Foreword

Ever since the adoption of the Sarbanes-Oxley act in 2002, the roles and responsibilities of boards of directors have been prone to debate, with a focus on the importance of director’s independence. Beyond the independence requirement, well functioning boards must also exhibit other qualities. However, there is simply no “one size fits all” or magical recipe as far as “good” corporate governance is concerned. This is in essence the thought provoking message of Professor Hilb’s essay, which of course resonates even more at the heart of the world’s worst financial crisis since the deep depression.

The new corporate governance concept Martin Hilb is articulating goes back to the roots of good corporate governance, which is the ability to act as a visionary and effective decision body, exerting both strategic leadership and control. It’s also an invitation to think twice about the applicability of “best practices” in different legal contexts and business models. Arguably, despite some common features, the appropriate corporate governance of a family business company will differ from that of a large listed company. In addition, both the financial crisis and previous cases of large corporate failures have raised critical questions about the role of board directors in risk management. Are boards sufficiently equipped with the necessary knowledge, skills and expertise to provide the appropriate strategic vision and control function? The answer is certainly more complex and nuanced than it seems. Overly generalist boards may not grasp certain technicalities (with dreadful consequences), yet overly technical boards may completely miss the big picture.

At the end of the day, the “right” board composition is matter of delicate balance, and involves group dynamics. According to Professor Hilb, what makes boards able to reach superior decisions as a group of qualified individuals and bring long-term value to the company is not the sum of their individual intelligence, but how they can complement each other so as to deliver a superior outcome. Accordingly, what should matter most is the proper combination of technical skills and of decision-making skills, namely the alchemy between complementary skills and characters. This combination should also include a clear team spirit, long-term vision, as well as an adequate incentive structure.
Of course, one may wonder whether this is by all means a “new” conception of corporate governance. On the one hand, what Professor Hilb presents simply follows common sense. On the other hand, his essay offers a refreshing look about the importance of the human factor in corporate governance in these challenging times, and therefore of human resource management dimension. The economics field is also rediscovering the non-perfect world of behavioural economics, where economic agents may not be as rational in all circumstances. The same applies to corporate governance, where one needs to better understand why the seemingly logical and intuitive ideas presented by Professor Hilb appear to be so seldom implemented in practice. This shows at least that there is still room for major improvement at the board level, as to bring sustainable long-term value to shareholders, customers, employees and society.

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NEW CORPORATE GOVERNANCE IN THE POST-CRISIS WORLD

By Prof. Dr. Martin Hilb, Managing Director of the Institute for Leadership & HRM and its Center for Corporate Governance at the University of St Gallen/Switzerland

The paper is based on the book “New Corporate Governance”, by Martin Hilb

What’s “new”

Based on the results of board evaluations conducted in various business sectors, we identified the following as the main weaknesses of current corporate governance practices:

- Most national corporate governance guidelines propose a “one size fits all” approach which is dangerous; it may support good governance, but it does not guarantee that the governance of a firm will become great;
- There is a lack of strategic direction in much of board practice;
- Board selection, appraisal, remuneration and development often lack integration and professionalism; and
- Often there is a lack of in-depth know-how in risk-management, at board level.

This paper presents an integrated corporate governance framework called “New Corporate Governance”, which is based on a reversed KISS-Principle:

- Situational
- Strategic
- Integrated
- Keep it controlled

This holistic framework for the direction and control of enterprises tries to overcome the above stated weaknesses of Corporate Governance in the past crisis world. What is “new”, you may ask?

The New Corporate Governance framework integrates the interests of shareholders, customers, employees and the public. The framework comprises four parts which are presented in this paper.
1. Keep it Situational: The Board as Change Agent

As a result of the many corporate scandals that have taken place around the world, best-practice corporate governance guidelines have been developed in most countries.

This is a positive development, although the following issues should be noted:

i. the Anglo-American model of governance is being promoted as the global standard,
ii. soft laws do not necessarily address the soft dimensions of a firm (in other words, laying down a new soft law does not replace the need for integrity in board relationships and processes),
iii. best-practice guidelines are typically designed for large, publicly listed firms (and hence they are often not suitable for small firms), and
iv. good governance guidelines do not guarantee great governance practice.

In adopting corporate governance guidelines developed elsewhere, companies should be aware of the fact that best-practice guidelines for:

Table 1. Keep it situational

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<th>Listed companies</th>
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<th>Non-listed companies</th>
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<td>Large companies</td>
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Hence, we base our approach on the principle: keep it situational. There is no “one-size-fits-all” corporate governance approach.

2. Keep it Strategic: The Board as Value Driver

We propose four main preconditions for success in developing, implementing and monitoring corporate strategy:

i. a strategically targeted composition of the board team,
ii. a constructive and open-minded board culture,
iii. an effective board structure, and
iv. shareholder and stakeholder oriented board measures of success.
These four components have to be integrated in a process, as shown in Figure 1. At each of the different levels, success measures are established relating to the important stakeholder groups, and then the responses of members of these stakeholders’ group are measured periodically to assess the performance of the company leadership.

In the following sub-sections, each of the four preconditions for successful development and implementation of corporate strategy are discussed.

A well-diversified board team

Peter Senge asked the question: “How can a team of committed board members with individual IQs above 120 have a collective IQ of 60?” The question could be restated as: “Where do good ideas on boards come from?” In response, Negroponte—Founder of the MIT Media Lab—says: “That’s simple… from differences.”

Together the above quotes are indicative that differences are an essential part of the strategic potential of a team, and that there have been too many boards that fail to create adequately diversified teams. Our suggestion for building differences into board composition is to mix disciplines, team roles, demographic variables and stakeholder parts.

Well-diversified board teams consist of members representing all relevant:

- functional competences (e.g. auditing, risk management, HRM, marketing),
- team roles (e.g. a controller, a critical thinker, a creative thinker),
- demographic data (e.g. age, gender), and internal and independent members.
- stakeholder “hats” such as customers, stakeholders, employees, society/environment.

Each board member has to cover various aspects at the same time, e.g. Functional Know How: Risk Management/Team Role: Critical Thinker/Membership: Independent/Social Data: Very Experienced Female/Stakeholders “Hat”: Shareholders.
A constructive and open-minded board team culture

We suggest that an effective board culture consists of five factors: an outward, learning orientation; a holistic perspective; a consensus orientation; a constructively open, trusting environment; and a mix of global effectiveness and local adaptability (we refer to this as “glocal”).

An effective board structure

Our experience in board management reveals two extreme ways of structuring board teams:

- a large board, operating through a number of different committees (such as Auditing, Nomination or Remuneration Committees), or
- a small board of professionals.

We recommend a third way:

- a small, legally accountable, well-diversified board, comprising a maximum of seven members (including an independent Chairperson, independent members and the CEO). We recommend that the board conducts its activities through only two committees: an integrated audit and risk management committee and an integrated board management committee which is responsible for nomination, feedback, remuneration and development of the board and top management.

In addition, large public companies can add a large network council (not legally accountable) whose members work in small projects teams, each of which is coached by one of the independent board members.

Shareholder and stakeholder measures of success

A combined team of supervisory and managing board members need to develop, implement and evaluate a shareholder— and stakeholder-oriented board vision. Such a vision should:

- provide a roadmap for future direction,
- generate excitement about future direction,
- instill confidence and trust in leadership, and
- offer criteria for success.

If corporate success is measured against such a vision, it will necessarily reflect both shareholder and stakeholder measures.
The following statement can serve as an example of a normative guiding principle:

“The primary role of the board of directors of this company is to help create long-term value for its shareholders, customers, employees and society. The board believes that the company should rank in the top quartile of peer companies in total shareholder return (including the cost of capital), as well as in voluntary loyalty levels of customers, employees and society as measured over 1 and 3 year periods.”

This strategic direction function is the basis for the targeted selection, evaluation, remuneration and development of board members and top management which will be described in the next section.

3. Keep it Integrated: The Board as A Team

In order to achieve the conditions required for strategic board management described in the last section, four key processes are recommended: targeted selection of members of the supervisory and managing boards, targeted feedback on their performance, targeted compensation and targeted development (illustrated in Figure 2).

**Figure 2. Keep it integrated**
In the following sub-sections we discuss the elements of Figure 3 in more detail, commenting on key principles and practices that can be used in their implementation.

**Phase I: Targeted board selection**

The use of a one-page interview schedule is recommended to guide the specific selection of board members. The interview schedule aims to score the potential of the interviewee on a number of criteria (such as Personality, Social, Professional and Leadership Competencies) from the perspective of at least three interviewers (at the level of Chairperson, the CEO and another board member). After the interviewee has been through at least two rounds of interviews, the interviewers hold a short meeting during which they attempt to reach agreement in the score awarded for each item on the schedule. Where a consensus cannot be met, further investigations are to be made into the nature of the response. A suitability ranking is drawn up on the basis of the final evaluation of each item.

**Phase II: Targeted board feedback**

After board members have been selected, it is natural to introduce an effective feedback program for board members.

We recommend that feedback be linked to the collective performance of the supervisory board and the individual performance of the CEO. In each case, there are a number of dimensions on which the performance can be evaluated.

Targeted board feedback is only suitable if positive performance is rewarded and actions are taken to address development requirements.

**Phase III: Targeted board remuneration**

Board members should be compensated in such a way that they perceive equity based on internal, external and corporate benchmarks.

The total net compensation package of a board member can be divided into fixed (e.g. 40 percent) and variable (e.g. 60 percent) components. The variable component can be made up of several measures of performance including:

- long-term financial performance (3 years),
- comparative value indices (e.g. 50 percent EVA, 20 percent customer loyalty, 20 percent employee satisfaction and 10 percent public reputation), and
- functional performance assessments (20 percent board committee performance; 30 percent individual board member performance; 50 percent corporate performance).
An important guiding principle in board remuneration is that every board member expects financial compensation to be fair. Modifications of the package above or below fair reward are unlikely to result in better performance, since board members are generally driven by intrinsic motivations (Frey, 2004). Thus, adequate and fair rewards are important prerequisites for good performance, but motivation is primarily affected through immaterial reward of good performance.

**Phase IV: Targeted board development**

Past board evaluations conducted by us have shown that in quite a number of leading companies, management and board succession planning is not discussed in depth at the board level. The board should ensure that development programs are in place to enable the company to offer 80 percent (for example) of all key positions in the company to internal candidates. In this regard the approach of having the CEO and her/his direct reporting managers present their succession plans to the board once a year has proved successful.

This procedure creates an opportunity for division heads to make a presentation to the board, socially. If an opening arises at the top management level, the board will be well prepared and can use the same form as that used for the targeted selection of external candidates.

**4. Keep it Controlled: The Board as Controller**

In this integrated approach, the controlling or monitoring board dimension encompasses the following functions (see Figure 3).

It may also be sensible to formulate some essential questions in a board meeting, about which board members should be continually informed. For example:

- Where is shareholder value being created and destroyed in the company?
- What are the major risks to which the company is exposed?
- What is the level of employee morale and voluntary loyalty compared to competitors?
- What are the threats to customer satisfaction and customer loyalty compared to competitors?
- What is happening to our corporate image?

![Figure 3. Keep it controlled](image)
- How does our strategy differ from that of our competitors?
- How is our stock viewed by the analysts who cover us?

Last, but not least, the board has an evaluation function.

**Figure 4. Development levels of Boards**

This paper presents a “Both-And” approach called “New Corporate Governance”. The objective of this approach is to overcome the “Either-Or” thinking that currently dominates corporate governance theory and practice, based on the principle espoused by F.S. Fitzgerald that: “The test of a first-rate [board] intelligence is the ability to hold two opposing ideas in mind at the same time, and still retain the ability to function.”
An effective board tries to balance both:

- Shareholder value and value for clients, employees and the public.
- Entrepreneurial action and checks and balances.
- Short-term results and long-term sustainability.
- Global learning and local adaptation.
- Culture of performance and culture of cooperation.
- Direction and control.
- Keep its nose in and its hands out of operational activities.

It remains to be seen whether boards have the will and resources to transform themselves into true directing and controlling teams; changing their orientations from corporate administration to corporate control-preneurship. The result of this challenge will determine whether companies will be among the winners or the losers in the face of global change and competition.
About the Author

Professor Martin Hilb is the Founder of the IFPM Center for Corporate Governance at the University of St. Gallen/Switzerland (www.ccg.ifpm.unisg.ch). He has conducted research at UBC in Vancouver, MGSM in Sydney and taught at the University of Dallas/Texas, SMU in Singapore and EIASM in Brussels.

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Martin Hilb has consulted organizations in the field of Board Effectiveness and HRM in 60 countries.
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The Forum sponsors regional and local initiatives that address the corporate governance weaknesses of middle- and low-income countries in the context of broader national or regional economic reform programs.

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