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GOVERNANCE IN THE NEW WORLD: Challenges and Opportunities

Hotel Epic Sana, Luanda, October 9 2015

Understand the world. Expand your world.

CORPORATE GOVERNANCE

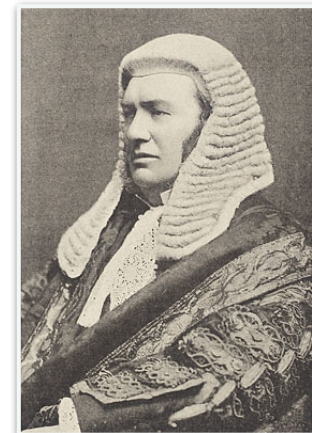
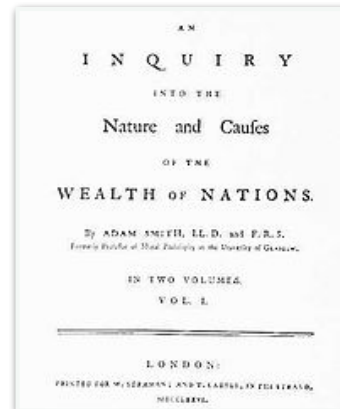
A FEW PICTURES: FROM PAST TO PRESENT



CORPORATE GOVERNANCE

A FEW PICTURES FROM THE OLD WORLD

Corporations: a fascinating history...



Roman law is the legal system of ancient Rome.

It gave rights **(beneficium)** and responsibilities **(officium)**.

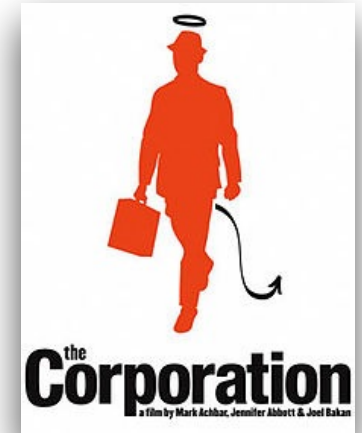
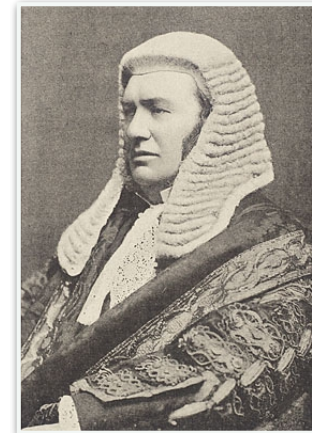
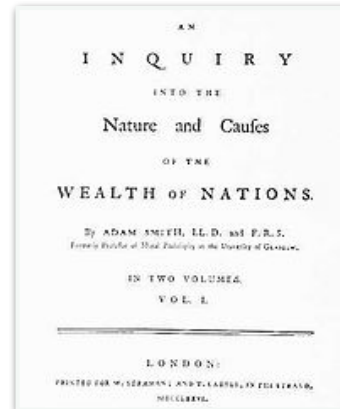
The alleged oldest commercial corporation in the world, the **Stora Kopparberg mining community** in Falun, Sweden, obtained a charter from King Magnus Eriksson in 1347.

The **Dutch East India Company** - first joint stock company - created in Amsterdam in 1602

Adam Smith in 1776 wrote in the *Wealth of Nations* that mass corporate activity could not match **private entrepreneurship**, because people in charge of others' money would not exercise as much care as they would with their own.

The House of Lords confirmed the **separate legal personality** of the company in 1862.

Why history is important: myth or reality?



« Badly understood history is an extremely dangerous thing »

**Y. AFANYASEV (1934-2015),
former President of Russian University of the Humanities**

A REMARKABLE STORY: THE DUTCH EAST INDIA CY



Governance illustrated : project finance in XVIth century ...

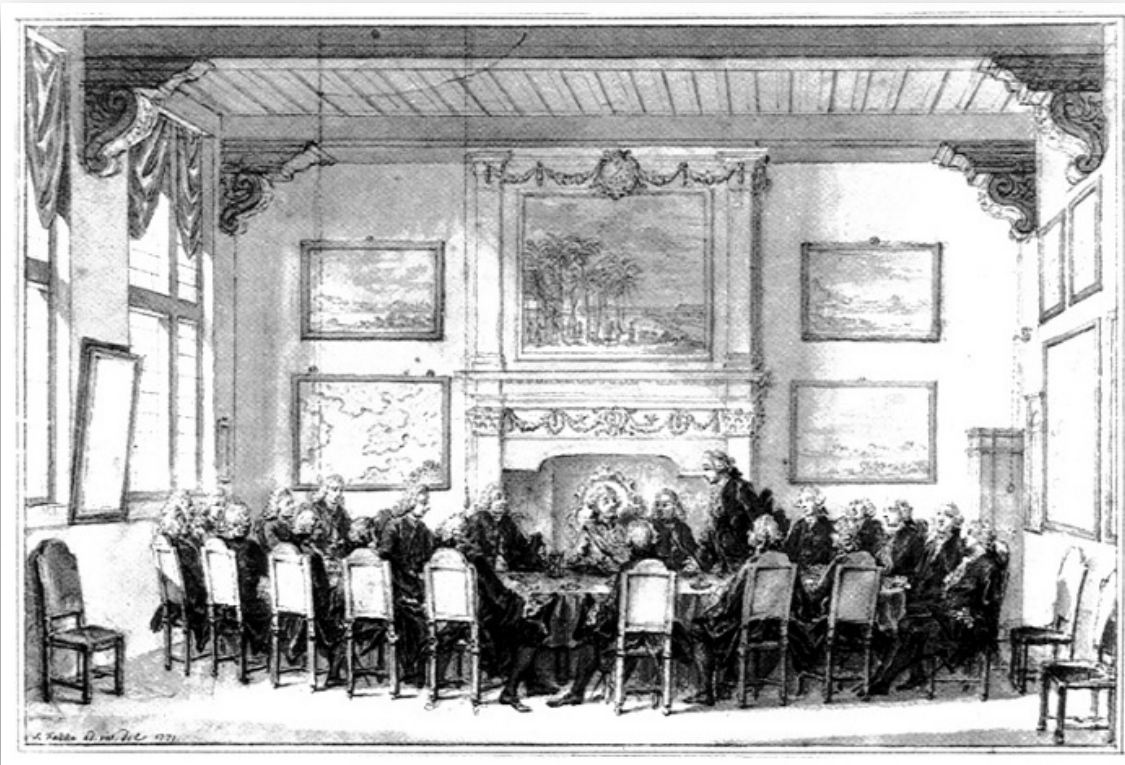
- ▶ **Project:** a boat that is going to get spices from the Far East ...
- ▶ **Shareholders**
- ▶ **Risky Returns**
- ▶ **Non-Executive Directors**
- ▶ **Delegated or Executive Director**
- ▶ **Executives**
- ▶ **Principle of 4 Eyes ...**
- ▶ **Shareholder supremacy:** shareholders appoint and revoke Directors
- ▶ **Shares traded on a stock exchange**

CORPORATE CAPITALISM: HOLLAND XVII-VIII

CREATION OF VOC (1602-1796):

The United East India Company

- ▶ First Joint Stock Company
- ▶ Motivated by Risk Pooling
- ▶ Traded on Amsterdam Stock Exchange
- ▶ 4,785 ships chartered
- ▶ Close to 1 Million people sent
- ▶ 2,5 Million Tons shipped
- ▶ Paid an average 18% annual dividend



AND THEN: VOC = VERENIGD UNDER CORRUPTIE

Directors trade on their own accounts
(at the expense of minority shareholders)

Insider trading

Excess dividends due to double book-keeping

Chinese Massacre in Batavia/Jakarta in 1740 due to sugar crash ...

Ended with Government Bailout

VOC: an early warning about « Greed is Good! » ?



The Moneylender and his Wife (Avarice and Virtue)
Quentin Metsys (Antwerp, 1514)

DID THE WORLD LEARN FROM THIS?

Problems repeated with British East India

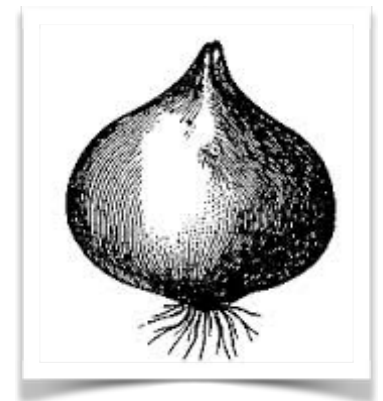
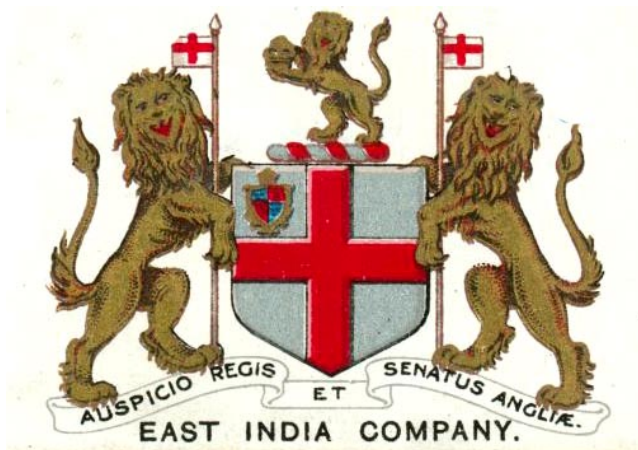
Much less performing than the Dutch

Indian Rebellion of 1857

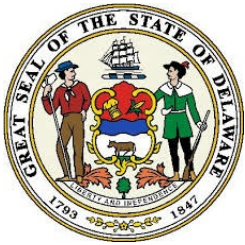
Company had to be bailed out by British Govt after

Led to the appointment of British Raj

Answer: Absolutely No learning!



CORPORATE CAPITALISM - XXth Century



▶ **EARLY 20TH CENTURY: LIBERALISATION**

- ▶ New Jersey allows Holding Companies
- ▶ Delaware competes them away with easier INC laws and lower taxes
- ▶ Fuels a move towards deregulation and liberalization



▶ **1933 - GLASS STEAGALL ACT:**

- ▶ Separates investment (casino) banking from deposit (retail) banking
- ▶ Creates FEDERAL DEPOSIT INSURANCE CORP to protect citizens



▶ **1999 GRAMM-LEACH-BILEY ACT:**

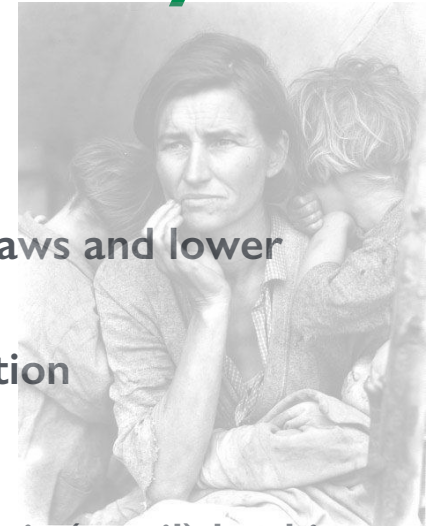
- ▶ Repeal of Glass-Steagall Act
- ▶ Allows Citibank to merge with Salomon Smith Barney
- ▶ One of the key contributors to the financial crisis: Delaware allows Citibank to merge with SSB ...



▶ **2007-08: FINANCIAL CRISIS IN US**

▶ **2008-NOW: JAPAN, US, AND EUROPE ALL IN FINANCIAL CRISIS ... IS CHINA NEXT?**

▶ **... 2001-2011: THE WORLD SERIES OF FRAUD ?**



CORPORATE GOVERNANCE PICTURES FROM « THE NEW WORLD »

CORPORATE CAPITALISM : 2001-2011



THE WORLD SERIES OF FRAUD?



Convicted: 03/15/2005 on nine counts of conspiracy, securities fraud and making false regulatory filings

CEO: WorldCom – Bernie Ebbers



Note to aspiring CEOs: If your company is staggering under massive debt, don't orchestrate an \$11 billion accounting fraud to try to cover it up. It doesn't work.

Bernie Ebbers turned WorldCom into the nation's second largest long distance telecommunications company through a series of rapid acquisitions that left it heavily in the red. In 2002, the Mississippi-based company admitted to improperly reporting \$3.8 billion in expenses, prompting Justice Department to open a criminal investigation into its business practices. The Securities Exchange Commission, meanwhile, focused on \$400 million that WorldCom personally loaned Ebbers.

WorldCom eventually filed for bankruptcy, and its stock price tumbled from \$64 per share to a little over \$1. Ebbers' "I had no idea what was going on" defense didn't work; he was convicted of securities fraud, conspiracy and seven counts of filing false reports with regulators. Ebbers is now serving a 25-year sentence in a minimum-security Louisiana prison.

Source: TIME – 10 Most Crooked CEO's

Where were the Worldcom Directors?



Richard Breedon
Corporate Monitor

“The board consistently ceded power to Ebbers.

As CEO Ebbers was allowed nearly imperial reign over the affairs of the company, without the board exercising any apparent restraint...

... even though he did not appear to possess the experience or training to be remotely qualified for his position.”

CORPORATE GOVERNANCE

HOW TO CREATE A BETTER NEW WORLD

STARTING POINT:

CONFLICTING INTERESTS AND EMOTIONS

- ▶ **Shareholders:** will I get my money back?
- ▶ **Non-Executive Directors:** I only have « down-side » / responsibility
- ▶ **Executive Directors:** we do the work !
- ▶ **Executives:** no, we do the work, compensate us, give us stock options!!!
- ▶ **Service providers (lawyers, accountants, corporate bankers, investment bankers ...):** the greater the mess, the better for us!
- ▶ **Employees:** we do the work and care ... but who cares about us?
- ▶ **Unions:** we are the saviors of the workers (not managers, not boards) ... trust us!
- ▶ **Regulators:** we have no power, so we also like to be « bought in » !
- ▶ **Governments:** and what about our taxes and our government employees?
- ▶ **Communities:** we often get the residual ... « toxic assets »

THE GLOBAL FINANCIAL CRISIS: 2000 - now ...

- ▶ **Shareholders:** we like growing share prices and contribute to the bubble!
- ▶ **Executive Directors:** there is increasing risk, so we have the answer: CDS!
- ▶ **Non-Executive Directors:** i am appointed by the EDs ... and Executives: we have little power, people do not listen to us in any case, execs know so much
- ▶ **Service providers (lawyers, accountants, corporate bankers, investment bankers ...):** the mess is getting greater, the better for us (as long as clients pay)!
- ▶ **Employees:** let us keep this bubble going ... and no one really cares about us?
- ▶ **Unions:** they focus on destroying the automobile companies ...
- ▶ **Regulators:** markets are perfect ... and now have a conscience (dixit Greenspan)
- ▶ **Governments:** we fully know, support and come from the industry - nothing to worry ... until we need money to be bailed out
- ▶ **Communities:** we lose jobs, suffer from « collateral damage »
- ▶ **The world:** this is a US financial crisis, a US crisis, a EU crisis, a Chinese crisis ...



LESSONS

- ▶ Amazingly **slow progress in governance**
- ▶ **Errors repeat**
- ▶ Governance excessively **seen as regulation**
- ▶ Our hope: that something good will come out of this mess
- ▶ ONE need: greater understanding (and study)
- ▶ One conclusion: **governance is « the other side of the coin »** - sustainable business performance is the result of superior governance
- ▶ The dilemma: **in the short run**, if you have to choose between great execution and great governance, **you choose for superior execution!**

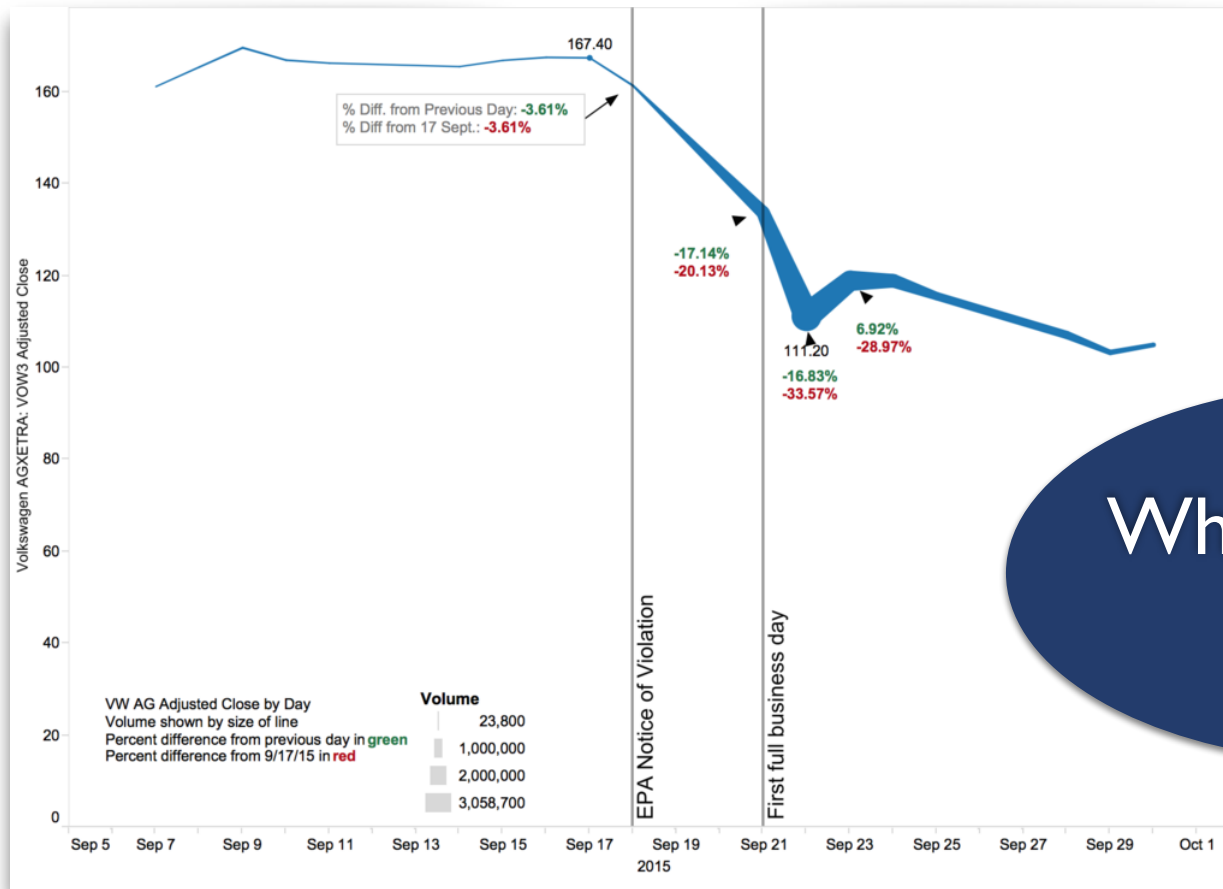
LET US MOVE FORWARD: BES AND VW



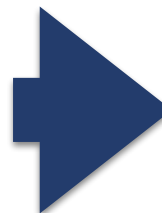
- ▶ Wrong tone at the top
- ▶ Poor culture
- ▶ Underperformance
- ▶ Lack of transparency
- ▶ Complexity
 - Technology
 - Corporate
 - Regional
- ▶ Excessive complacency of regulators (until intervention)
- ▶ Hubris of leaders that turns into stupidity
- ▶ No whistleblowing
- ▶ Rationalisation and acceptance of unacceptable business practices
- ▶ Unsustainable business practices
- ▶ Cutting corners that turns into fraud



The VW Diesel Debacle



Where was the Board?



CORPORATE GOVERNANCE

WHAT IS IT?

GOVERNANCE - WHAT?

- ▶ **Greek : KUBERNAO - Steering, Directing, Controlling ...**
- ▶ **What GOVERNMENTS do ...**
- ▶ **Multiple forms of GOVERNANCE:**
 - **Corporate**
 - **Functional**
 - **Project**
 - **Personal**
 - **Regional**
 - **National**
 - **Global ...**



CORPORATIONS - WHAT?

- ▶ From Latin «**CORPUS**»: A body of people
- ▶ **LEGAL ENTITY** authorized by a **STATE** (E.G. Roman or British Empire) for a certain **PURPOSE** that is written down in a **CHARTER** and typically **REGISTERED** with a **Government** («**LICENCE TO OPERATE**»)
- ▶ **RIGHTS AND RESPONSIBILITIES** similar to those enjoyed by individuals (E.g. must act responsibly, can be convicted for Fraud, dissolved in Court, ...)
- ▶ **MULTIPLE TYPES:** Limited/Unlimited Liability, State/Private, Profit/Not-for-Profit, Sole Owner/Partnership/Shared Equity Ownership, ...
- ▶ **DEATH:** by the **Corporate Officers** (Dissolution) or by the **Court** (for Fraud, Irresponsibility of owners, Insolvency ...)

CORPORATE GOVERNANCE - HOW?

► **DIRECTORS** meet to organize the supervision and execution of the project:

- **Key People**
- **Strategy**
- **Resources (Finance!)**
- **Organization ...**

► **GENERAL ASSEMBLY OF MEMBERS:**

- **Reports by (outgoing) Officers/ Directors on progress**
- **Distribution of Benefits (Beneficium)**
- **Evaluation & Discharge of Directors**
- **Decision to continue the project and conditions for doing so**
- **Changes of Charter**
- **Distribution of Responsibilities (Officium) including Election of (incoming) Directors ...**

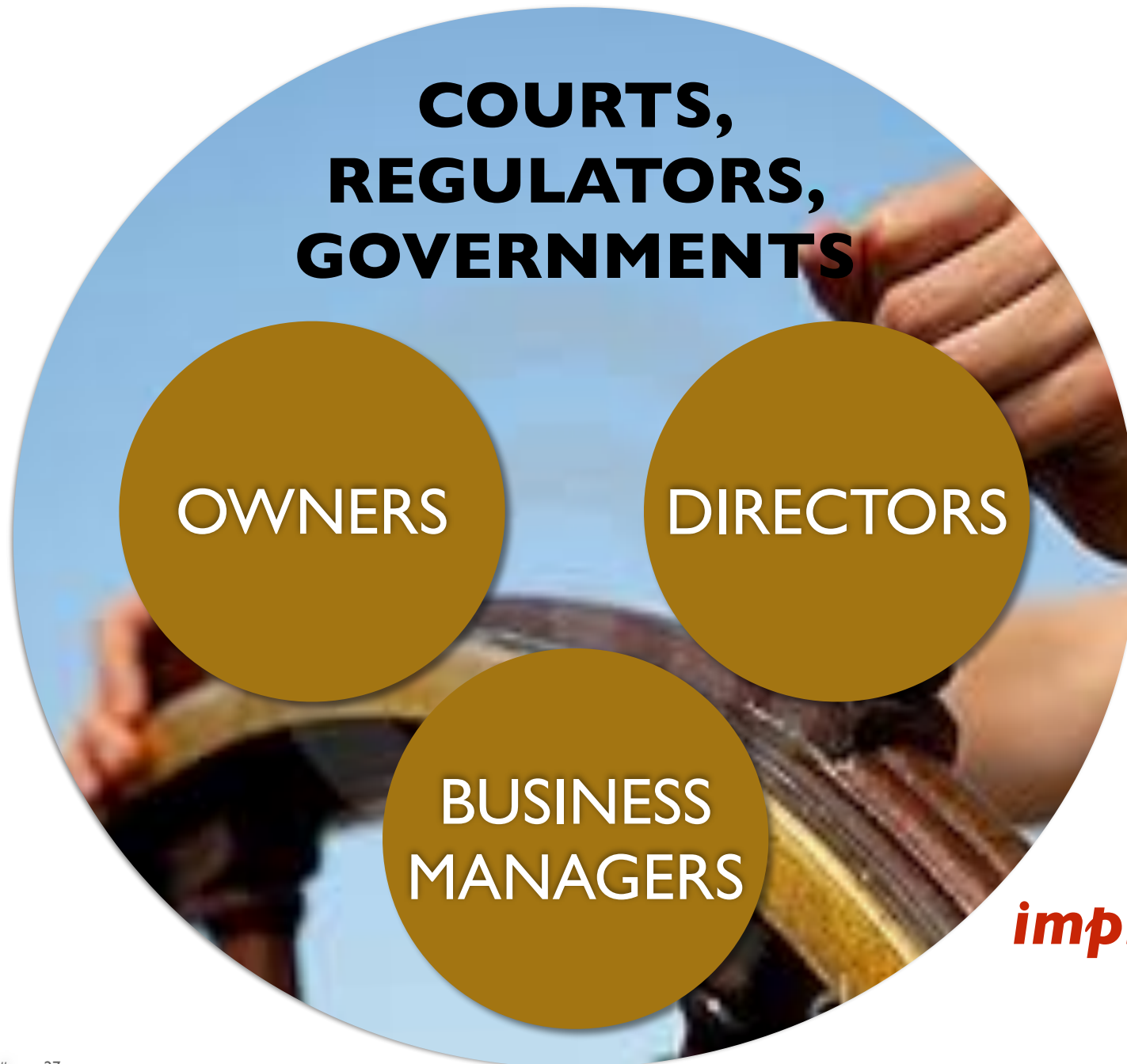


**The Syndics of the Drapers' Guild
(Rembrandt, 1662)**



British Airways AGM

FUNDAMENTALS OF CORPORATE GOVERNANCE



***What
implications?***

WHAT IMPLICATIONS?

- ▶ Governance is **SYSTEMIC** and is a **MULTI-STAKEHOLDER** «play »
- ▶ It attracts **POWER**
- ▶ **POWER AND PROFIT** versus **PEOPLE, PLANET, PROFIT?**
- ▶ **A game of POWER** or **FAIR PLAY** with **PEOPLE AND PLANET**
- ▶ **LOCAL** context matters
- ▶ One gets the **QUALITY** of governance owners/shareholders and govts **ALLOW / WANT**
- ▶ **GLOBAL CORPORATIONS** do manage for corporate executives (for they are corporate owners)
- ▶ Governance is **SPIRIT & form**
- ▶ **FORM** should serve spirit
- ▶ **ALIGNMENT** between govts, owners, directors, and managers is key for sustainable value creation

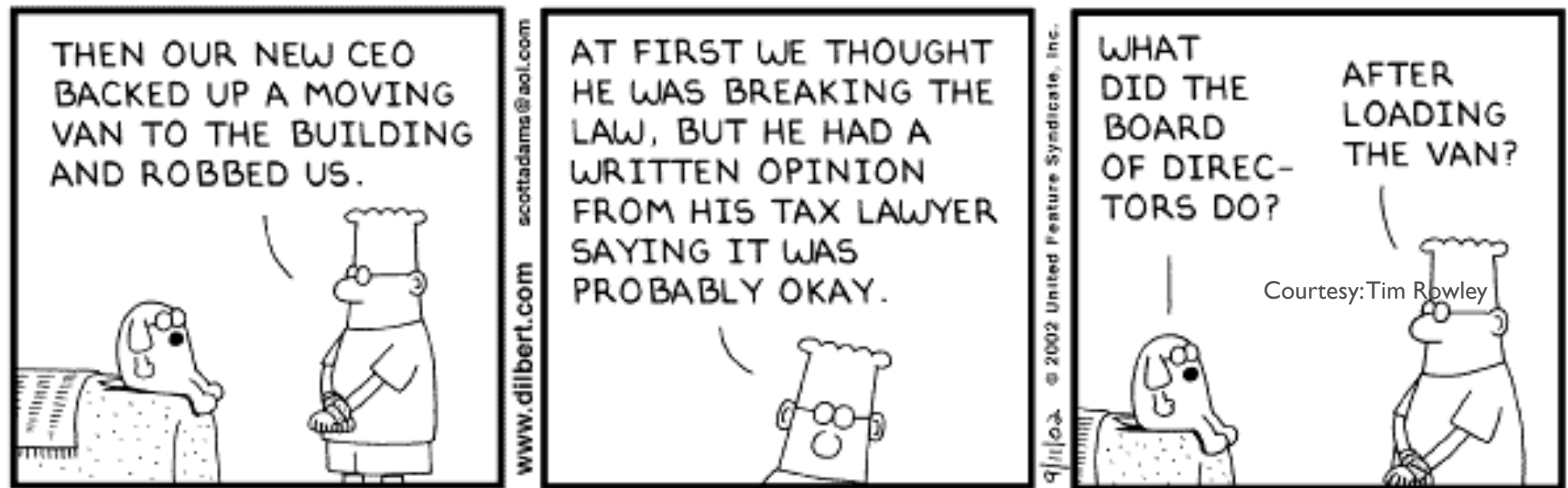
CORPORATE GOVERNANCE WHERE HAVE WE COME TO?



Corporate governance in continental Europe is improving rapidly
Source: The Economist, 23rd June 2011

CORPORATE GOVERNANCE CHALLENGES TO BOARD EFFECTIVENESS

- **What do effective directors do?**
- **What distinguishes them from ineffective ones?**



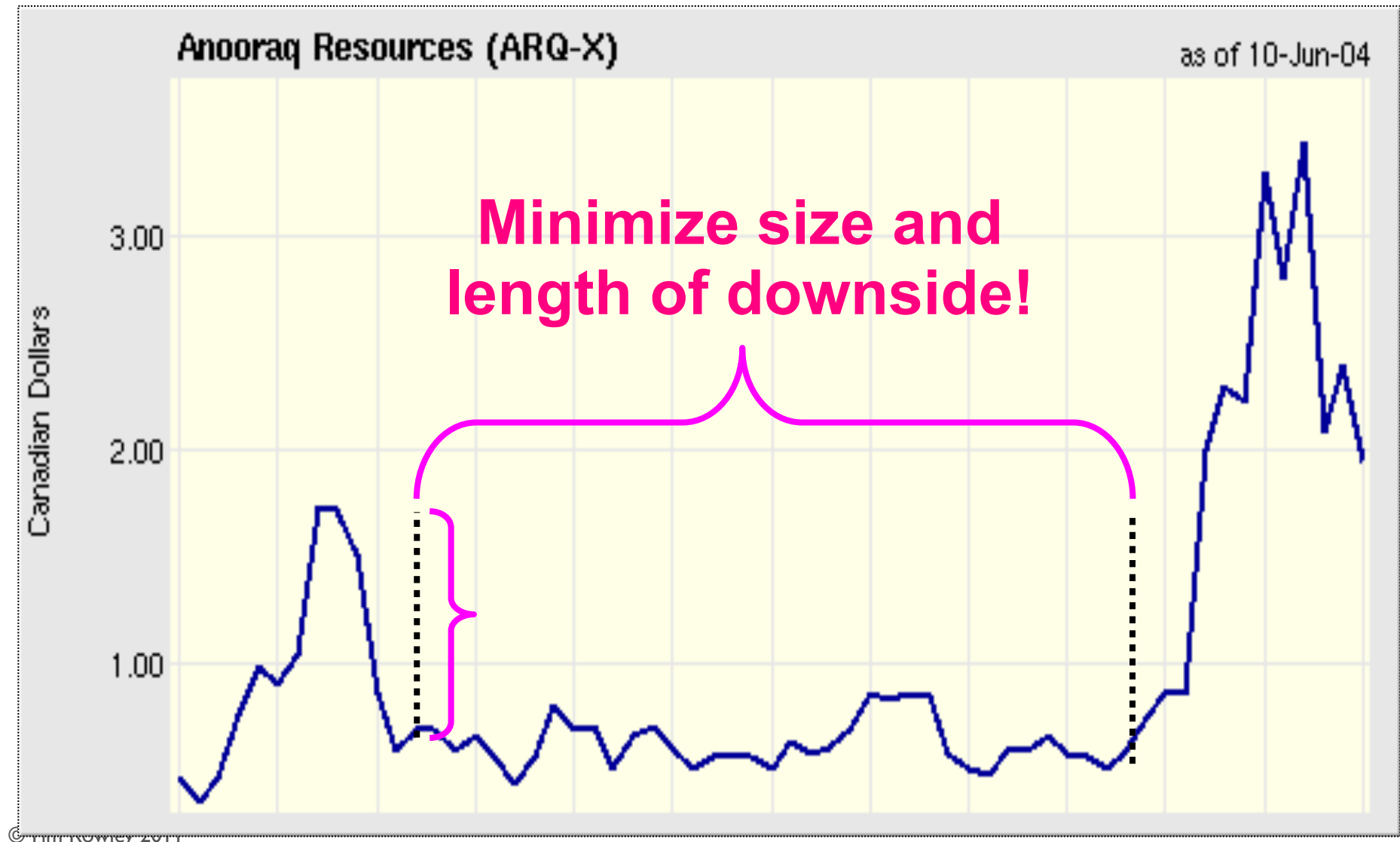
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Challenge I : SQ Gaps ...

Purpose? Mission? Duty (of Care?)? Spirit?

- ▶ **Do we understand our duty to the organization ... or do we govern for the shareholder?**
- ▶ **Are we Governing ... or are we Managing?**
- ▶ **Do we aim to contribute to a LT Value Creation agenda (EVA 2.0) ... or are we asked to only discuss ST issues or shareholder issues?**
- ▶ **Do we seek to avoid Value Destruction ... or do we compete with Executives in Value Creation (more for Executives)?**
- ▶ **Are we ready to manage the Crisis when it comes ... or are we too busy managing the company daily?**
- ▶ **Do we act as members of one Collegial Body/Team Players ... or are we a bunch of individuals imposing our views on each other?**
- ▶ **Do I bring my moral compass to meetings (values, integrity, honesty, excellence ...) ... or do I leave that for other occasions?**

Board's Contribution : manage the downside *more than upside!*



Challenge II : IQ Gaps ...

Information? Insight? Competences? Talents?

- ▶ **Do I understand my role ...** or was I just appointed to approve subjects neatly prepared by managers or owners?
- ▶ **Do I have the information ...** or am I (relatively) clueless?
- ▶ **Do I understand the problems ...** or are we discussing symptoms?
- ▶ **Do we develop key insights into problems and solutions ...** or are we all over the place in our discussion (debating society)?
- ▶ **Do we ASK the right questions ...** or do we TELL execs what to do?
- ▶ **Do we focus on the strategic issues ...** or do we focus on operational details?
- ▶ **Do we understand our industry ...** or are we a group of generalists or specialists of other industries?
- ▶ **Do we understand each other ...** or do we have big (cultural) gaps amongst us?
- ▶ **Do we have the required competences (and even TALENTS) ...** or do we have the required competences (and even TALENTS) in our board?

Challenge III : TQ Gaps ...

Time? Experience? Past? Future?

- ▶ **Do we spend the time required to do our duty ...** or do we always run out of time and never delve deeply into issues?
- ▶ **Do I have too many engagements to prepare, to attend or do follow-up of board meetings ...** or do I focus on a limited number of board memberships where I add value?
- ▶ **Do we manage to bridge the TIME gap with Executives ...** or do we simply let executives run the show?
- ▶ **Are we sufficiently forward looking ...** or do we mostly analyze past performance and discuss dividends?
- ▶ **Do we have the required experience at the table ...** or do we all go into this without much experience?
- ▶ **Did we learn the lessons from the past ...** or do we regularly repeat our errors (like firing CEOs in succession)?
- ▶ **Do we understand changing industry dynamics ...** or are we hanging on to recipes of the past?

Challenge IV : EQ Gaps ...

Emotions? Caring? Passion?

- ▶ **Do we care deeply about our directorships ... or do we do it because we have to or were asked?**
- ▶ **Do we care about our fellow directors and our executives ... or do we dislike some profoundly or are at best indifferent?**
- ▶ **Is there passion in the board ... or is everything rather « in control »? or are people rather skeptical about the board?**
- ▶ **Are we frustrated about our lack of performance ... or are we in satisfactory under-performance mode?**
- ▶ **Are we afraid to ask questions or speak our mind ... or do we have the courage to confront each other and speak our mind?**
- ▶ **Do I have dogmatic views on matters ... or am I eager to explore other views and change my mind depending on other views?**
- ▶ **Do we develop positive dynamics in our discussions ... or is there « toxic » behavior at the board? Too confrontational?**
- ▶ **Do we look forward to our board meetings ... or are we bored and annoyed at the time spent?**

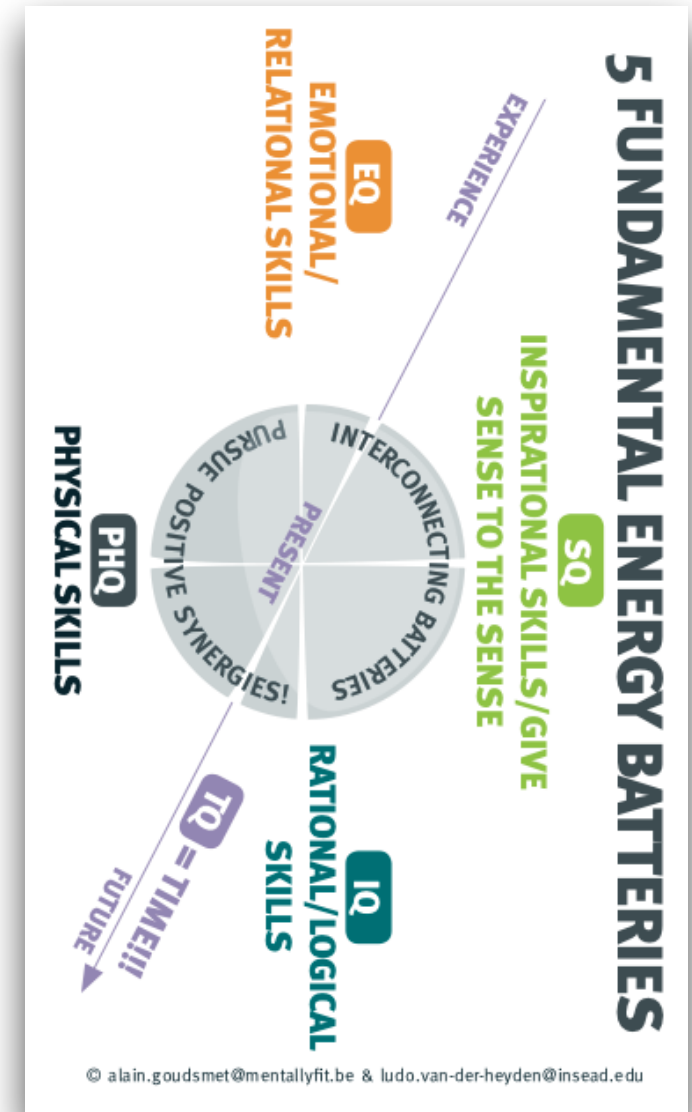
Challenge V : PhQ Gaps ...

Action? Courage? Location?

- ▶ **Do we have the courage to take responsibility and act ...** or do we keep talking, postponing decisions to the next meeting?
- ▶ **Do we all make a difference to the board and the organization ...** or do we simply rubber stamp and do our « legal duty »?
- ▶ **Am I actively contributing to meetings (even activist?) ...** or do I tend to be passive and let things happen? Or contribute negatively?
- ▶ **Do we share what we see ...** or do we not share our perspectives and our visions for the organization?
- ▶ **Do we have the courage to « put our body on the tracks » ...** or do we rationalize that others are at fault?
- ▶ **Are we able to make tough decisions and demands ...** or do we tend to postpone decisions to the next meeting? Or let managers make the calls and too easily approve their contribution?
- ▶ **Do we meet in hotels ...** or do we meet in our model and problem locations?

First Conclusions on Director Effectiveness

- ▶ **Governance is a complex subject**
- ▶ **It is hard to do a good job sustainably (on all issues, on all boards, at all meetings)**
- ▶ **At all cost, avoid taking away energies from the board ... and from the management!**
- ▶ **The central matter is that the board gets to do the right thing (not you)!**
- ▶ **Practice and develop your board skills!**
- ▶ **Are you striving for excellence?**
- ▶ **Examine your portfolio of activities: are your other activities (boards) synergistic or rather not? How many industries do you span?**
- ▶ **These factors are INVARIANT across countries, companies, and cultures ... though contexts do MATTER (see next)**



CORPORATE GOVERNANCE SUMMING UP AND FINAL COMMENTS

CG: SUMMING UP & FINAL COMMENTS: WHY?

- Governance **makes business more sustainable**
- Governance is too much led by governments, legislators and regulators
- UN with **GLOBAL COMPACT** is contributing (not business)
- Business needs to catch up and **become « forces for a better world, planet, people »**
- A key issue for countries that try to **attract foreign investment**
- A fascinating area where it does not take that much to shine ... and **take the lead**
- **Planet is looking for « better » governance**

CG: SUMMING UP & FINAL COMMENTS: WHAT?

- **World has (again) recognized the importance of governance**
- Governance is **distinct from execution** - except in crisis : **CGO and CEO ...**
- **Governors are responsible first for the organization ... and not the shareholder**
- Governance is a multiple stakeholder game and **is about in-storing fair play in business, ownership, and as corporate citizen**
- **Conflicts of interests, private agendas and emotions abound**
- **5 fundamental challenges to board effectiveness**

For further information :
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