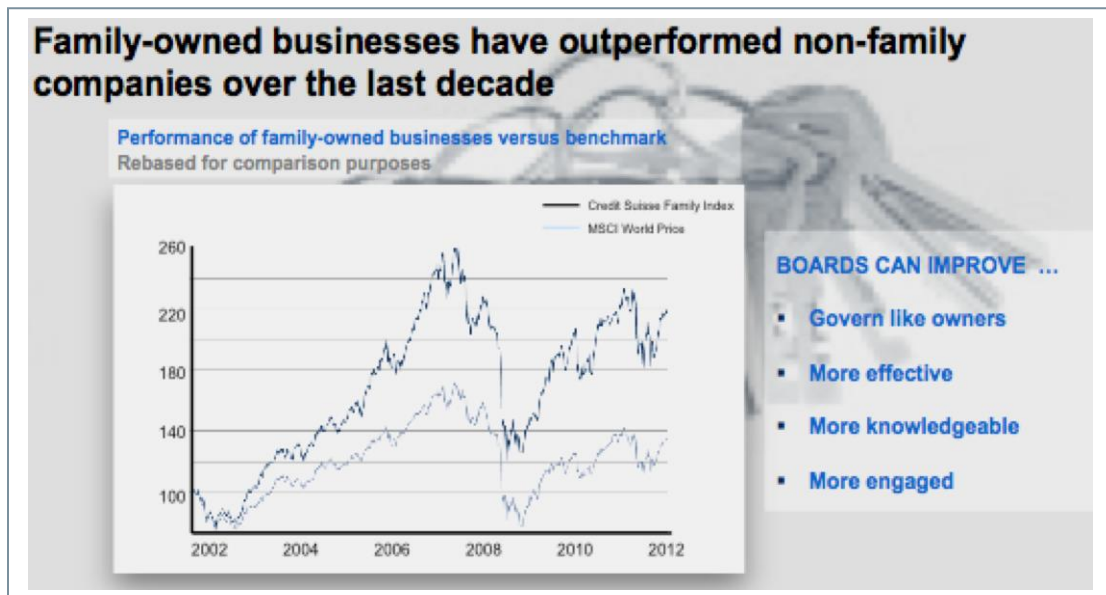
While performance is both short and long-term, there is also the health of the organization to consider, with indicators of long term performance such as employee satisfaction, the pipeline of new products and brand health constituting the fundamentals of the organization that will drive the long-term performance and long-term value creation of the business tomorrow.



Source: McKinsey & Company

MGI research reveals that organizations that focus on long-term health perform better. Evidence also suggests that businesses should engage with all stakeholders - not just with shareholders - to address the question of trust. Companies such as Alcoa now have a systematic process for partnering with customers, suppliers, employees, public agencies, NGOs and local communities, as well as shareholders and creditors.

But perhaps the most striking data shows that family-owned businesses have outperformed non-family companies over the last decade, which leads him to conclude that boards should act and think like owners.

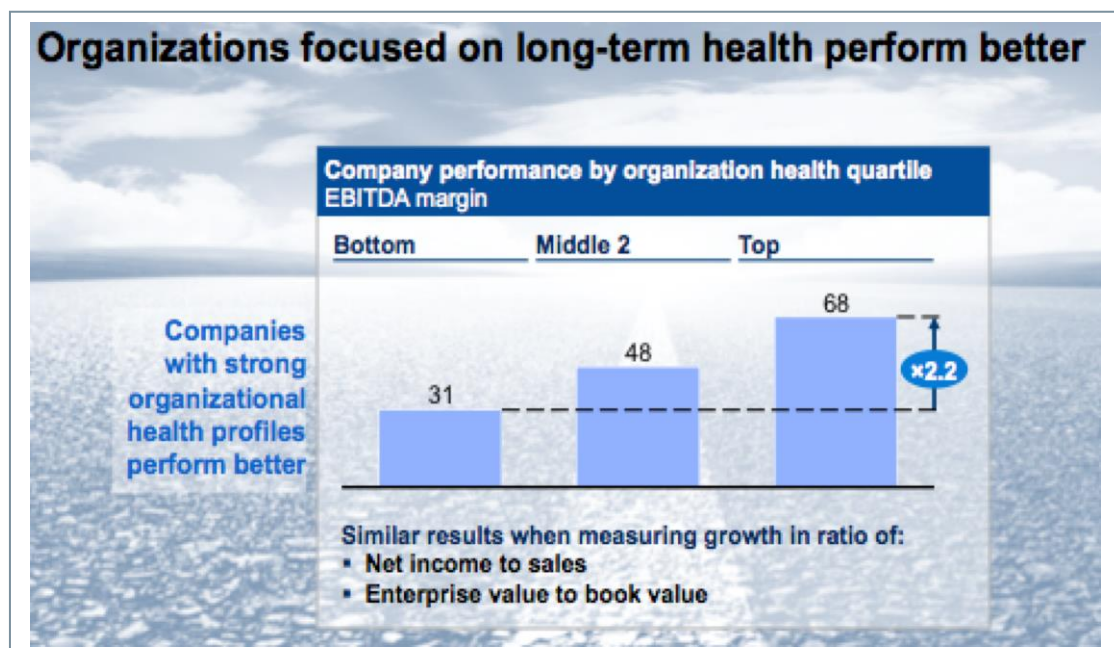


Source: McKinsey & Company

This entails thinking about the long-term view for performance and health, the issue being not one or the other, but one AND the other. The key message here is that sense of ownership can help improve boards' effectiveness, their industry knowledge and their level of engagement.

Despite the frustration that board members may feel over spending 80% of their time on compliance issues and only 20% on strategy, committing more time to the long-term will ultimately help redress the balance.

The challenges of a globalizing world place a tremendous burden on companies and their business models, but for those companies who can successfully balance their short-term performance and long-term strategy, the 21<sup>st</sup> century will be filled with opportunity.



Source: McKinsey & Company



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*"Sense of ownership can help improve boards' effectiveness, knowledge and level of engagement."*

Eric Labaye

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#### Student Survey findings

In our global society, what are the most important challenges businesses should be involved in? Top 3 student rankings:

1. Environmental protection
  2. Energy availability/efficiency
  3. Labor issues
- 

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## INSIGHTS

- Sense of ownership can help improve the board's effectiveness, its industry knowledge and its level of engagement.
  - Indicators of long run performance include employee satisfaction, the pipeline of new products, brand health.
  - Companies should engage not only with shareholders but with all stakeholders.
- 

## FOOD FOR THOUGHT...

- 1/ In terms of your leadership and governance, what can you do to strengthen the capacity to manage volatility, find balance between the short- and long-term, and instill the positive outcomes of having an owner mindset?
- 2/ What action and opportunities for your organization lie ahead with respect to growth, innovation, global reach, leveraging data and raising resources productivity?
- 3/ How do you see your organisation weathering the 5 "mega-trends" affecting the global economy?

## 2. Governance and leadership at a crossroads

**Professor Patricia Charléty**, ESSEC Business School

**Professor Atsuomi Obayashi**, Keio Business School

**Dr. Werner Brandt**, CFO, SAP AG

**Mr. Alain Champigneux**, Employee Elected Board Member, Renault

**Professor Katsunori Mikuniya**, University of Tokyo;

Former Commissioner, Financial Services Agency of Japan

**Mr. Thierry Peugeot**, Chairman, Supervisory Board, Peugeot SA

Only excellence in governance will overcome the current crisis of confidence in leadership with the reaching of a tipping point where corporate governance drives corporate strategy rather than the inverse.

### *Walking the talk?*

For Dr. Werner Brandt, CFO of SAP, this is the only way for companies to regain the trust they need to operate successfully: Leaders today care about corporate governance because it aims to secure not just what the company does, but also how it acts. The crossroads we have reached – as a result of ongoing erosion in trust – is that corporate governance has become a central leadership topic.

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*“Leaders today care about corporate governance because it aims to secure not just what the company does, but also how it acts.”*

Dr. Werner Brandt

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The spectacular failures in governance of the late 90s and early 2000s have clearly driven the decline in trust in business and the parallel rise in the importance of corporate governance, further fuelled by excessive risk taking in the recent financial crisis. However, Professor Katsunori Mikuniya of the University of Tokyo and former Commissioner of the Financial Services Agency of Japan reminds us of the importance of achieving a balance between healthy risk taking and regulation. In practicing good governance, organizations must ensure that they continue to be innovative and entrepreneurial while avoiding the taking of excessive risks.

### *Does audit include image?*

Companies can no longer rely on audit, compliance, legislation and accounting to ensure good governance. The massive government bailouts of banks and car makers have already led to additional regulation - the Dodd-Frank Act and Basel III being prominent examples - and Dr. Brandt believes there is likelihood for more to come, also identifying a more subtle factor contributing to the issue related to the increase in the power of the individual.

Up until recently, a company was almost only judged by whether it was financially healthy and followed the law. Today, companies such as SAP are also measured by whether they are sustainable, if employees are happy and diverse, and if the company contributes positively to society. In other words, far more stakeholders beyond the shareholder determine the measures of success.

Technology has powered this trend, enabling stakeholders to exert influence to an extent that was impossible just a few years ago. Consumers, employees, NGOs and the general public have far more ability today to analyze, compare, make decisions and publicly express their opinion than ever before. The ability of a disgruntled United Airlines passenger to

generate 12 million page views for a song posted on YouTube about his damaged guitar - and arguably trigger a 10 percent drop in the company' share price - is one of many examples of the increasingly significant voice of stakeholders. In short, governance matters more than ever.

So what does this mean for corporate governance?

Dr. Werner Brandt  
identifies the requirement  
to focus on the 3 Cs

- Compliance
- Comprehensive governance
- Communication

**Compliance:** Companies must be fully compliant with all rules and regulations, with zero tolerance for missteps in this area.

**Comprehensive governance:** Companies can no longer concentrate on reporting and governing primarily for shareholders, but have to balance this more strongly with the interests of employees, customers, and the general public. At SAP, this approach is reflected in the four corporate objectives used to steer the company and set goals for everyone – including the board. They are: revenue, operating profit, employee engagement and customer loyalty. In addition, key leaders carry targets related to the public image and reputation of the company.

**Communication:** Companies must communicate more openly about their corporate governance activities and about those topics that matter to all stakeholders. With this in mind, SAP communicates 2012 performance and beyond in one integrated report and indeed, the company will no longer be publishing an annual financial report along with a separate sustainability report and any number of smaller additional statements.

#### The well-being of all stakeholders

Excellence in governance has also called into question the traditional view that the sole objective of a corporation is to maximize profits. Thierry Peugeot, Chairman of the Supervisory Board at Europe's second largest carmaker Peugeot SA, argues that the well-being of all stakeholders should be considered. While businesses have to make profits in order to create wealth, the way in which businesses are governed, and the relationships between management, the board, shareholders and outside stakeholders impacts on many challenges faced by society as a whole.

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*"I do not believe that companies exist just  
to make profit or maximize wealth."*

Thierry Peugeot

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Professor Patricia Charléty of ESSEC Business School suggests an integrative approach, encouraging people to work more closely together - managers discussing with employees, shareholders collaborating with the board - to take into consideration not only the financial point of view but indeed the views of all those concerned. In this way, corporate boards benefit from having a diversity of perspectives, including a higher percentage of female board members, and greater employee representation.

The idea of a 'dream team' board of Directors, composed in the interest of both the company and its stakeholders is an idea raised by Alain Champigneux, Employee Elected Board Member at Renault. He suggests that the board should of course include directors specialized in finance, but also comprise managers from other companies, directors whose qualifications are in line with the firm's activities, and also employees who he sees as essential stakeholders contributing to the success of the company.

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### Student Survey findings

What responsibilities do companies have in today's world? Top 3 student rankings:

1. Maximizing value for shareholders
  2. Satisfying customer needs
  3. Creating value for the communities in which they operate
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## INSIGHTS

- Financial health and compliance are necessary but not sufficient conditions for long-term performance and sustainability.
  - Society (including employees, consumers, NGOs, etc.) now has the ability to analyze and publicly communicate its analysis.
  - Corporate governance is comprehensive and balances the interests of shareholders with all stakeholders.
- 

## FOOD FOR THOUGHT...

- 1/ To what extent are your organization's culture and behaviors driven by effective corporate governance? What are (would be) the outcomes? What are the objectives assigned to the board?
- 2/ What effect would strengthening governance through the SAP example have on your customers? On your suppliers?
- 3/ How do (could) employees as stakeholders contribute to the health of your organization?

## AN OVERVIEW OF CORPORATE GOVERNANCE AND LEADERSHIP

### Speakers



**Mr. Eric Labaye**, Director  
McKinsey & Co



**Professor Patricia Charléty**,  
ESSEC Business School



**Professor Atsuomi  
Obayashi**, Keio Business  
School



**Dr. Werner Brandt**, CFO,  
SAP AG



**Mr. Alain Champigneux**,  
Employee Elected Board  
Member, Renault



**Professor Katsunori  
Mikuniya**, University of  
Tokyo, Former  
Commissioner, Financial  
Services Agency of Japan



**Mr. Thierry Peugeot**,  
Chairman, Supervisory  
Board, Peugeot SA

# CORPORATE GOVERNANCE AND SOCIETY

*"A business that makes nothing but money is a poor kind of business"*

*Henry Ford*

The Council on Business and Society advocates a wider, deeper role for corporate governance as serving the interests of business, shareholders, stakeholders and the wider perspective of society itself. The following chapter demonstrates the positive effects of government legislation and influence on corporate governance, highlights the impact of dualism and voluntary codes of governance and finally, provides a set of effective proposals for the shape of governance to come.

Three perceptions:

- **The economic context:** Corporate governance - Strongly needed but effective only if market governance and long-termism prevail
- **The cultural context:** Corporate governance - The German answer to a global issue
- **The legislative context:** Governance and the role of government.



# 1. The economic context: Corporate governance - Strongly needed but effective only if market governance and long-termism prevail

Mr. Pierre Bollon, Executive Officer, French Asset Management Association

A fundamental shift is underway in the world economy which requires both change and adaptation. In this new era, corporate governance will increase in importance. Understanding the essential role of governance, the French Asset Management Association has focused on the exercising of voting rights by asset managers, devising a corporate governance code and monitoring the governance of France's major companies. However, although improvement has been made in governance structure and practice, even more is required if organizations are to effectively champion the change ahead.

## Can corporate governance help ride out the sea change?

While economies in Europe are seemingly in a period of autumn and may well be heading towards winter, many individuals and governments remain hopeful that spring and summer will return. Some believe Europe's financial crisis was inevitable and are even surprised it didn't happen sooner given the context in which greed, short termism and addiction to debt were underlying influences. Initially, access to debt actually delayed this crisis as innovative finance instruments hid the difficulties that existed. Eventually, lenders said "enough" with the result that the world is now going through the sometimes painful experience of deleveraging.

Pierre Bollon, however, does not foresee a cyclical economic process, with a typical spring or summer. He sees an entirely new era. Firms will have to change and adapt and difficult decisions must be made, requiring courage. In this process, corporate governance will be of the utmost importance.

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*"This is a sea change for the world economy. Things post-crisis will be different."*

Pierre Bollon

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## What role has the French Asset Management Association played in governance changes?

Comprising 500 small and entrepreneurial to large firms that manage 2.6 billion Euros, The Association recognizes the importance of corporate governance and has taken several steps to strengthen it:

### Encouraging the exercising of voting rights

Many French companies were once characterized as having absentee owners and in this light, 15 years ago or so, the Association created a governance committee that recommended asset managers exercise their voting rights. It is important to stress that this recommendation was not so much driven by asset managers' clients – who indeed, were not demanding such a step – but on asset managers seeing it as their fiduciary duty to be more engaged in governance and voting despite this representing a cost in following companies more closely in order to form clear decisions when voting.

### Formulating a corporate governance code

This established what asset managers should expect from companies in which they invest including concepts such as one share, one vote, opposition to poison pills and significant representation on a board among independent directors.

### Establishing a monitoring system

This involves assessing the governance of France's 120 largest companies and notifying Association members if the governance at these companies is contrary to the code. These steps have been a huge success, with increasing numbers of asset managers attending annual meetings, engaging in a dialogue with the firms they own, voting their shares and at times voting against firm resolutions.

### Further systemic changes are needed to consolidate improvements in how organizations manage governance

While considerable progress has been made in strengthening corporate governance in France, other important areas requiring focus are say-on-pay and more director education. In looking beyond improving governance for individual companies, there are several additional areas where governance in the wider perspective needs to be improved:

#### An owner mindset

- Asset managers and shareholders must behave as owners, with a long-term focus

#### Deleveraging

- Deleveraging must occur, with debt becoming less important, and bondholders must have a voice

#### Norms

- Global accounting norms should be adopted

#### Financial firms

- Determinations should be made regarding whether special governance is needed for financial firms

#### Greater market governance

- Greater market governance is required. Markets have been liberalized, perhaps too much. More regulation may be needed to ensure properly functioning markets

#### Focusing on ESG

- Both companies and markets must focus on ESG: Environmental, Social and corporate Governance.

## INSIGHTS

- Good corporate governance builds on good financial markets governance.
- Asset managers should behave more as owners, engage and vote their shares appropriately.
- Creditors' should have a voice to prevent excessive risk-taking which is detrimental to society.



- As companies, asset owners should integrate non-financial issues.
- 

## FOOD FOR THOUGHT...

- 1/ To what extent do the benefits for your organization and its customers lie in the active involvement of asset managers?
- 2/ What effect would having a corporate code of ethics and governance have on your organisation and its stakeholders?
- 3/ To what extent is your business and, to a wider extent, your sector focused on environmental, social and corporate governance? What are the short- and long-term benefits of ESG for you and your business sector?
- 4/ For asset managers and analysts: To what extent are/should financial and non-financial reporting be analyzed by the same analyst?
- 5/ Companies: to what extent should the financial and non-financial reports be integrated?
- 6/ For the regulator: to what extent/how should creditors have a voice in corporate governance?

## 2. The cultural context: Corporate governance - The German answer to a global issue

**Dr. Götz Schmidt-Bremme**, Chief, Economic Affairs, German Embassy of Paris  
**Professor Klaus-Peter Müller**, Chairman, Supervisory Board of Commerzbank AG;  
Chairman, Government Commission on the German Corporate Governance Code

To increase Germany's companies and capital markets attractiveness to investors, its corporate governance code establishes both standards and 90 recommendations for good governance. Stakeholder-oriented in nature, they emphasize underlying principles of a social market economy such as transparency and sustainability. Compliance is voluntary (though non-compliance requires an explanation), providing companies with flexibility, and in all evidence, the governance code, along with Germany's dualistic board structure, has worked well for the country, creating a vibrant, entrepreneurial business climate that is respected across the globe.

A dualistic structure is a defining characteristic of German business, and has proven quite successful

Most countries have a one-tier corporate structure, with one governing board that is often controlled by members of management. In contrast, explains Professor Müller, Chairman of the Supervisory Board at Commerzbank AG, Germany requires two boards: a management board that operates the enterprise and a supervisory board that oversees and advises the management board. These two boards are completely separate and independent, with supervisory boards increasingly involved in strategic planning.

A convergence is occurring between countries with one-tier boards and those with dualistic structures. Increasingly, countries with one-tier structures are separating the CEO and chairman roles or are appointing an independent lead director. Both approaches can work and the dualistic approach has proven successful in Germany.

Germany's voluntary code on corporate governance helps strengthen Germany's businesses

10 years ago, a government commission was formed in Germany to develop a corporate governance code and standards for listed German companies. The purpose of this code was to increase the attractiveness of Germany's companies and capital markets to international investors, as well as taking into account all stakeholder groups and including 90 recommendations on the rights and duties of management and supervisory boards. These deal with topics including the management board's duty to provide information to the supervisory board and its independence. Importantly, companies have no legal obligation to follow these recommendations; voluntary in nature, boards must, however, indicate in the Declaration of Conformity if the recommendations have been followed and explain when they have not.

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*"Companies don't have to obey the  
German Corporate Governance Code;  
they do have to explain."*

Professor Klaus-Peter Müller

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The code is flexible, with deviations from it being both legally admissible and sometimes necessary. Such deviations are not automatically considered an expression of bad governance, the essential point being that there has to be an explanation when there are

deviations. This clause ultimately provides transparency to the capital markets in order for the markets to draw their conclusions.

### A stakeholder orientation has become an accepted practice for German companies

The German Corporate Governance Code has a stakeholder orientation that goes beyond just the interests of shareholders in maximizing profits. The approach of the code conveys the obligation of management and supervisory boards to act in accordance with the principles of a social market economy. Ethics, sustainability and avoidance of excessive risk are all important.

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*"Management boards are responsible for managing the enterprise in the interests of stakeholders; they have an obligation not just to shareholders but to society."*

Professor Klaus-Peter Müller

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### Transparency is critical for good governance

To make capital markets work effectively, the solution is not increased regulation. What is indeed needed is even greater transparency which provides investors with visibility on matters such as remuneration and gives investors more information with which to make decisions.

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## INSIGHTS

- Good corporate Governance relies on more transparency, not more regulation.
  - "Comply or explain": deviations from the code's recommendations should be allowed provided companies explain.
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### FOOD FOR THOUGHT...

- 1/ Is a dualistic structure of governance (Board of Management and Board of Overseers) viable for both small and large companies alike? What are the pros and cons?
- 2/ To what extent does your organisation work within a voluntary environment for governance? Does regulation help or hinder?
- 3/ To what extent is transparency also a leadership quality?
- 4/ For the regulator: should more flexibility be introduced in the choice of the Board Structure (example of France where companies can opt for the monist or dualistic structure).

### 3. The legislative context: Governance and the role of government

Professor Sridar Arcot, ESSEC Business School

Professor Rodrigo Bandeira de Mello, Fundação Getulio Vargas, EAESP

Mr. Mats Isaksson, Head of Corporate Affairs Department, OECD

Government policies definitely affect corporate governance, for policies and their enforcement shape the environment for corporations. Professors Sridar Arcot, Rodrigo Bandeira de Mello and Mr Mats Isaksson of the OECD explore various policy frameworks, each of which has benefits and shortcomings, with the conclusion that there is not a one-size-fits-all approach to policy or governance, though the desire among companies for flexibility must be balanced by the need for investors of disclosure transparency. As experience in Brazil shows, especially in developing markets, the government is not just a policymaker; it may be a partner, a lender and even an owner.

#### How do governments create conditions for companies to grow?

For Mats Isaksson, there is no doubt that the government plays a role in governance and the OECD has developed a set of corporate governance guidelines whose purpose focuses on economic efficiency which in turn drives economic growth. This is achieved when companies can access capital and sell equity which they then use for growth. For investors to invest amid uncertainty requires laws on corporate governance and the stock market that include rules relating to transparency and disclosure.

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*"Company law and the stock market  
provide an ability for companies to access  
risk capital for growth."*

Mats Isaksson

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However, the rules that exist in many countries may be based on an antiquated financial view of the world. These rules assume that shareholders have a direct view and interest in a company, which today is often not the case due to the rise of institutional investors and middlemen. Other notable changes in the market include market fragmentation and use of trading techniques such as indexing and ETFs and it is due to these new realities that the OECD will be reassessing its guidelines for corporate governance at a future date.

#### What impact does allowing voluntary disclosure have on companies?

In the UK in the early 1990s, the Cadbury Committee developed a code of corporate governance best practices. Compliance with this code was voluntary, but if companies did not comply they were expected to explain the reason for not doing so. Within the UK and around the world, this approach gradually took off. Among the code's best practices are separating the chairman and CEO roles; appointing a senior, nonexecutive director; having one third of directors as non-executives; having a CEO service contract of not more than one year; and creating committees in areas such as audit, remuneration and nomination. Professor Arcot's research shows voluntary compliance in the UK has risen steadily and now exceeds 60%, though among firms that haven't complied, many offer no explanation for their non-compliance. When explanations are provided, they tend to be general and are rarely specific, which may be acceptable for family firms where the family can be expected to closely monitor its investment, but problematic for widely held companies where investors want to monitor the firm but lack the information to do so. In Professor Arcot's view, corporate

governance is complex and there is not a one-size-fits-all solution, believing it good practice to provide companies flexibility in deciding which practices to adopt based on their situation, but seeing drawbacks in a purely volunteer compliance system where there is weak legal protection for investors in widely held companies. In this light, governments need to attribute further thought to those circumstances requiring more compliance or explanation.

### Brazil's experience shows that the government is more than just a regulator

Professor Bandeira de Mello explains that in developing markets such as Brazil, the government often plays a greater role than simply establishing rules. In Brazil, the government has always had a close link with the private sector, both embracing the market and enacting policies to help the country develop. Furthermore, the government has acted as a legislator, a lender and an owner of companies and controls or influences many of the resources that firms need, affects issues such as licensing and often has influence regarding the naming of CEOs and directors. The idea of government playing a "blurred role" is not limited to Brazil however. In many countries, the government plays a key role in supporting industries or companies, providing access to capital, deciding on executives and directors and deciding upon regulations, thereby actively contributing to the impact on corporate governance.

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#### Student Survey findings

Government legislation is essential to ensure a balance between business interests and society:

Disagree: 17%

Agree: 67%

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## INSIGHTS

- Transparency and disclosure are important for protecting investors, promoting economic efficiency and growth in the interest of society.
  - Rules should be adapted to acknowledge the rise of institutional shareholders and middlemen who are not the ultimate owners of companies.
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## FOOD FOR THOUGHT...

- 1/ To what extent does your organisation work within a voluntary environment for governance? Does regulation help or hinder?
- 2/ To what extent is transparency also a leadership quality?
- 3/ Regulator: Given the diversity of companies, what are the respective benefits of mandatory compliance or flexibility?

## CORPORATE GOVERNANCE AND SOCIETY

### Speakers



**Mr. Pierre Bollon**, Executive Officer, French Asset Management Association



**Dr. Götz Schmidt-Bremme**, Chief, Economic Affairs, German Embassy of Paris



**Professor Klaus-Peter Müller**, Chairman, Supervisory Board of Commerzbank AG; Chairman, Government Commission on the German Corporate Governance Code



**Professor Sridar Arcot**, ESSEC Business School



**Professor Rodrigo Bandeira de Mello**, Fundação Getúlio Vargas, EAESP



**Mr. Mats Isaksson**, Head of Corporate Affairs Department, OECD

# CORPORATE GOVERNANCE AND FINANCE

*"The real measure of your wealth is how much you'd be worth if you lost all your money"*

Anonymous

In times of change and crisis, a mark of stability becomes a basis for reassurance and trust. In this context, bondholders and rating agencies are attributing greater importance to corporate governance as a means to measure a company's soundness, and while private equity has performed solidly throughout the past few years, it suffers from a poor public image that effective governance may be able to improve. A final pillar of stability is anchored in shareholder power and active engagement, where shareholder meetings may take on the role of a governance event.

Five studies:

- Corporate bond financing, credit risk, ratings and governance
- Audit and optimal financial disclosures
- Private equity investments, value creation and social consequences
- Shareholder power and responsibilities + Engagement policies with active institutional investors (view of large shareholders)
- Trends in board leadership and shareholder engagement policies.



# 1. Corporate Bond Financing, Credit Risk, Ratings and Governance

**Professor Patricia Langohr**, ESSEC Business School

**Professor Chao Chen**, School of Management, Fudan University

**Mr. Blaise Ganguin**, Head of Corporate Ratings

- EMEA & Managing Director, Standard & Poor's

**Professor Katsunori Mikuniya**, University of Tokyo; Former  
Commissioner, Financial Services Agency of Japan

Creditors are another important group of stakeholders who care about a firm's stability and who look to ratings agencies to provide critical risk information. Increasingly, bondholders and ratings agencies are considering corporate governance as a factor in assessing companies and in times of rapid change, governance, vision and the leadership provided by CEOs and directors are even more important.

## Where have the creditors gone?

Professor Chao Chen of the Fudan University School of Management states that in many discussions on governance, stakeholders are typically defined as shareholders, employees, customers, and the community. However, there is little or no mention of creditors, and no discussion of a firm's obligation to its creditors. This is problematic given that creditors - who are often investors that purchase bonds - play a key role for many firms and are a critical stakeholder. While managers are often focused on short-term earnings, on the other hand creditors care about a firm's credit rating, its credit risk and the probability of default. The conclusion is that corporate governance is beneficial for both shareholders and bondholders.

## For ratings agencies, corporate governance is also an important consideration in assessing companies

Mr. Blaise Ganguin, Head of Corporate Ratings - EMEA & Managing Director, Standard & Poor's, confirms that governance is definitely taken into account by S&P when developing ratings, indicating that over recent years, S&P has tightened its methodology in assessing governance. This assessment involves looking at the culture of a company's management to assess if managers behave as long-term owners or if they act in self-interest. S&P expects companies to have good governance *de rigueur* and therefore does not provide positive marks for governance: it is considered either "neutral" or "negative."

## Governance in times of crisis

Having witnessed two financial crises in Japan - in the early 1980s and again in 2008 - Professor Mikuniya of the University of Tokyo asserts that corporate governance is particularly important in rapidly changing situations.

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*"Decisions about governance made in times of stability determine future winners and losers."*

Professor Katsunori Mikuniya

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In Professor Mikuniya's experience, companies that exhibit good governance during a crisis focus on governance during times of stability, which in effect readied the company for a crisis. He also believes that strength and stability in a crisis comes from a clear corporate vision and philosophy that includes a long-term focus and an emphasis on ethics.



### Governance in times of change

The CEO and board also have critical roles, according to Mikuniya, because when structural change is large and rapid, the CEO becomes more important. Sound governance starts with the CEO and the board: they must have vision, be able to forecast economic conditions and make good decisions and although contributions are needed from all stakeholders, the contribution of the CEO is particularly important. Good governance involves balancing 'virtuous combinations' - risk taking while controlling risk, bold actions along with financial security.

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## INSIGHTS

- Creditors are concerned with the long run viability of the company and may counter-balance those managers focused on short-term earnings and taking excessive risk.
  - Companies exhibiting good governance during a crisis also exhibited good governance in times of stability (in Japan).
  - The role of the CEO is particularly critical in times of crisis.
  - The vision and leadership of the CEO are important factors to assess the long term health of a company.
- 

### FOOD FOR THOUGHT...

1/ Should the firm have more obligations to the creditors who are sometimes also investors (bondholders)? When? How?

2/ Is the same governance (CEO, board) appropriate for times of stability and of crisis?

## 2. Audit and optimal financial disclosures

Dr. Werner Brandt, CFO, SAP AG

Professor Holger Daske, University of Mannheim, Business School

Professor Yasuhiro Ohta, Keio Business School

Over the past decade accounting scandals have led to a flood of financial disclosure regulations. A hope among global businesses is for one set of accounting standards around the world. However, to date, countries have had different levels of oversight, enforcement and compliance due to different types of regulatory institutions. It has been said that in many countries stronger institutions are needed, but ultimately, producing complete and accurate financial statements is the obligation of management. Best practices involve delegating responsibility to the audit committee, which in turn works closely with the firm's independent external auditor.

*Providing accurate and complete financial information is an obligation of management*

The starting point for thinking about financial reporting is recognizing that it is the obligation of management to provide accurate and complete financial information for the market. At SAP, the management committee and the supervisory board created financial guidelines and established five layers of oversight. The supervisory board delegated responsibility to the audit committee for pulling together the information for the financial reports, with the audit committee then engaging the firm's independent auditor. The audit committee and the external auditor developed best practices that guide how they work together.

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*"An effective audit requires cooperation  
between the audit committee and the  
external auditor."*

Dr. Werner Brandt

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Among best practices guiding the relationship between the audit committee and the external auditor are alignment of the audit committee with the company's strategy; full transparency with the auditor regarding strategy and operations; and a report by the auditor regarding the company's internal controls. In addition, the auditor is involved in all meetings of the audit committee and there is a seamless flow of information between the audit committee and the auditor.

*As businesses become more global, they should be linked by one set of accounting standards*

Professor Daske states that as businesses are increasingly global, one idea is to create a common set of accounting standards. However, this is currently far from a reality. For example, in Japan, about 1% of public companies use IFRS (International Financial Reporting Standards), another 1% uses the U.S. version of GAAP and 98% use local Japanese GAAP.

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*"We need alignment of capital markets  
regulation."*

Professor Yasuhiro Ohta

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In practice, alignment requires more than just common standards. Even when countries adopt standards such as IFRS, there often are significant differences in how reporting occurs. This is because of:

- Incentives
- Lack of institutions
- Lack of compliance

#### Incentives

Despite standards, actual reporting practices are driven by incentives and company choices.

#### Lack of institutions

Many countries lack strong institutions to ensure that standards are translated into practice. While the SEC has existed in the U.S. for more than 70 years, Germany has only had a comparable institution for five years. In Europe, institutions to enforce standards are often weak and lack resources.

#### Lack of compliance

As a result of weak institutions, there are issues with the compliance and enforcement of these standards. Professor Daske notes that audit checklists are not thoroughly followed, and while 100% of U.S. banks comply with mandated regulations, perhaps only 50% of banks outside of the U.S. comply. Moreover, even when compliance with regulation is lacking, firms can receive a positive opinion from their auditor.

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*"IFRS has benefits, but only if there are strong supporting institutions."*

Professor Holger Daske

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## INSIGHTS

- Transparency: financial disclosure is essential.
  - In a global world, common accounting standards are necessary.
  - Strong institutions are required to guarantee homogeneity in reporting.
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## FOOD FOR THOUGHT...

- 1/ To what extent are accountability and efficiency complements or substitutes?
- 2/ To what extent is the audit committee aligned with your organization's strategy?
- 3/ How much time is dedicated to compliance in your company and is there a formalized compliance structure in place?

### 3. Private equity investments, value creation and social consequences

**Professor Jose-Miguel Gaspar**, ESSEC Business School  
**Mr. Vincent Gombault**, Managing Director Funds of Funds  
and Private Debt, Axa Private Equity  
**Mr. Jean-Louis Grevet**, Founding and Managing Partner,  
Perceva Capital

As an asset class, private equity in Europe has performed well, creating value and delivering good returns. Why should that be? One notable reason is better governance characteristics due to the factor that private equity investors are highly engaged directors. And yet the private equity industry faces image problems, not least because its effects may produce extremes that opinion has difficulty in comprehending: at times buyouts result in lost jobs, while some deals produce massive rewards.

#### A good track record

Private equity has been an extremely successful asset class. Professor Gaspar defines private equity as an investment model that concentrates firm ownership in the hands of active, professional investors. As a result of the industry's success, there are now about 30,000 funds around the world, managing \$3 trillion. Research on private equity yields several important insights.

#### Why is private equity so successful?

- Superior performance
- Highly pro-cyclical activity
- Returns are counter-cyclical
- Persistence in performance
- Better governance characteristics
- Growth strategies

**Superior performance:** Private equity produces higher margins, higher productivity and higher capital efficiency than other investment classes.

**Highly pro-cyclical activity:** The amount of private equity activity fluctuates with economic cycles. During boom times, cash is plentiful and there is more activity.

**Returns are counter-cyclical:** While activity is high during boom times, the abundance of cash drives up prices and drives down returns. The best performing funds are those started in bad times.

**The industry exhibits persistence in performance:** Unlike other asset classes like mutual funds which do not repeatedly do well over and over again, a good private equity fund will repeatedly perform well.

**Better governance characteristics:** One of the reasons private equity performs better is its governance. Companies owned by private equity firms have smaller boards, with more outsiders, which meet more often.

**Growth strategies:** In the 1980s, private equity investors bought underperforming companies, fired management and loaded companies with debt. But today in Europe, leveraged buyouts are a growth story.

Private equity has evolved from a niche asset class to a more mainstream, more stable investment

According to Vincent Gombault, private equity was initially an “alternative” investment, which is no longer true. Even after the recent financial crises, most funds are able to raise capital, and the total amount raised is significant. Mr. Gombault’s observations on the industry include:

**Greater stability:** Today there is less volatility. Funds are using less debt (about 50%), and few deals (< 1%) end up in bankruptcy. With low interest rates, investors shouldn’t expect 20 - 25% IRRs, but 10 - 15% is realistic.

**Longer horizons:** Private equity investors are keeping their investments long term, such as five years. Because of this long-term focus, the 20% carry aligns interests.

Private equity investments in France’s mid-market require focus, expertise and experience

Because of France’s unique environment and laws, knowledge and expertise of the French market is essential. With this focus, Perceva views each investment as different, requiring different strategies and actions. This might include shoring up a balance sheet, reassuring creditors, working with local authorities or developing new products to drive growth. Each investment is handled differently based on the specific situation.

The private equity industry struggles with image

As an industry, private equity has a bad image. Mr. Gombault suggested this is because successful deals can result in very large returns, which are reported by the press in a negative light. Professor Gaspar sees such returns are a natural result of taking risk. In looking at specific areas affecting the industry’s image, he concludes:

Jobs	▪ Net job creation is negative, as private equity investments often shed jobs. However, these investments also create jobs, and those jobs tend to be higher level and better paying.
Innovation	▪ Companies owned by private equity investors have no innovation advantage.
Leverage	▪ The use of leverage is only responsible for about one third of the industry’s returns; improving firm performance and selling assets at favorable times are also responsible for about one third.
Incentives	▪ The intent of the standard model of 2% fees and 20% carry is to align incentives. However, research shows that 60% of the present value of a general partner’s compensation comes in the 2% fees.

## INSIGHTS

Behind the over-performance of private equity investments:

- Concentrated ownership
  - In the hands of professional active investors
  - With a long term view
  - Leverage
  - And controlled risk-taking.
- 

## FOOD FOR THOUGHT...

- 1/ How can you transfer the keys to the success of private equity to your company?
- 2/ What would be the costs (job losses, etc.) for society?

## 4. Shareholder power and responsibilities and Engagement policies with active institutional investors

**Professor Patricia Charléty**, ESSEC Business School

**Mr. Bernard Icard**, Head of Equity Proprietary Investment,  
Caisse des Dépôts et Consignations

**Mr. Hector Lehuedé**, Senior Policy Analyst, OECD

**Professor B. Espen Eckbo**, Tuck School of Business at Dartmouth

**Mr. Vegard Torsnes**, Ownership Policy Group, Norges  
Bank Investment Management (NBIM)

**Mr. John C. Wilcox**, CEO, Sodali

The power of shareholders varies by country based on a country's laws and regulations. While the specifics vary by country, in general shareholders can exercise power by proposing resolutions and directors, engaging in proxy fights, and how they vote. Moreover, with short holding periods and high ownership rates of index funds and ETFs, many shareholders are not interested in governance.

However, there are still engaged, responsible shareholders who behave as owners by holding stocks long term and by actively engaging with firm management.

*The power of shareholders varies by country, by company and by shareholder*

A common view is that shareholders are passive and have lost power, and that power has transferred to boards. While in certain cases this may be true, in some countries shareholders have greater legal protection and also more power. Ways that shareholders can exercise power include:

- **In private:** Shareholders can meet with management, raise difficult questions and express their views.
- **In public:** Shareholders can use the media, engage in proxy fights and submit resolutions on topics such as say-on-pay.
- **Voting:** Shareholders can propose and vote for resolutions; it is easier to oppose management by proposing resolutions than vote against management-sponsored resolutions, as about 95% pass. They can also try to build alliances to vote for/against a resolution.
- **Proposing directors:** Depending on the country, shareholders may be able to nominate directors.

*Changes in market conditions require rethinking the rights and obligations of shareholders*

The OECD has published a study on the election and remuneration of directors in various countries. This study shows that while shareholders can express dissatisfaction in several ways, it is rare for shareholders to exercise voting rights, and a proxy fight is difficult and expensive.

As a result, what is left to shareholders is to approve or reject the board. However, rules vary from country to country: in some, shareholders can nominate directors, in others shareholders are not allowed to nominate directors and in others still, the ownership threshold to nominate may be up to 10%. In addition, contesting the election of directors is rare. Changes in the market require rethinking the rights and obligations of shareholders.

Key shareholder areas include:

- **Board profiling:** A trend among companies in selecting directors is to create a specific profile for the skills and experiences desired in a new director.

- **Lack of voting:** Increasingly, asset owners are index funds, ETFs or foreign investors that have little interest in a company's governance. In some countries asset owners are actually not allowed to vote.

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*"Many asset owners are not worrying about voting."*

Hector Lehuedé

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- **Shorter holding periods:** Contributing to the lack of interest in voting and governance is shorter holding periods by investors, who aren't behaving as interested long-term investors. Mr. Lehuedé said that the average holding period of a stock in 1991 was 2–3 years; today on average, an NYSE stock is held for just five days.

#### Deeply engaged asset owners can have much power

Caisse des Dépôts et Consignations invests \$11 billion in European equities, which it holds long term, for an average of 5 - 7 years, with fund managers taking a bottom-up approach, conducting industry analysis and engaging in thorough due diligence. While the firm remains a minority owner, fund managers still meet once yearly with the top management of every company they own. These occasions are not always friendly, as fund managers, accredited with the right to vote and attend shareholder meetings, do ask hard questions.

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*"We need access to top management. It is the only way to really address issues with companies"*

Bernard Icard

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This "soft engagement" positions the firm as a responsible investor, pushes companies to incorporate corporate governance as a value and promotes the firm's own values.

#### And what about active institutional investors?

Institutional investors, who care about good governance and are increasingly factoring governance into their investment decisions, engage with the companies they own through direct interactions and by voting. Moreover, it is in the best interests of companies to engage with their shareholders, actively getting to know who their shareholders are, building a relationship with them and explaining their governance practices and customizing communication.

#### NBIM sees corporate governance as an important part of its investment decisions

Norges Bank Investment Management (NBIM) is the asset manager of Norway's sovereign wealth fund, with \$650 billion in assets, 60% of which are invested in equities, 30% in fixed income and 5% in real estate. NBIM is a long-term investor with a goal of building and safeguarding value over the next 30 years. NBIM seeks moderate risk and high returns.

As a long-term investor, NBIM buys companies that its fund managers believe in and strives to build trust-based relationships with its companies. Given that fund managers evaluate companies, they are expected to integrate corporate governance into their analysis.

NBIM is a top 5 shareholder in 800 companies and a top 10 shareholder in 2,400 companies, and, overall, owns shares in 8,000 companies worldwide. Because of its size and prominence, NBIM sees its responsibility to be an engaged investor.



Key factors for NBIM are:

- Transparency
- Board accountability

#### Transparency

NBIM is a transparent investor and discloses in its own quarterly reports on how it voted. It demands transparency in the companies in which it invests.

#### Board accountability

NBIM expects to see high levels of accountability at board level in the companies in which it invests.

Once NBIM owns shares in a company, it exercises its rights as a shareholder primarily through voting and all funds at NBIM that own shares in a company come together to decide how to vote. In deciding how to vote, NBIM makes its own decision and does not rely on checklists from an organization such as ISS. NBIM attends shareholder meetings and engages with companies directly where appropriate. Moreover, when interacting with a company, NBIM expects to hear from the company why they should vote a certain way.

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*"Corporate governance is becoming a more important part of investment decisions"*

Vegard Torsnes

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There are many steps that corporations can take to improve their corporate governance and how their governance is perceived by investors

John C. Wilcox, CEO of Sodali, remarks that companies that do not engage with shareholders get the shareholders they deserve. For him, engagement is not rocket science and recommends several simple, though effective steps to take:

Key steps for Sodali are:

- Benchmarking corporate governance against peers
- Explaining the business rationale for governance
- Analyzing who the firm's shareholders are. Know your audience and listen to them.
- Developing a holistic investor relations program and viewing the shareholders meeting as a governance event.

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*"Companies are under pressure to be more flexible and customized in how they communicate with shareholders."*

John C. Wilcox

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## INSIGHTS

- Good corporate governance and transparency are increasingly important criteria for long term investment choices in companies.
  - Profiling, selecting directors and board accountability are priorities for shareholders.
  - It is in the mutual interest of long term investors and companies alike to engage with each other.
  - Engaged investors do actually promote the firm's own values.
  - Companies should analyze who their shareholders are and be customized in how they communicate with them.
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## FOOD FOR THOUGHT...

- 1/ To what extent should regulations require shareholders to have more responsibilities through mandatory voting? What would influence the effectiveness of this?
- 2/ Historically, funds have separated the investment decisions from efforts related to corporate governance. How would highly analytical analysts incorporate softer governance issues into their decisions?
- 3/ What is the sense (if any!) of a "one share, one vote" approach?
- 4/ In your view, to what extent is the best protection from being subject to takeover keeping shareholders informed?

## CORPORATE GOVERNANCE AND FINANCE

### Speakers



**Professor Patricia Langohr**,  
ESSEC Business School



**Professor Chao Chen**,  
School of Management,  
Fudan University



**Mr. Blaise Ganguin**, Head  
of Corporate Ratings -  
EMEA & Managing  
Director, Standard & Poor's



**Professor Katsunori  
Mikuniya**, University of  
Tokyo; Former  
Commissioner, Financial  
Services Agency of Japan



**Dr. Werner Brandt**, CFO,  
SAP AG



**Professor Holger Daske**,  
University of Mannheim,  
Business School



**Professor Yasuhiro Ohta**,  
Keio Business School



**Professor Jose-Miguel  
Gaspar**, ESSEC Business  
School  
and Private Debt, Axa  
Private Equity



**Mr. Vincent Gombault**,  
Managing Director Funds  
of Funds  
and Private Debt, Axa  
Private Equity



**Mr. Jean-Louis Grevet**,  
Founding and Managing  
Partner,  
Perceva Capital



**Professor Patricia Charléty**,  
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**Mr. Vegard Torsnes**,  
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Bank Investment  
Management (NBIM)



**Mr. John C. Wilcox**, CEO,  
Sodali

# GOVERNANCE AND THE BOARD

*"Corporate governance is different from management. Management runs the enterprise. The board or governing body ensures that it is being run well and in the right direction."*

Bob Tricker\*

\*Tricker, R. I., Corporate Governance - practices, procedures and powers in British companies and their boards of directors, Gower, Aldershot UK, 1984

The health of businesses may have a huge positive impact on society, the environment and the economy, and purposeful governance can make all the difference. This commitment towards the wider perspective is discussed in the following texts which together forward proposals on how to improve the professionalism of boards, learn from cultural approaches to board management, align shareholder and company interests, seek models of excellence in family-run businesses and add increased value to boards via the presence of women and employee representation.

Five scenarios:

- Trends in board leadership and shareholder engagement policies
- Leadership of family and state firm boards
- Women on boards: director gender quotas
- Employee participation
- Board crisis management: China v. the US.



## 1. Trends in board leadership and shareholder engagement policies

**Professor B. Espen Eckbo**, Tuck School of Business at Dartmouth  
**Professor Paul Danos**, Tuck School of Business at Dartmouth  
**Professor Pei Sun**, School of Management, Fudan University  
**Professor Karin Thorburn**, Norwegian School of Economics  
and Lindenauer Center for Corporate Governance at Tuck  
**Mr. Vegard Torsnes**, Ownership Policy Group, Norges Bank  
Investment Management (NBIM)  
**Mr. John C. Wilcox**, CEO, Sodali

At the core of corporate governance is the role of the board in overseeing how management serves the long-term interests of shareholders and other stakeholders. International perspectives diverge on the primary responsibilities of board directors, with an Anglo-Saxon model that emphasizes the protection of shareholders' assets and return on investment, while in continental Europe many feel that the board's responsibility is to protect the employees first, and shareholders second.

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*"Management boards are responsible for managing the enterprise in the interests of stakeholders; they have an obligation not just to shareholders but to society."*

Professor Klaus-Peter Müller

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Klaus-Peter Müller argues that Germany's voluntary code on corporate governance helps strengthen the business community, and increases the attractiveness of the country's companies and capital markets to international investors. "Companies don't have to obey, but they do have to explain. Comply or explain." For Müller, the flexibility of the German Corporate Governance Code is not an expression of bad governance, but the key is to explain when there are deviations. This provides transparency to the capital markets so that they can draw their own conclusions.

For John Wilcox, CEO of Sodali, it is important for shareholders and companies to align their interests. He prefers a slightly different version to the German model. "Boards should have to comply AND explain. Boards need to give sufficient information to shareholders so they can make informed votes about the quality of directors." Wilcox believes boards should have a legal duty to explain to shareholders how they are doing their job with an obligation to write a memorandum about how the company is run, how decisions are made and what the company's values and culture are. This, he believes, will drive directors to think more about how they do their job.

With a fiduciary responsibility to protect the interests of the firm and its owners, Professor B. Espen Eckbo identifies some of the key challenges to board effectiveness. He questions whether a board that meets 8 times a year is sufficient to be effective, and highlights the difficulty for minority shareholders to have their voices heard.

Professor B. Espen Eckbo identifies 6 areas of focus to ensure improved professionalism of the board of directors:

- Election reform
- Remuneration
- Education
- Director independence
- Activism
- Talent search

#### Election reform

Efforts aim to make it easier and less expensive for shareholders to vote on directors.

#### Remuneration

Say-on-pay is a trend that is pushing boards to be more sensitive to executive compensation.

#### Education

Directors must be more informed about many topics, especially risk management.

#### Director independence

The trend toward having greater board independence is increasing.

#### Activism

Many stakeholders are increasingly active in trying to bring about changes in the board.

#### Talent search

Boards are broadening what they are looking for in terms of criteria, such as more women and a diversity of experiences.

There is much at stake. When companies take the initiative on corporate governance, they can preempt activism among shareholders and avoid onerous legislation and rules. Yet all too often, companies and their shareholders have adversarial relationships and fail to achieve diversity without the threat of legal action.

Surprisingly, minority investors can play a key role in China, even with state-owned enterprises

In China, ownership is often concentrated with a controlling shareholder, particularly the state. Institutional investors can, however, still play an important role though it is important to note that while pension funds are prohibited from investing in the stock market, mutual funds can.

The key roles of institutional investors in China are:

- **Passing resolutions:** The votes of controlling shareholders don't count when passing resolutions, so they must rely on others, including institutional investors.
- **Nominating directors:** To nominate directors, such as former party officials, mutual fund support may be required.

What can be done to improve how companies are governed?

John Wilcox states that the relationship between companies and shareholders is often described as being adversarial and a power struggle. This need not be the case as



shareholders and companies want the same things. It is because of this, that it is important for shareholders and companies to align their interests.

Shareholders and companies can align interests by:

- Adopting the 'comply or explain model'
- Private sector initiative
- Frequent communication
- Good governance among shareholders
- Elimination of short-termism
- Business statesmanship

Adopt the "comply or explain" model: In Europe, some guidelines are voluntary, granting companies flexibility to comply or explain why they have not complied. Mr. Wilcox prefers a slightly different version: 'comply and explain', which would drive directors to think more about how they do their job.

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*"Boards should have to comply AND explain. Boards need to give sufficient information to shareholders so they can make informed votes about the quality of directors."*

John C. Wilcox

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Private sector initiative: Often shareholders seek rights and often companies dig in their heels and refuse, as a result producing legislation and firm rules that no one likes. In this light, corporations need to take the initiative to come up with solutions that improve governance. Moreover, companies that proactively engage with their shareholders can control shareholder activism. When a company accepts capital and becomes a public company, part of the deal is that the company should be willing to engage with shareholders - the annual shareholders meeting being regarded as a governance event.

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*"Activism occurs when companies have not done a good job of engaging with their shareholders."*

John C. Wilcox

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Frequent communication: Companies must decide who their spokesperson is and what topics to speak with investors about, including performance and risk management, remuneration, succession planning, director recruitment and evaluation, ethics, culture, reputation and more. While lawyers often say that boards can't communicate such information to shareholders, none of this constitutes material, non-public information.

Good governance among shareholders: Often institutional investors themselves are not well governed. They demonstrate a lack of fiduciary duties. A new code is therefore required to guide the conduct of institutional investors.



**Elimination of short-termism:** Many of the problems that exist can be traced to investors and companies that are focused on the short term. Everyone needs to take a look in the mirror and work to rectify this.

**Business statesmanship:** Former GE CEO Reginald Jones was a statesman who understood the responsibility of serving all stakeholders. In contrast, Jack Welch personified the celebrity CEO who was focused on his position, pay and perks. We need business leaders – much in the vein of Reginald Jones - who are statesmen.

**Long-term investors can use governance as a lever to improve long-term company performance**

Norges Bank Investment Management (NBIM), the world's largest sovereign wealth fund, believes its competitive advantage is to use its long-term perspective to work with companies to improve their governance and performance, providing NBIM with superior returns. NBIM is an active investor that votes its shares and engages with the companies it owns.

**Diversity in the boardroom has value. Even though the value of gender quotas is inconclusive, such quotas can have important social benefits**

Today, about one in seven directors in Europe is a woman and most of these female directors are from countries that have adopted quotas such as Norway, where women account for 42% of directors. Data shows that female directors are more likely to be independent outsiders and in general, outsiders are often better able to perform the monitoring function on boards while insiders are stronger in the advisory function.

Overall, it is inconclusive whether having more women on boards creates value for companies or investors. Whereas there is some evidence showing some positive results, it is hard to conclude that there is a causal relationship. However, when boards do have more women the educational level on the board rises, attendance at board meetings increases and boards may have a greater stakeholder orientation. In Norway, after voluntary targets for female board representation were not achieved, the government specified quotas for the largest companies and were told that if they were not compliant by April 2008, they would be dissolved. This hard line resulted in full compliance, but while these quotas have increased female representation on boards, the impact on company/shareholder value is unclear. Mandatory quotas are fundamentally a political issue, but history shows that often this is the only way to change society. Quotas force change and it is for these reasons why they may be beneficial. Moreover, quotas for women on boards have been enacted or are being considered in Spain, Italy and the Netherlands.

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*"We have seen little change without legal action."*

Professor Karin Thorburn

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#### Student Survey findings

Who should have most **influence** on the selection of corporate board members? Number of responses:

Shareholders	(Most) 173	(Some) 99
Company management	(Most) 122	(Some) 121
Current board members	(Most) 69	(Some) 146
Employees	(Most) 46	(Some) 148

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## INSIGHTS

- The relationship between companies and their shareholders need not be adversarial: companies and shareholders often want the same things.
  - Boards should broaden in terms of criteria and represent more diversity in terms of experience.
  - The trend is toward having greater board independence.
  - Boards have an obligation not to just shareholders but to society.
- 

## FOOD FOR THOUGHT...

- 1/ Should boards comply OR explain ("European view") or comply AND explain (J Wilcox)?
- 2/ How can shareholders (stakeholders) and board interests be aligned?

## 2. Leadership of family and state firm boards

Professor Pei Sun, School of Management, Fudan University

Mr. André Chieng, Chairman, AEC, China

Mr. Bernhard Simon, Managing Director and Family Spokesman,  
Executive Management Board, Dachser GmbH

Governance is extremely important for family-owned firms. Thinking hard about good governance allows family firms to build trust, succeed across generations and attract talented managers and directors. In China, the environment and philosophy has been conducive to creating family-owned companies, but has not been favorable to transmitting companies from one generation to the next. State enterprises in China, which have been supported by the population, have been numerous and largely successful. But as China's economy and middle class grow, the future path for these firms is not clear.

Bernhard Simon explains here why governance is so important in a family-owned company and describes how governance works at his family-owned firm. In parallel, André Chieng discusses both state and family-owned firms in China, with particular focus on the challenges these organizations face.

Even in family firms, corporate governance is extremely important

Operating in the transportation and logistics sector, Bernhard Simon's firm fundamentally sells trust built on good governance. The family and the company's management think about and talk about governance frequently. The family has a family constitution, and the governance structure the family has decided upon is that the family is a shareholder, has a family office with a spokesman and the family focuses on the company's direction, values, M&A, financing and whether management is fulfilling the company's mission. Practically, the family has delegated power to the supervisory board (with two family representatives) and a management board. These boards decide on the company's strategy, investments, succession plans, compensation and dividends, risk management and other financial and operational issues, with a clear rule that the family cannot override them.

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*"We make clear that the responsibility of  
family members is to be shareholders."*

Bernhard Simon

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This governance structure has proven successful. The company has grown and performed well and has been able to attract and retain talented executives and outside directors, and the family is now in its third generation of ownership. Even though executives and directors do not receive equity in the company, they are attracted by competitive compensation and a stable yet entrepreneurial environment.

China's environment has been conducive to the creation of new family-owned firms, but has not been favorable to the transmission of firms

In the West, there are many companies that have existed for hundreds of years, but in China, the concept of companies is more recent. However, companies were often created for different purposes than in the West: while a business offers less prestige than being a government official, it might serve the purpose of providing for a family. Despite different types of governments in China, the general philosophy of Confucianism, which has always

been important in China, has been favorable regarding the creation of new companies by families. However, China has faced challenges in transmitting companies from one generation to the next, the problem being that preference was given to kinship, not expertise or capability, with the result that companies passed on to the next generation often fail.

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*"Thinking hard about good governance allows family firms to build trust, succeed across generations and attract talented managers and directors."*

Professor Pei Sun

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André Chieng believes Chinese families can learn from the success of Jewish families, where children initially work outside of the family company to gain experience and prove their success, and then compete in order for the most capable family member to be chosen to lead the company. In comparison, it must be emphasized that China's one-child policy would make this more challenging.

The attitude toward state firms in China is very different than in the West; the future of China's state-owned enterprises is unclear

State firms are rare in the West and those in the West have negative opinions of China's state firms. However, the attitude in China is different because these firms are seen as belonging to the public with many typically seen as elite. In general, these firms have performed relatively well and had fewer problems than U.S. firms during the recent financial crisis.

While referred to as "firms" or "companies", the government-appointed managers of these entities have taken orders about what to produce, who to employ and what to invest in. The state and the managers leading these firms often have had contradictory objectives, such as increasing employment while not losing money, that differ from those of typical enterprises.

The government now says that it will be less involved in overseeing state enterprises, stating that it is focused on a market economy and will return state-owned firms to the private sector in order to compete in the global marketplace. But the jury is still out. The state still interferes in the management of firms and still has the power to appoint the CEO, which is typically an opaque process. As China's economy and middle class grow, the future path for these firms remains unclear.

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## INSIGHTS

- Good Corporate Governance is naturally associated with long run performance for family owned firms.
- Responses to guarantee that the firm is run in the family's interest vary across companies/cultures: delegation to a management board under the supervision of the family, delegating management to a selected member of the family.

## FOOD FOR THOUGHT...

- 1/ Transmission is often critical in family owned companies and the specific problem should be addressed (competition between possible candidates in the family members, etc.). How?
- 2/ Is a "family constitution" at Dachser a generic solution to potential specific issues in family owned companies?

### 3. Women on boards: of gender and power

**Professor Karin Thorburn**, Norwegian School of Economics  
and Lindenauer Center for Corporate Governance at Tuck

**Professor Viviane de Beaufort**, ESSEC Business School

**Ms. Noreen Doyle**, Director, Credit Suisse

**Ms. Susan Lindenauer**, Director, Women's Legal Defense Funds

In 1911, the French Academy of Sciences failed to elect Marie Curie to be a member by a margin of one vote, electing instead a little remembered man who was involved in wireless telegraphy. No wonder the first woman to win a Nobel Prize, and the only person to win Nobels in multiple sciences, observed that "the way of progress was neither swift nor easy."

Gender diversity in the boardroom is a case in point. A century after Curie was overlooked by the French Academy of Sciences, the statistics on the number of women who have reached an executive board position make disappointing reading. Yet with so much research showing that organizational performance is improved when there is a more gender balance, it is difficult to understand why businesses haven't been quicker to put this right.

Professor Karin Thorburn's review of academic evidence on the voluntary appointments of female directors to European boards shows the progress made in Norway over the last decade - now boasting a 42% female board representation. While other European countries have set similar goals for the years ahead, progress remains slow. The absence of sanctions may explain the fact that Spain has only 11% female board directors, though it is Italy that will have to change gears if the country is to meet its quota by 2015 from the current level of only 6%.

More women are serving on more boards because of quotas and a greater focus on diversity

When Norway's voluntary targets for female board representation were not met, the government specified quotas, informing the largest companies that if compliance was not reached by April 2008, the company would be dissolved. The result was full compliance. "We have seen little change without legal action", Thornburn observes.

Country	Year passed	Quota size	Year of compliance	Sanctions	% female directors
Norway	2003	<b>40%</b>	2008	yes	<b>42%</b>
Spain	2007	<b>40%</b>	2015	no	<b>11%</b>
Iceland	2010	<b>40%</b>	2013	yes	<b>25%</b>
Finland	2010	<b>one</b>	2010	yes	<b>27%</b>
France	2011	<b>40%</b>	2017	yes	<b>22%</b>
Belgium	2011	<b>33%</b>	2019	yes	<b>11%</b>
Netherlands	2011	<b>30%</b>	2016	no	<b>19%</b>
Italy	2011	<b>33%</b>	2015	yes	<b>6%</b>
European Union	Women on the Board Pledge for Europe				<b>14%</b>

But does greater gender diversity on the board create value for companies or investors? Though Professor Thorburn identifies a number of studies that find a positive relationship between the percentage of female directors and firm performance, based on stock performance, ROE, sales growth and other indicators, she points out that it is impossible to make any inferences about causality. "Are profitable firms more likely to hire woman? Or do women prefer directorships in profitable firms? We face similar issues with studies that find a correlation between gender diversity and CSR or better management practices, and it is difficult to claim that adding women to the board will improve company performance."

However, shareholders seem to value voluntary appointments of female directors more than appointments of male directors. A study of new outside director appointments in Australia from 2004 to 2006 showed that stock price reaction was significantly higher (approx. 2%) on the announcement of female directors, and similar results have been noted in Spain and Singapore.

Data also shows that greater gender diversity on US boards positively affects the monitoring function of the board, with better attendance records, and a higher likelihood of equity-based board compensation. Greater monitoring increases the value of firms with weak shareholder rights, though it reduces the value of firms with strong shareholder rights.

The example set at the top then spills over from the board to top management. Firms with more women on the board have more female top executives, though the existing corporate culture may also serve to attract more women.

#### The composition of non-profit boards is very different from boards of for-profit companies

In the United States, non-profit boards tend to be much larger (often having 30 or so board members, to assist with the goal of fundraising), and women represent 43% of the directors on these boards. However, the representation of women is highest among non-profits with smaller budgets, but is much lower at non-profits that have budgets of more than \$100 million.

So how does greater gender balance effect the decisions made by the board? When Norwegian quota firms were compared to similar non-quota firms elsewhere in Scandinavia, they were found to undertake fewer workforce reductions, and saw a relative increase in employment levels and labor costs that coincided with a relative decline in operating profitability. Critics would argue that adding more women on the board had damaged the bottom line, favoring altruism over profitability.

In the wake of the quota, many non-listed Norwegian firms - often small, profitable firms with concentrated ownership and few if any women on the board - changed their legal structure to avoid compliance. Did they feel that the quota destroyed value, or was it done to protect the male incumbents? It is hard to say, but overall it is difficult to conclude that the reform had any long-term valuation effects.

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*"Women have tremendous capabilities and  
fit well on boards."*

Professor Viviane de Beaufort

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So should corporate board gender quotas be imposed? Because the evidence about the impact on a firm's value is inconclusive, the board gender quota is a purely political and gender equality issue. In Norway for example, the quota was proposed by the Ministry for Children, Family and Equality. But without legal action, little will change. After all, in the UK a golf club membership is a four times better predictor of receiving a corporate board position than a top university education. Perhaps the question therefore is whether we want a society where men and women have equal influence and economic power? And for Professor Thorburn, there is only one answer to that question.



## Women and their relationship to Power: Taboo or new Corporate Governance Model?

While women still represent fewer than one in five corporate board members of Fortuna 500 companies in the US, with similarly dismal percentages elsewhere in the world, the dial is slowly shifting towards higher levels of gender diversity. Given the skills, experience and insight that women bring to the position, boards that fail to include more women, irrespective of legislation or quotas, are missing out on an important voice when making critical decisions that affect corporate performance.

But as the percentage of women on boards increases, is there an opportunity for companies to embrace a new mixed power model that blends the best of leadership, decision-making and capability on the one hand, and rationality, empathy and organization on the other? Research by Professor Viviane de Beaufort of the ESSEC Business School suggests that greater gender balance can positively impact the governance model.

Based on a qualitative study that included interviews with Board Members, Company Directors, politicians and civil servants from France and abroad, Professor de Beaufort looks at the different relationship women have with power, whether a female style of leadership exists, and how women have the opportunity to position themselves differently to then promote different governance values and managerial practices.

If women can shift from being a minority on the male dominated board, they may no longer face pressure to become more masculine in the way they exert power - and in doing so lose the feminine qualities that contribute to the 'wealth' of the Board - and produce a juxtaposition of opinions and personalities that make 'good advice'. This viewpoint was expressed by 69% of the French and 78% of the international interviewees involved in the research, who felt that women have specific qualities or attributes for board membership (see boxes for examples).

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*"Women do things for the good of the company and not for appearances. They have a real concern about making things move forward; they are less into politics and their personal positioning. They bring more objectivity and sense of the practical. Women are idealists and impassioned."*

S. Ouziel

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*"More collective, using less unverifiable assertions, more courageous, more able to think freely."*

D. Ernotte-Cunci

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*"Capable of cooperation and compromise, better ability to anticipate through listening and intuition, better sense of the concrete."*

A. Arcier

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Source: Replies to a study by Prof. Viviane de Beaufort

The results also suggest that women who seek positions of power and mandates on boards are more interested in a power to 'act' rather than power for power's sake. Motivated by a strong desire for good governance, to have an impact, and serve the general interest, many

respondents spoke of the collective exercise of power, advocating a non-executive Board set-up and run as a team.

All the women interviewed shared an acute sense of responsibility when it come to power, notably regarding four aspects:

- The duty to participate in the change of a system of Governance
- The absolute respect of the rules and ethical principles
- A responsibility towards other women, namely those of the younger generation
- The belief that exerting power requires courage

One of the most striking findings, in an age of gender quotas and compliance, is the importance of having the right skills in order to justify their position on the Board. Women are often judged on their experience and accomplishments, whereas men sometimes have the privilege of being judged on their potential.

De Beaufort's research also identifies areas in which the governance model should change, with the implication that stronger female representation would help achieve these goals. Many women consider that the current model is too financial, and not sufficiently operational, with HR policies and aspects including succession planning and technical and technological skills systematically lacking on the Board agenda.

They also state that while the issue of compensation is important, and should be linked to more demanding and specific performance criteria, the role of the board is to ensure the sustainability of the company and not just the income of Board members.

Gender diversity in the boardroom may be slow, but the benefits to the business are compelling. With a more consumer-oriented outlook, a focus on sustainable development, and both analytical and people skills, women bring vision, respect ethics, and are willing to change the status quo – all valuable contributions that would help overturn current public attitudes to corporations.

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## INSIGHTS

- Gender quotas are mainly a political and gender equality issue: nothing would change without a law.
  - No clear conclusion can be drawn regarding the presence of women on boards and firm value.
  - Greater gender diversity enhances the monitoring (versus advisory) role of boards.
  - Greater gender diversity is correlated with higher attendance (for both men and women).
  - Women seem more attached to “social values” (jobs, etc.), than men.
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## FOOD FOR THOUGHT...

- 1/ Compared with a man, how does the judgment differ when deciding on whether a woman qualifies for a board position?
- 2/ Is increasing representation of women on boards a solution for a more society-oriented Corporate Governance?

## 4. Employee participation on the board

**Dr. Christoph Schneider**, University of Mannheim, Business School  
**Mr. Alain Champigneux**, Employee Elected Board Member, Renault  
**Dr. Werner Brandt**, CFO, SAP AG  
**Professor Katsunori Mikuniya**, University of Tokyo;  
former Commissioner, Financial Services Agency of Japan  
**Mr. Thierry Peugeot**, Chairman, Supervisory Board, Peugeot SA

While few would challenge the importance of employees as stakeholders whose perspective can help companies to make sound long-term decisions, there are two differing views about their representation on a corporate board. Dr. Christoph Schneider of the University of Mannheim Business School summarizes them as Voluntary Representation, in which a board's representation is not mandated but should be determined by the owners of the firm's assets, and Mandatory Representation, involving laws that require employee representation on the board.

Countries have adopted different models and laws regarding employee representation and laws in Germany do not require representation if a firm has fewer than 500 employees, but require that large companies such as SAP provide 50% of their board seats to employee representatives. In contrast, in France, representation is required if employees own more than 3% of the stock, and in the case of Peugeot, two employees participate in board meetings, but they do not have voting rights. Lastly, in Japan, it is rare that employees are represented at board level, but employees have a high degree of protection under the law.

So what are the ingredients for successful employee representation? Starting with the individual, Alain Champigneux underlines the importance of the representative's background, position, and independence of mind to be credible and taken seriously by other directors and the management.

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*"Employee representation provides a valuable perspective, creates peace between a company and trade unions and helps explain decisions externally along with mitigating risks."*

Alain Champigneux

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He argues that the individual should be representative of a large part of employees and be connected to them to ensure a good "bottom-up" as well as "top-down" circulation of information and relay between employees and directors, the best way of ensuring this being to have employee-elected directors stemming from the different trade unions.

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*"Boards benefit from having a diversity of perspectives. Participants on the PSA supervisory board come from multiple geographies and have diverse experiences."*

Thierry Peugeot

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Among other benefits of employee representation is their deep attachment to a firm's stability and success, as firm health ensures future employment. And as members of society, employees tend to care how a firm impacts society. Alain Champigneux sees no risk to having employee representation, though he recommends that employee representatives

should be irreverent and not simply agree to everything, as employees often have important information about a firm and their voice offers an important perspective. He also believes that, unless removed for other reasons, 10 years is long enough for an employee representative to stay on a board before losing contact with employees and needing to pass the torch.

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*"Boards should be 'dream teams' that include different points of view. A diversity of perspectives helps a board to make the best possible decisions."*

Alain Champigneux

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The possible down sides can include cultural conflicts on boards caused by employee representatives, leading to a contentious boardroom. Alain Champigneux also acknowledges that employees may focus on their own self-interest, as opposed to the interests of the firm, and may collude with management to make decisions that are not in the interests of other stakeholders, such as avoiding a takeover.

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## INSIGHTS

- Employees being long run stakeholders through their representation on boards favors consideration of long term objectives.
- Employees have a unique knowledge of the company; their presence on boards favors "bottom-up" as well as "top-down" circulation of information for better informed decision making by the board and improved implementation of decisions.
- The selection process of employees and organization of the Board should favor competence as well as a constructive dialogue within the Board.
- Companies in different cultures/countries respond in different ways to the need to take the employees' perspective into account.

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## FOOD FOR THOUGHT...

- 1/ What are the benefits of mandatory employee representation on boards compared to voluntary representation by companies?
- 2/ Alain Champigneux stressed the possible drawbacks of employee influence on Corporate Governance (self-interested focus, collusion with management). How to benefit from the unique position of employees while limiting the downside consequences?

## 5. Board crisis management: China v. the US

Professor Paul Danos, Tuck School of Business at Dartmouth

Mr. Stuart Cable, Goodwin Procter LLP

Professor Xiaozu Wang, School of Management, Fudan University

In the United States, laws and norms have been developed for how to handle a wide range of crises. In China, while the written laws are often quite similar to those in the U.S., the norms for board behavior and action are new and still evolving.

Professor Paul Danos of the Tuck School of Business at Dartmouth, Stuart Cable, a partner at law firm Goodwin Procter LLP and Professor Xiaozu Wang of Fudan University look at the differences between the world's biggest economic powers.

In the U.S., boards respond to crises based on law and lore

A number of laws passed in 1933 guide the responsibilities of directors, and understanding these laws is critical, as "the buck stops in the boardroom." For a corporation, any crisis is the responsibility of the board. A few rules are critical as boards make decisions during a crisis. These are:

- **Fiduciary duty:** This concept has two key principles:
  - duty of care: this means that in exercising judgment, the board of directors must be careful and deliberate
  - duty of loyalty: this means that board members must be loyal to the company, with no self-dealing.
- **Business judgment:** this rule says that directors are free and flexible to make decisions in the best interests of the company as long as a director makes a decision with due care. If due care is used, a director will not be held personally responsible.

In China, laws about board behavior are relatively new, and behaviors are still evolving

China has adopted many of the corporate laws from the U.S. regarding board governance, as well as rules from Europe - particularly Germany - about having a separate supervisory board. However, even though the written laws are similar, they are recent and norms are still being developed. As Professor Xiaozu Wang explains, "We are still learning how to behave in a boardroom - it takes time."

To best illustrate the different responses of U.S. and Chinese boards, we can cite *three examples* of board crises:

Example 1: A director receives an unsolicited letter from a party to acquire 100% of the firm.

In China, a board would never receive such a letter because Chinese firms have one controlling stockholder. In the U.S., such a letter would be shared with the rest of the board, and it would cause the board to establish a process for deciding how to respond. This process would usually involve lawyers and investment bankers. If the board decided not to sell the company at this time, this decision would be protected by the business judgment rule. If the board decided to sell, it has the fiduciary duty to get the best price for shareholders.

Example 2: A CEO is accused of sexual misconduct.

In China, the board would convene and decide how to respond to minimize damage and protect the company's reputation. The most likely action would be an investigation and the board chairman, who usually represents the largest shareholder and is more powerful than the other directors, would likely make the final decision. In the U.S., the response of the board would be very similar to that in China, though norms would require an independent investigation. Ultimately, the investigation would yield a report and the board would have to exercise judgment in making a decision.

Example 3: A board receives notice from the SEC about a potential for a material misstatement.

In China, the board may not react with urgency, as they may not see this as a crisis. However, because penalties for fraud are severe, any perceived hint of fraud would prompt an immediate board reaction. In the U.S., a board will quickly disclose that the company has been contacted by the SEC and will authorize an independent committee to investigate. Based on the investigation's results, the board will decide how to proceed. The challenge is one of uncertainty, as investigations and actions by the SEC can take time.

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## INSIGHTS

- Despite similar rules, the practice of Corporate Governance differs.
- History and ownership differences explain partly the differences observed.
- Due to the presence of controlling shareholders in most Chinese firms:
  - some CG events do not occur (e.g. unsolicited takeover)
  - some CG problems essentially addressed by the Chairman of the Board usually represent the controlling shareholder rather than collectively by directors representing all shareholders (as in the U.S.)

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## FOOD FOR THOUGHT...

1/ The presence of a controlling shareholder as in China has benefits (involvement) but also drawbacks: how can the organization of the Board protect the firm and minority shareholders from conflicts of interest?



## GOVERNANCE AND THE BOARD

### Speakers



**Professor B. Espen Eckbo,**  
Tuck School of Business at  
Dartmouth



**Professor Peter Bates,** Tuck  
School of Business at  
Dartmouth



**Professor Pei Sun,** School of  
Management, Fudan  
University



**Professor Karin Thorburn,**  
Norwegian School of  
Economics and  
Lindenauer Center for  
Corporate Governance at  
Tuck



**Mr. Vegard Torsnes,**  
Ownership Policy Group,  
Norges Bank Investment  
Management (NBIM)



**Mr. John C. Wilcox,** CEO,  
Sodali



**Mr. André Chieng,**  
Chairman, AEC, China



**Mr. Bernhard Simon,**  
Managing Director and  
Family Spokesman,  
Executive Management  
Board, Dachser GmbH



**Professor Viviane de  
Beaufort,** ESSEC Business  
School



**Professor Xiaozu Wang,**  
School of Management,  
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**Ms. Noreen Doyle,**  
Director, Credit Suisse



**Ms. Susan Lindenauer,**  
Director, Women's Legal  
Defense Funds



**Dr. Christoph Schneider,**  
University of Mannheim,  
Business School



**Mr. Alain Champigneux,**  
Employee Elected Board  
Member, Renault



**Dr. Werner Brandt,** CFO,  
SAP AG



**Professor Katsunori Mikuniya,**  
University of Tokyo; former  
Commissioner, Financial  
Services Agency of Japan



**Mr. Thierry Peugeot,**  
Chairman, Supervisory  
Board, Peugeot SA



**Mr. Stuart Cable,** Goodwin  
Procter LLP

# GOVERNANCE, THE CEO AND LEADERSHIP

*"Nearly all men can stand adversity, but if you want to test a man's character, give him power".*

Abraham Lincoln

Challenging times present opportunities for leadership to shine. In this last chapter, we focus on leadership qualities within the context of governance and the vital role of the CEO, from setting a firm framework of values based on integrity, accountability and transparency, to ensuring that business ventures gain good governance early. However, CEO image can run into rough waters when media scrutiny picks up fast on the apparent paradox of increased compensation in difficult times or mishandled crisis management that affects society and the planet at large. Via telling case studies, we cover CEO effectiveness, the pitfalls of media scrutiny and how crisis may give rise to true leadership moments.

Six keys:

- Entrepreneurial leadership vis-à-vis stakeholders
- Compensation & CEO effectiveness
- How integrity enables sustainable long-term performance
- CEO: power, accountability and transparency
- Media scrutiny and CEO effectiveness (BP case study)
- Accountability and its limits - The Siemens case.



# 1. Entrepreneurial leadership vis-à-vis stakeholders

Mr. Geoffroy Roux de Bezieux, CEO, OMEA Telecom/Virgin Mobile

Regardless of company size or stage, corporate governance matters. Small companies should build in good governance early, as doing so readies the company for growth and prepares the company to raise capital.

In addition to adopting basic governance principles, it is important for entrepreneurs to consider the perspectives of all stakeholders in order to change the common perception that business leaders are self-interested, to one where entrepreneurs and business leaders are seen as caring for all stakeholders.

Even small, entrepreneurial companies need to think about corporate governance

Geoffroy Roux de Bezieux advises entrepreneurs to think of their business as a small solo business, which means looking at the cash flow every day. On the other hand and in parallel, in terms of corporate governance, entrepreneurs need to treat their company as if it is a large multinational.

When entrepreneurs start a company, their funds often come from friends and family, and little thought is given to corporate governance, with a tendency for a 'deal with that later' approach. It is right for an entrepreneur to focus primarily on growing the business and entrepreneurs typically have big dreams: they want to grow fast, raise capital and become a big company. Therefore, to ready the company for subsequent growth, to raise equity from external shareholders and to be transparent to investors, CEOs need to put basic principles of governance in place early on. Entrepreneurs are also often stubborn, have big egos, are fiercely independent and are not over-keen on setting up processes (such as financial controls) or involving others in important decisions (such as their own compensation). However, it must be repeated that the reason for entrepreneurs to care about good corporate governance is that it readies their company for the next steps of growth, including raising capital.

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*"By improving governance from the beginning, it makes the company ready for its next steps."*

Geoffroy Roux de Bezieux

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Bad corporate governance and corporate behavior have negative consequences for all businesses

The recent economic crisis has widened the gap between the public and business leaders and since 2008, criticism of business has been sharp. The public believes that business leaders are self-interested with a tendency not act in the interests of all stakeholders or of the public. While these opinions are based primarily on the perception of big corporations, companies of all sizes are tarnished. This makes the job of an entrepreneur even more difficult.

A result is that the public has called for more regulation and politicians are accommodating this demand. However, alternatives to prevent and avoid regulation are proactive self-regulation and good corporate governance: if more companies behave properly, public attitudes will eventually change. Yet there are two major challenges to overcome in

reaching this: firstly, that even one incident of misconduct reported by the sensationalist media will hurt any progress that is made and secondly, it is difficult to obtain alignment within the business community, which is not so much a fellowship as an “assembly of different interests.”

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*“Corporate governance by big corporations will help corporations of all sizes. This will help show the general public that business is here to serve the common good”*

Geoffroy Roux de Bezieux

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#### Student Survey findings

Who should have most **influence** on the decisions made by CEOs? No. of replies:

Board of directors	(Most) 173	(Some) 127
Company management	(Most) 128	(Some) 176
Customers	(Most) 127	(Some) 126
Employees	(Most) 51	(Some) 197

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## INSIGHTS

- Corporate Governance is also an important issue for small, newly family financed businesses as it conditions the future growth of the company seeking external capital.
  - Misconduct from some companies, together with cases of business leaders' calling for more (over?) regulation out of self-interest, creates top-heavy regulation. Good corporate governance and auto-regulation are good responses to prevent (over) regulation.
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## FOOD FOR THOUGHT...

- 1/ Could Governance of the media and the political sphere be an issue to approach?
- 2/ To what extent could/should sound governance (dealing with conflicts of interest, etc.) principles be adapted to other (political, etc.) spheres?

## 2. Compensation and CEO Effectiveness

Professor Ernst Maug, University of Mannheim, Business School  
Mr. Michel de Fabiani, Board Member and Chairman,  
Appointments, Remuneration and Governance Committee, Vallourec  
Professor Alexandra Niessen-Ruenzi, University of Mannheim, Business School

At the same time as governments in Europe and around the world are imposing austerity measures and reducing social benefits, CEO compensation has risen dramatically. And the golden parachutes awarded to CEOs who left under a cloud of poor performance or scandals, are unfathomable to many. Often, media backlash and public anger trigger legislation.

Why has CEO pay increased and what should boards do to better manage the issue?

According to Professor Niessen-Ruenzi of the University of Mannheim Business School, CEO pay has increased in the absolute and has increased far more than the S&P index. The spread between what CEOs are paid and what other workers earn has also increased dramatically.

Two theories to explain the gap between CEO and other employee remuneration:

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*"Firms do react to public appearances about compensation. They change the composition of the pay, not the level."*

Professor Alexandra Niessen-Ruenzi

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- **Optimal contracting:** The view of classical economics is that high compensation results as companies enter into contracts in order to attract and retain qualified CEOs. This theory holds that there is a shortage of capable leaders with the necessary general management skills, causing the price of those skills to increase. The theory also indicates that the best paid CEOs are those who manage the largest firms.
- **Extract rent:** Under this theory, termed the managerial power approach, CEOs leverage their situation to extract the highest possible rent. This theory indicates that neither firm size nor skills explains the huge increases in compensation.

On reaction to CEO pay, Professor Niessen-Ruenzi states that shareholders do care about compensation, as evidenced by rising share prices when boards adopt sound compensation plans and negative reactions when golden parachutes are adopted. The discussion around say-on-pay provisions has gained a great deal of attention, but these provisions do not exist in many countries and indeed, have not made a difference in executive compensation.

When it comes to public attitudes, much of the public is concerned about income inequality. 75% of the population believes that executive compensation is too high and it is often this public anger that triggers legislation. In boardrooms, such public attitudes are taken into account and can play a role in determining the composition of pay. In the 1990s, salary was a hot button, so boards limited salaries. In 1993, the issue was stock options. More recently, there has been anger about bonuses. In each instance, the board changed the components of executive compensation, but not the level.

### Directors must link CEO pay to performance

Michel de Fabiani contends that there is no “right” level of CEO compensation. The reality is that firms must pay appropriately in order to attract and retain CEOs and other executives that are expected to lead increasingly global, increasingly complex companies. The issue is when there is no correlation between an individual’s pay and company performance. Pay is most problematic when a person leaves a company and still receives a significant payout.

To help improve the compensation equation, Michel de Fabiani suggests:

- Benchmarks
- Alignment of incentives
- A package of tools
- Selecting performance criteria
- Medium and long-term incentives

#### Benchmarks

Firms should benchmark the compensation of CEOs against firms in comparable situations.

#### Alignment of incentives

Often incentives are not aligned with performance, and as a result a CEO is paid well even when his firm doesn’t perform well. Directors should therefore consider making elements of compensation variable so they are linked to performance.

#### A package of tools

Boards need to pick from a package of tools including salary, bonus, stock options and more. The precise tools should be based on the company’s situation.

#### Selecting performance criteria

Precise performance targets need to be established and communicated and it is important that these criteria are linked with company strategy. Also, instead of absolute criteria, performance needs to be looked at in relative terms versus the industry.

#### Medium and long term

While annual bonuses may be appropriate, directors should include medium- and long-term incentives.

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## INSIGHTS

- Compensation is both a problem (rent extracting) and a solution (optimal contracting).
  - There is no “right” level or structure for CEO compensation, each contract should be tailored based on the company’s situation and objectives.
  - Optimal contracts should align incentives with performance effectively attributable to CEOs.
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## FOOD FOR THOUGHT...

- 1/ To what extent should contracts explicitly include social/societal incentives (employee satisfaction, etc.)?
- 2/ To what extent are stakeholders' interests already reflected in the long-term incentives of your organisation (share value, etc.)?
- 3/ To what extent would including social/societal incentives undermine the focus of CEOs?



### 3. How integrity enables sustainable long-term performance

Mr. Pierre Guyot, CEO, John Deere France

At John Deere, integrity is the fuel for sustainable long-term performance and a core value that permeates the entire company. The culture, the brand, the tone at the top and the behavior of top executives and mid-level managers all start with integrity. The company has a code of conduct, guidelines and management processes that emphasize integrity and together, these processes and behaviors differentiate John Deere, increase efficiency and fuel strong, sustainable performance. Why is integrity so important for John Deere and how does the company go about ensuring integrity throughout the organization?

*John Deere is a successful global company built on a foundation of values*

John Deere was founded in 1837. Mr. Deere imported steel from England and used it to make plows in the United States. He focused on creating innovative products, growing market share and expanding, which included making acquisitions.

Early in the company's history, Mr. Deere and the company's other leaders articulated four core values - integrity, quality, commitment and innovation – which still provide the driving force behind the company. In the past decade, John Deere has been fortunate to have strong tailwinds. Around the globe, there is a need for food (particularly grain and protein), shelter and infrastructure and as the globe's population and wealth both rise, this benefits John Deere. As a result, the company has grown to \$32 billion, with a 7% CAGR over the past 10 years. John Deere is now focused on becoming a \$50 billion company by 2018.

In addition to this strong performance, John Deere has been named a most admired company and a most ethical company. Even in China where John Deere has only had presence for 10–15 years, Deere is already recognized as a great company. This is equally true in Brazil as well, where John Deere has been identified as one of the country's great places to work.

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*"Values are embedded in the culture and in how we do business."*

Pierre Guyot

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*The company's challenge is to live its values*

The company's values are clear. The challenge is bringing these values to life so that all John Deere employees' behavior is driven by these values each day.

*John Deere brings corporate values to life by:*

- Guidelines and policies
- Code of conduct
- Culture
- Walk the talk
- Management processes
- Seniority

### Guidelines and policies

It is important to formally tell employees what is expected of them via specific guidelines and policies.

### Code of conduct

The expected behavior has been codified and set forth in a code of conduct.

### Culture

John Deere has created a culture of integrity and compliance.

### Walk the talk

Integrity doesn't just come through policies; it comes from the tone set at the top of the organization by the CEO and the senior executives. It also comes from the "tone from the middle" because middle management is closer to the front lines and touches more people.

### Management processes

This includes the processes by which decisions are made. People see how they are arrived at and whether this is consistent with the culture and guidelines.

### Seniority

At John Deere, most of the company's senior leaders have been with the company 20–30 years. The values and culture have been deeply instilled.

Most importantly, all of these elements come together in how Deere operates on a day-to-day basis. This includes behaving with integrity with employees, customers and vendors. An example of how the company lives its values is that employees are allowed to take reasonable risks; even if such risks result in the company losing a significant amount of money, the company focuses on the value in learning from the experience. But if an employee cheats on an expense report, they are immediately dismissed.

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*"At John Deere, it is all right to make mistakes as long as they are made in good faith. But if a person cheats on their expense report, they are out in one minute. This tells people how we do business."*

Pierre Guyot

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### John Deere's values and how they are lived differentiate the company

Many companies have values, guidelines, policies and cultures that value integrity. What differentiates Deere is linking these values with performance. At Deere, the culture of integrity and the way that everyone acts is hard to copy. It creates greater efficiency and greater trust with employees, customers and suppliers and the result is a more effective, more efficient operation with improved performance.

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### Student Survey findings

What are the key attributes of a successful CEO (top 3 rankings)?

1. Financial and commercial success
  2. Ethical behavior
  3. Takes a strategic view of business
-

## INSIGHTS

- Transparency: guidelines for employees, transparency in decision processes contribute to trust, an (intangible) asset for the company.
  - Integrity, trust in employees, customers and suppliers translate into improved performance in the long run.
  - Long term involvement of senior leaders at John Deere (20-30 years with the company) ensures they share a long term view.
  - This favors reasonable risk-taking and investing human capital in the company (learning from experience).
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## FOOD FOR THOUGHT...

1/ Long-term involvement with the company is key at John Deere's.

Long term involvement also has costs (outside experience may be positive, and it lowers the incentives to ensure "outside options" which may have value for both employees and companies).

2/ How do long term relationships compare to possible substitutes (compensation, etc.) for giving the incentives to think "long run" in organizations in terms of costs and benefits?

## 4. CEO: power, accountability and transparency

**Professor Pino Audia**, Tuck School of Business at Dartmouth  
**Professor Ernst Maug**, University of Mannheim, Business School  
**Mr. Mats Isaksson**, Head of Corporate Affairs Department, OECD  
**Mr. Gilles Pélissier**, Former Chairman, ACCOR Group;  
Independent Director, Accenture, TF1, BIC, NH Hotels  
**Mr. Peter Solmssen**, General Counsel, Siemens

Good corporate governance is about people. For all of the codes and regulations that have been introduced in the last 20 years, typically in response to various corporate scandals, it is the values, the behavior and the accountability of those at the top which sets the tone and determines the relationship that business holds with society.

And no one is held more accountable than the CEO. Among the corporate scandals that have shaped attitudes to business in the last decade, it is the man in the corner office who is identified with the behavior and actions of the firm. Kenneth Lay at Enron and Bernie Ebbers of Worldcom are forever synonymous with the accounting scandals that wiped billions off shareholder value; BP chief Tony Hayward was publicly vilified for his management of his company's oil spill in the Gulf of Mexico. And media magnate Rupert Murdoch found himself testifying in front of the UK parliament about allegations of phone hacking and other illegal conduct by News Corp.

*Are we right to place the blame so squarely on the shoulders of one individual?*

Few would argue that Kenneth Lay deliberately pursued a path of fraud on a breathtaking scale, and that the management style and communication skills of BP's Tony Hayward fell woefully short. In other instances however, the CEO is the scapegoat for board misconduct, such as former Olympus CEO Michael Woodford who was dismissed after he made allegations about board misconduct involving massive advisory fees in connection with the purchase of a UK company. It was only after investigation by authorities in Japan, the UK and the US that the company announced that its entire board would resign.

Either way, the behavior and leadership of the CEO is a vital piece in the corporate governance puzzle. Curiously though, most conferences on the subject focus on shareholders and boards, overlooking the critical and often unappreciated role that CEOs play in leading governance. Because CEOs are often singled out as villains who steal from the company or shirk their responsibilities, these conceptions have led to the belief that there is a principal/agent problem. But as Mats Isaksson, Head of Corporate Affairs at the OECD insists, "a good board can never compensate for a bad CEO but a good CEO can compensate for a bad board."

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*"We have to encourage CEOs to get more  
involved in corporate governance  
discussions."*

Mats Isaksson

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*Accountability is important for individuals and organizations, but taken too far can have negative consequences*

Clearly, accountability is important for both individuals and the organization, but Professor Pino Audia of the Tuck School of Business argues that when taken too far, accountability and the ability of others to judge and pass sanctions can have negative consequences. "Leaders are put in the difficult position of having to decide which sources to be accountable to, whether that be shareholders, employees, consumers or the media." And as the amount of

information available to the public continues to grow, he believes that the accountability pressures on CEOs will only increase, and with it the risk of unintended consequences. "If people are only accountable for outcomes, and not processes, they may focus excessively on the outcomes." Poor decisions as well as unethical decisions can often be traced back to an extreme emphasis on outcomes and little regard for the process by which they are achieved.

### Balancing business operations with corporate governance

As former Chairman of the world's largest hotel group, ACCOR, Gilles Pélisson has overseen his fair share of quarterly reports, and explains that he has simply come to accept his accountability to institutional investors. "As the world moves faster and faster, people want and expect prompt information," but for the man who also once ran telecoms giant Bouygues Telecom and Euro Disney, he feels that there is a paradox that goes with the role.

While recognizing the power and resources CEOs might have at their disposal, Pélisson contends that running a listed company means you are always short on time. As a consequence CEOs are always faced with how to use that precious time, balancing the governance with other priorities. "Do you stay at the office and analyze data, or do you walk the floor to see first-hand the customer experience?"

In any case, Pélisson asserts that a CEO doesn't wake up in the morning focused on corporate governance. "Your first thought is serving the customers, and engaging in research to know how they think and feel. The next focus is employees, who are key to a company manufacturing or delivering its product or service. CEOs must think about how best to motivate employees and the values, principles and policies they need to establish." It is only then that CEOs think about governance, including a focus on the size and make-up of the company's board.

### Leadership and responsibility

With such a potentially decisive role, it is surprising to learn that some large organizations lack a real CEO. But that is the contention of Peter Solmssen, General Counsel at German industrial conglomerate, Siemens. Solmssen had worked for many years in the senior management of GE, "a company with one clear CEO who was the ultimate decision maker and who took this responsibility seriously." Upon moving to Siemens, he saw a culture where decisions were made by committee, without clear accountability. At the time of his arrival, a bribery scandal was tarnishing the company's image and threatening its business. Recovering from the scandal required a culture change driven not by committee, but by strong leadership. The company's new CEO made integrity the company's number one priority, and led by example. Along the way he sought the involvement and support of all the company's stakeholders, including the labor unions and shareholders, including the Siemens family itself. As Solmssen sees it, "there are some things a CEO can't delegate and has to own. While laws and rules are necessary, good governance is about values and behavior, which starts at the top."

Amidst the challenges of running an organization, what is the advice to CEOs for setting the governance agenda?

- Lead by example
- Be transparent
- Leverage the loyalty of employees
- Leverage the goodwill of customers
- Set limits

1. **Lead by example:** CEOs are being watched and scrutinized at all times, by all parties. CEOs can never relax and must always be role models, especially in a crisis.

2. **Be transparent:** CEOs will be asked hard questions, such as how can they justify their compensation. They must be transparent in their answers and must be able to simultaneously balance two objectives. The first is to deliver a consistent, uniform message about what the company does. The second is to tailor the message to each distinct audience.
3. **Leverage the loyalty of employees:** Employees want to feel that they belong. If CEOs can achieve that, they will generate loyalty among employees who will then go above and beyond what they are being asked.
4. **Leverage the good will of customers:** Companies are often afraid of social media, but you need to create communities that will help you. Social media is a reality and it can be leveraged to create influential support.
5. **Set limits:** CEOs can't let each employee behave as they see fit. Diverse global companies, with employees around the world, must have clear and specific rules to guide behavior on issues like gift policies or expenses. It is the CEOs job to say, "Here are the rules."

*Will such behavior help to rebuild society's trust in corporations and their executives?*

When asked how credible they would deem information about a company that came from a CEO, just 38% of the global respondents to the 2012 Edelman Trust Barometer said they would trust the information, down from 50% last year. It was the biggest drop since the survey began 12 years ago. Clearly the public remains skeptical, but for Professor Ernst Maug of the University of Mannheim Business School, this is in part a communication gap that influences public perception.

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*"It's time to put the human aspect back into the governance equation and find a common language with society."*

Professor Ernst Maug

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## INSIGHTS

- The CEO is the focal point in a company's governance: being the ultimate decision maker, he is ultimately responsible before all stakeholders.
- Being the reference, he must lead by example.

Two caveats:

- Excessive accountability on CEOs may lead to the wrong incentives (e.g. accountability for outcomes such as quarterly results)
- The CEO's paradox: watched by everyone yet alone.

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## FOOD FOR THOUGHT...

Loneliness and accountability: group decision making often leads to better decisions, but can also be used by individuals to try to protect themselves from the consequences of bad decisions:

- 1/ Which decisions should be efficiently delegated/taken by the Board?
- 2/ Is the efficient delegation the same in terms of crisis (What are the respective roles of the CEOs and the Board in times of crisis)?

## 5. Media scrutiny and CEO effectiveness

**Professor Katsuhiko Shimizu**, Keio Business School

**Ms. Marret Arfsten**, MBA Student, Tuck School of Business at Dartmouth

**Mr. Zhi Hao Kevin Tay**, MBA Student, Tuck School of Business at Dartmouth

CEOs are under intense pressure, especially in a crisis. A relentless media cycle and the explosion of social media have intensified this pressure and scrutiny. For CEOs to be effective, they need to respond to a crisis calmly and confidently, show an ability to lead, take responsibility and deal with the onslaught of attention. Boards must take this into account when selecting a CEO and ensure that the CEO leads the organization to develop crisis response and social media plans.

For Tuck Professor Pino Audia, the intense scrutiny of the media often overlooks the complexity of being a CEO, and how his or her decisions are impacted by the environment in which they operate. "Context is very important for those decisions," he explains, "and brings better understanding of their leadership".

To illustrate the impact that accountability pressures arising from the media may have on CEOs' decisions, Tuck School of Business students, Ms. Marret Arfsten and Mr. Zhi Hao Kevin Tay, under Professor Pino Audia's supervision, led a workshop that focused on the BP oil spill and the communications during this crisis by BP CEO Tony Hayward. Professor Katsuhiko Shimizu of the Keio Business School moderated facilitated the workshop.

### Case Study of BP Oil Spill in the Gulf of Mexico

On April 20, 2010 an oil rig in the Gulf of Mexico exploded, killing 11 individuals and causing millions of gallons of oil to spill into the Gulf over three months until the flow was capped. The rig was operated by Transocean, a vendor of BP. This is the largest oil spill in history, surpassing the Exxon Valdez spill from 1989, which at the time was the largest oil spill in U.S. history.

While BP CEO Tony Hayward initially handled this crisis well, his effectiveness decreased over time.

Quickly following this explosion, Mr. Hayward went to the accident site. He was visible and transparent with the media, and showed empathy. He took responsibility on behalf of BP for the accident and the clean-up. This is in contrast to the reaction of Exxon's CEO who didn't visit the site of the Valdez spill for some time and assigned blame to others.

But over the next six weeks, Mr. Hayward began deflecting blame, shifting responsibility, and lost his composure when he uttered, "I just want my life back." Five months after the flow of oil was capped Mr. Hayward was dismissed from his position. In contrast, Exxon's CEO stayed on for four years after the Valdez disaster.

The emergence of the internet created a more challenging environment for BP than Exxon.

The amount of media coverage and the nature of this coverage were far different in 2010 than in 1989. In the six months following the accident, there were 20 times more articles about the BP incident than the Exxon event, and the percentage of articles mentioning the CEO was also far higher. More than 10% of articles mentioned Tony Hayward; during one month he was mentioned in about 20% of articles. Exxon's CEO was only named in about 10% of articles during two months.

There are many steps BP could have taken to improve their handling of this crisis, including:

- **Revising the CEO selection process:** Attendees believed that BP's board failed to consider how Mr. Hayward would respond in a crisis, and that he was clearly not up to the task. Boards must consider the ability of a CEO to function in such a situation.
- **Having crisis communication plans:** Attendees faulted BP for not being more prepared,



with a plan in hand that the company was ready to execute.

- **Having a social media manager:** One attendee said many companies now have a person who is responsible for blogging or tweeting on behalf of the CEO, something that BP did not have.

As pressure mounts, CEOs' judgment can become impaired, and they may engage in defensive coping mechanisms

There are three reactions that companies and executives should avoid in difficult situations:

1. **Impression management.** They try to shape how they are viewed by taking out ads in newspapers and having their pictures taken with victims (BP and Exxon).
2. **Self-justification.** They try to justify their actions, pass the buck and procrastinate (BP and Exxon).
3. **Cognitive overload.** They become overloaded because they feel they are being chased and held personally accountable (BP).

Being a CEO is clearly challenging, and to serve in this role, CEOs need to put their own personal lives aside and prepare for worst-case scenarios.

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#### Student Survey findings

With the increased scrutiny of the decisions of CEOs, I feel less willing to aspire to a CEO role at a public company. All Schools combined:

Disagree: 59%

Agree: 23%

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## INSIGHTS

- In selecting CEOs, boards should consider both times of stability and times of crisis.
  - Information technology amplifies the pressure on CEOs in times of crisis, calling for an adequate and quick response from the CEO.
  - Transparency and public accountability: CEOs are expected to lead by example even in the worst-case scenarios.
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## FOOD FOR THOUGHT...

- 1/ To what extent are the same competencies expected from CEOs in times of stability and in times of crisis?
- 2/ To what extent has your CEO/organization endorsed or set up a crisis response process and social media plans? What concrete benefits, in terms of your stakeholder ecosystem, do/would these bring you company?



## 6. Accountability and its Limits – the Siemens case

Mr. Peter Solmssen, General Counsel, Siemens

Siemens was involved in a corruption scandal that threatened the viability of the company. Peter Solmssen, General Counsel for the firm, presents how the company responded.

Siemens has long been a technology leader, a highly international company and a company that didn't shy away from risk taking. But in 2006, following record revenue growth, Siemens was implicated for paying bribes to government officials. This led to a massive investigation, arrests and a tarnishing of the Siemens reputation.

Siemens anticipated fines and penalties up to \$10 billion, and was confident it could deal with these penalties. However, more concerning was the ability to continue securing government contracts, which is the lifeblood of the company's business.

The company undertook its own massive investigation which included offering amnesty to employees to share what they knew, which many employees accepted and in the process disclosed secret banks accounts used to pay bribes and lies told to the board. Siemens replaced most members of executive management, named a new CEO and brought in Mr. Solmssen from GE as general counsel.

Within two years Siemens was out of the fire. The investigation was complete, the company was able to continue as a government contractor and a settlement was reached with the U.S. Department of Justice.

Several myths surrounded this situation.

In learning what had happened, Mr. Solmssen observed that the culture didn't involve lawyers to ensure that laws were followed, and decisions were made by committee, without one person being responsible.

Observations on the  
Siemens scandal:

- Myth: This behavior used to be legal. In fact, it wasn't. It was accepted and hadn't been caught.
- Myth: Everyone does it (pays bribes). This isn't true. Companies such as GE and IBM are completely clean.
- Myth: We have to pay bribes to succeed. Not true. Since Siemens has been completely clean, the company has gained market share and had record profits.
- Myth: The U.S. government was out to get Siemens to help GE. Not true. Having previously been at GE, Mr. Solmssen knows that the U.S. government was not out to get Siemens and wasn't trying to help GE.

Recovering from this scandal has required culture change driven by strong leadership.

Emerging from this scandal took strong leadership. The company's new CEO made integrity the company's leading priority. He didn't delegate; he led by example. Governance was addressed, the company became focused on integrity in its financial statements, a cadre of real CFOs was brought in and for the first time Siemens created a real general counsel position. All of these actions were embraced by the company's employees.

The company's strategy has been to repair its image and change the rules of the game by telling its story in public forums, such as this conference and the World Economic Forum in Davos. The message is, "We are better off than we were," because paying bribes is unethical, costly and risky. Other ways Siemens has exercised leadership is by forming "cartels of the good." In such cartels, companies commit to being clean. Siemens has worked with these cartels, trade associations and governments to produce collective action that eliminates paying bribes. Siemens also shares best practices with other companies, so they can learn from Siemens' experience.

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*"The leader has to make it clear that integrity  
is the number one priority."*

Peter Solmssen

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## INSIGHTS

- Although Corporate Governance is not about ethical behavior/respecting laws, good corporate governance requires ethics following the law as a minimum.
  - Clear responsibility helps prevent unethical/unlawful behavior.
  - CEOs and directors must have unquestionable ethical standards.
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## FOOD FOR THOUGHT...

1/ When does the pressure of accountability induce leaders to unethical/unlawful behavior?

## GOVERNANCE, THE CEO AND LEADERSHIP

### Speakers



**Mr. Geoffroy Roux de Bezieux**, CEO, OMEA Telecom/Virgin Mobile



**Professor Ernst Maug**, University of Mannheim, Business School



**Mr. Michel de Fabiani**, Board Member and Chairman, Appointments, Remuneration and Governance Committee, Vallourec



**Professor Alexandra Niessen-Ruenzi**, University of Mannheim, Business School



**Mr. Pierre Guyot**, CEO, John Deere France



**Professor Pino Audia**, Tuck School of Business at Dartmouth



**Mr. Mats Isaksson**, Head of Corporate Affairs Department, OECD



**Mr. Gilles Pélisson**, Former Chairman, ACCOR Group; Independent Director, Accenture, TF1, BIC, NH Hotels



**Mr. Peter Solmssen**, General Counsel, Siemens



**Professor Katsuhiko Shimizu**, Keio Business School



**Ms. Marret Arfsten**, MBA Student, Tuck School of Business at Dartmouth



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# CONCLUSIONS

*"Umuntu ngumuntu ngabantu" - "I am because you are, you are because we are."*

Unknown

## A Global Alliance of Schools of Management

### COUNCIL ON BUSINESS AND SOCIETY

**T**he Council On Business And Society: Six leading international Business Schools with a shared commitment and belief in humanism and the power of academic excellence transposed into business excellence, innovation and transformational leadership.

The Council's mission is to create a multi-school process to study a series of critical issues facing business and society, organize international forums for dialogue and develop and disseminate educational materials and insights designed to foster continuing debate on the issues covered.

### THE WHITE PAPER

Based on the contributions of the 1<sup>st</sup> Annual Forum on Corporate Governance and Leadership in a Global World, November 16 – 17, 2012, this White Paper has provided many insights from a multi-level, multicultural perspective that bring to light three focal points of debate, reflection and recommendation for effective governance and leadership:

- Sense of ownership
- Transparency
- Long-term view.

Rather than opposing shareholders to society, or shareholders to management, the findings of this White Paper focus on convergence to produce a positive conclusion. Underlying these focal points is the notion that governance and leadership include the wider perspective of a company's ecosystem of stakeholders: its employees, auditors, investors, the communities upon which it has an impact, the media and legislating bodies.

External rules and obligations of compliance are essential, as are indeed the internal mechanisms, on both a human and systemic level, of the company itself that include company values, codes of governance and codes of ethics or conduct. Self-discipline within, combined with positive external guidelines and monitoring, serve to generate stability, foster trust, build reputation and contribute to the long-term performance and meaning of a company.

Within the context of the economic shift of balance from West to East, financial crises and the impact of almost instant global communication, this White Paper provides many insights and points for reflection which we hope will provide a basis for the positive strengthening of corporate governance and leadership within your organizations.

For further information or insight into our work, partners and fields of expertise, The Council On Business And Society invites you visit its website or refer to our list of Council and School contacts.

[www.councilonbusinessandsociety.com](http://www.councilonbusinessandsociety.com)

## BOARD OF DEANS

### PIERRE TAPIE

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Dean Tapie holds an Engineering degree from the Ecole Polytechnique of Paris, a PhD. In Biophysics from University Paris XI and an MBA from INSEAD

Dean of ESSEC since 2001, Pierre Tapie was Dean of Purpan Graduate School of Engineering and CEO of Intellagri. He currently serves as Chairman of the Conférence des Grandes Ecoles and a member of the AACSB's internationalization task force. From 2008-11, he was also Chairman of the Board of the Globally Responsible Leadership Initiative founded by EFMD and UN Global Compact.



### MARIA TEREZA FLEURY

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Dean Fleury holds a PhD. in Sociology from the University of São Paulo

Maria Tereza Fleury is Dean and professor of Strategy at FGV-EAESP; former Dean of FEA USP from 1998-2006. She is also a visiting scholar at IFM -University of Cambridge, was visiting research IDS University of Sussex, IDE, Tokyo, and a visiting professor at ESSEC, France. She is currently board member of several international and Brazilian institutions: Center for China-Latin America Studies Tsinghua University, Columbia Global Center-Columbia University, Universidade Catolica de Lisboa, Instituto de Empresa-Madrid, the Brazilian Academy of Management, the Editorial Board of RAE FGV, the International Journal of Human Resources and the Journal of Emerging Markets.



### XIONGWEN LU

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Dean Lu received his PhD. In Economics from Fudan University and was a Research Fellow and Visiting Scholar at Tuck School of Business

Xiongwen Lu is Dean of the School of management, Fudan University, China. He has served as Vice-President of the Chinese Society for Management Modernization since 2010 and currently holds the position of Board Director of the Graduate Management Admission Council and serves as a member of the AACSB Asia-Pacific Advisory Council and the EFMD Asia Advisory Board.



### HIROKAZU KONO

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Dean Kono received a PhD. In Engineering from Keio University

Hirokazu Kono has served as Dean and Professor of the Graduate School of Business Administration at Keio University and Business School since 2009. A founding member of the Asia Pacific Industrial Engineering and Management Society, he has served as Deputy Editor of the Industrial Engineering and Management Systems journal since 2009. He is currently President of the Association of Asia-Pacific Business Schools (AAPBS).



### JÜRGEN M. SCHNEIDER

University of Mannheim, Business School

Dean Schneider holds an MSc. and a PhD. In Business Administration, both obtained at the University of Mannheim

Jürgen M. Schneider was appointed Dean of the University of Mannheim Business School in 2010. He was formerly CFO of Bilfinger SE, an international construction and services group with more than 58,000 employees. In addition to his position as Dean, he chairs the supervisory boards of two German companies.



### PAUL DANOS

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Dean Danos holds a B.S. & MBA from the University of New Orleans and received his PhD. in Accounting from the University of Texas

Paul Danos has been Dean of Tuck since 1995, enjoying one of the longest tenures of a top-level business school. Widely recognized as a preeminent expert in the field of business education, he has served as director of several corporations, schools and professional associations. Before Tuck, he was Senior Associate Dean at the University of Michigan.



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