NEW CORPORATE GOVERNANCE
IN THE POST-CRISIS WORLD

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The paper is based on the book “New Corporate Governance”, 3rd Edition, New York 2009,
by Martin Hilb. This book is published in English, Chinese, Vietnamese, German, Spanish and
Portuguese.

What’s “new”

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

- 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 integra-
  tion 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:

Keep it
- Situational
- Strategic
- Integrated and
- 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 post 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:

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Table 1. Keep it situational

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 to be established relating to the important stakeholder groups, and then the responses of members of these stakeholders’ group are to be measured periodically in order 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 of the fact that differences are an essential part of the strategic potential of a team, and that too many boards have failed 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, shareholders, 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 should consist 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 team, 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 whom 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 2 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 performance 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 on 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 vacant key positions in the company to internal candidates. In this regard the approach of having the CEO and her/his direct reporting Vice Presidents 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**
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 to evaluate board effectiveness on an annual basis.

**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.”
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.

He was associated with Nestlé in Switzerland, Martin & Co in Germany and Schering-Plough Corporation USA, ultimately in the role of Director of Essex Chemie AG.

Martin Hilb has consulted organizations in the field of Board Effectiveness and HRM in 60 countries.
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Established in 1999, the Global Corporate Governance Forum is a multi-donor trust fund facility located within IFC Advisory Services. Through its activities, the Forum aims to promote the private sector as an engine of growth, reduce the vulnerability of developing and transition economies to financial crises, and provide incentives to corporations to invest and perform efficiently in a socially responsible manner.

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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