TAKING BACK THE BOARDROOM

Thriving as a 21st-Century Director

2nd Edition

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One key element in improving economic efficiency is corporate governance, which involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and shareholders and should facilitate effective monitoring, thereby encouraging firms to use resources more efficiently.

OECD DIRECTORATE FOR FINANCIAL,
FISCAL AND ENTERPRISE AFFAIRS
Ad Hoc Task Force on Corporate Governance

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Preface

Since the writing of the first edition of this book, the corporate world has experienced the implosion of the Internet boom with losses exceeded US\$1 trillion in market values, the fraud-driven collapse of Enron, Worldcom, and Adelphia, a massive investigation on stock option backdating practices engulfing more than 350 corporations including many in the Fortune 500, the collapse of the Thai government triggered by the business dealings of the former prime minister, and ongoing revelations of ethical lapses in such media conglomerates as Hollinger, and technology giants as Siemens. Mismanagement at large corporations like EADS (parent of Airbus), General Motors, DaimlerChrysler, and United Airlines have destroyed billions of dollars in shareholder value. At the same time these corporate disasters were occurring, new legislation, notably the Sarbanes-Oxley Act of 2002, has been introduced, passive institutional investors like mutual funds have become activist, the takeover market, fueled by billions of dollars in private equity, has deepened, and governments worldwide have intensified pressures on corporations to behave better.

At the center of this maelstrom is the corporate director, who sits at the apex of the corporation to monitor the decisions that affect employees, customers, suppliers, shareholders and the community, and continues to be the least understood person in the modern public corporation. This contradiction has resulted from a lack of knowledge among directors on what they should be doing in the boardroom, and how they should fulfill their legal and moral responsibilities; now made more confusing by the plethora of new legal liabilities since the collapse of Enron and the strategic complexities from global competition. The buck stops with the director and so he must understand his responsibilities and the means to discharge them. The increasing

pressures for corporate performance and shareholder value maximization mean that the days of the inactive board, dominated by a company's managers are over.

The sea change in the boardrooms of the largest corporations calls for directors to account for their actions on issues as diverse as economic performance to social responsibility. Since the passage of Sarbanes-Oxley (2002), the courts are less sympathetic to the excuse that directors were ignorant of operational lapses and are now more willing to impose higher penalties for non-compliance and violations. Such international organizations as the World Bank, Organization for Economic Co-operation and Development (OECD), the Asian Development Bank (ADB), and global investors as Fidelity and the California Public Employees Retirement System (CalPERS) have set their sights on influencing the direction of corporate governance standards and practices worldwide.

For corporations based in the emerging economies of the Asia-Pacific, awareness of the trends and practiced in the modern corporate boardroom is crucial to competing globally; they must move quickly to conform and even lead in this important area. Corporations in the advanced economies of the European Union (EU) and the United States are increasingly forced to do business in institutional and cultural contexts that challenge their long-held beliefs about appropriate governance practices. This practice-oriented book is aimed at providing the theoretical foundations for 21st century directors and would-be directors to understand key responsibilities, hone managerial skills and improve knowledge on current best practices in the boardroom. Improving practice will protect directors from the statutory and moral liabilities that come with the job, allowing them to achieve even more in their capacity as leaders of their companies.

Introduction

Taking Back the Boardroom: A Director's Call to Arms

Reading this book will not make you a better as a director. Thriving as a better director is a personal decision you have to make. Rather, it will increase your awareness of what it takes to be a better director and to convince you that it is worth the trouble to invest yourself into becoming one.

In the first part of this book, we attempt to understand the philosophical and moral foundations for directing. This is essential to a director during a time of great change and uncertainty. The demands on directors come from the government, society, shareholders, employees and other stakeholders. Often, these demands conflict, and a director has to know how to prioritize and deal with them. Without an internally consistent framework to understand your duties as a director, you will easily become lost, confused and exposed to legal liabilities. First, one has to understand the agency theory view of corporate governance from a law and economics perspective. This view of corporate governance drives the roles and responsibilities of directors from which flow their moral and fiduciary liabilities. Next, one has to know how the chairperson (in the board and in individual committees) contributes to the effective functioning of the board. We will focus on the chairperson's role in setting the agenda, providing vision and leadership, and managing the meeting process so that effective decisions can be taken. The power relationships between the chairperson and the board and management, and how they drive the role of the chairperson are also explored.

In the next part of this book, we examine the issue of boardroom ethics and social responsibility. It has been stated repeatedly that good governance implies transparency and accountability. However, while

transparency and accountability are necessary conditions for good corporate governance, they are far from being sufficient. It has become increasingly clear that for directors to perform their jobs well, they need to have a well-placed personal sense of ethics, which translates into the collective ethics of the board. The Asian Crisis of 1997 and the stock option backdating scandal of 2007 have one thing in common: poor ethical conduct by the management of companies and poor oversight by their boards of directors. In this section, we ask how directors should think about ethics, given the diversity in backgrounds, experience, personal beliefs and philosophies that one might encounter in the boardroom. In particular, when dealing with different cultures and country practices, how should the question of ethics figure in our decision making in the boardroom? We need to explore these questions because until we can clarify how our values drive the way we think about business issues we are incapable of good governance.

Finally, we examine the nuts and bolts of how a board of directors should be organized. It has often been said that the board has power *de jure* but not power *de facto*. Although the legal system of governance has imbued the board to act with sovereignty in matters of the business of the firm, it has often been prevented from doing so by a power structure that favors either management or the controlling shareholder or both. This section will review the proper role of management and board of directors under agency theory. To exercise power *de facto*, the board has to *organize* itself. The amount of information, the lack of time and resources, and the imbalance between the control of information by management and the board is such that unless the board is able to obtain and use information effectively, it will always be at a disadvantage to management. The typical way a board is organized is via the committee structure. Thus, this section will discuss the committee structure extensively, including the roles of individual directors in specific committees, the function of the committee, and the relationship of the committee to the board and to management as a whole. Contrary to popular belief, board organization is not only for large boards but also beneficial to smaller boards. Even if individual directors have to assume multiple board responsibilities formal organization ensures that issues are not missed and

information is not ignored. Organization places the responsibility for decision taking squarely in the hands of the directors and sends an unequivocal message to management and other stakeholders that the board is in the driver's seat.

The last section of the book focuses on special situations in which directors may find themselves. These situations are driven by changes in the capital and legal structure of the firm. Directors may find themselves in the midst of change in the capital structure, for example a private company undertaking an Initial Public Offering (IPO) or a public company undertaking a going-private transaction. These changes will naturally bring about changes in the responsibilities and liability exposures of directors. Other directors may find themselves in family owned or privately controlled firms, such as venture capital financed start-ups. The roles, responsibilities, and duties of directors in such firms, in which there is no public shareholder, are discussed in this section.

Finally, the cases and illustrations used in this book are used to illustrate the managerial issues discussed in the chapters and are not designed to criticize specific decisions taken by the management of the organizations. Cases are useful because they provide a context, without which it would be difficult to talk specifically about issues. The cases also add human interest and serve to illustrate that the problems you face as a director, which you may think are unique, are in fact commonly shared.

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