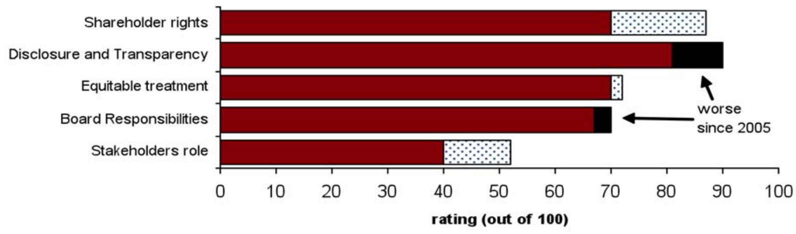
Corporate Governance Roundtable 2017: Effective board leadership

Professor Say H Goo, FCIS, FCS
Professor of Law, University of Hong Kong
Deputy Head of Law Department and Director of LLB Studies
Founding and former Director, Asian Institute of International Financial Law (AIIFL)
Visiting Professor, Columbia University
Honorary Visiting Professor, Exeter University
Honorary Fellow, Monash University
Distinguished Visiting Professor, East China University of Political Science and Law

Areas of improvement and decline

Figure 6.3: Corporate Governnace Worse in Transparency and Board Responsibilities since 2005?



The data in the figure show corporate governance scores for Hong Kong's listed companies for 2012 compared with 2005 in each of 5 corporate governance related areas scored by the Hong Kong Institute of Director's Annual Scorecard. They assess Hong Kong listed companies based on criteria in the OECD's Principles of Corporate Governance and the Hong Kong Exchange's Code on Corporate Governance Practices.
Source: Hong Kong Institute of Directors (2013).

What does Board leadership involve?

- vision & mission legally and ethically
- achieving vision & mission legally and ethically

On to this you can add:

- helps company adapt to changing circumstances
- responds to crisis
- identifies opportunity for change and growth
- creates future leaders

To achieve this, board needs to

- work hard, not ceremonial job, more and more is expected
- meet increasing amount of regulatory compliance
- be engaged in and understand the business of company
- listen, diversity (of experience, functions, background, international mix, gender etc) helps bring different voices and make better decisions
- do risk management

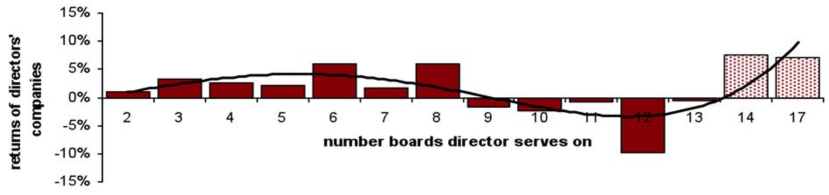
- be shareholders focused but increasingly taking in stakeholders' interests, engagement on governance issues, board should help company to be good corporate citizen
- do succession planning, attracting talents (look for skill sets required, functional expertise, education/induction training not enough)
- have strategy sessions, driver & outcome sessions on board calendar

Other things you need:

- lead director or non-executive chairman
- need to work as a team
- need to have board intelligence
- majority independent directors
- sitting CEO should not sit on too many other boards as INED, not too many INEDships

Multiple directorships decreases performance

Figure 6.20: More Directorships Means Better and then Distracted



The data in the figure show the returns of the companies various Hong Kong directors serve on (presumably over their tenure). For example, directors with 6 board seats led their companies to a roughly 5% compound annual average rate of return. Authors like Lei and Jie (2011) argue these data reflect the desire boards to get the best talent but such talent becomes overwhelmed if taking up too many board positions.
Source: webb-site.com

How do you assess effectiveness?

- Is board delivering what it sets out to do (its vision and mission)?
- annual review, evaluation of board effectiveness and individual directors (Appendix 14, C.2.1-C.2.3)

What can be done to improve?

- Diversity?
- Cap on INEDship?
- Report by INED?
- Stakeholder voice?
- Stakeholder Directors in the board?

Why stakeholder directors

- Board decisions are always dictated by the interests of shareholders only
- Anglo-American law: Director duty to act in the interest of company
- Shareholder supremacy: interest of company means interest of all shareholders – profit maximization
- Economic case for shareholder supremacy: shareholder supremacy allows resources to be allocated efficiently in a free market since as the residual claimants shareholders have incentive to ensure companies are run efficiently.
- Companies exist to reduce transaction costs (Coase, Nature of the Firms)
- Problem is when costs can be externalized, shareholder supremacy does not allow resources to be allocated efficiently (see Parkinson)

- "Where producers can externalize costs there is also an efficiency issue, since they will make decisions that involve a misallocation of resources … if the signals provided by the market are systematically distorted as a result of weak competition and other forms of market failure, then following those signals will not always lead to the most efficient available outcomes. Once this is acknowledged the local and tangible benefits of social responsibility begin to look more attractive than the speculative and abstract social gains flowing from a rule of strict profit maximization.'

  - John Parkinson, Corporate Power and Accountability, at 310-311.

- With shareholder supremacy, directors are only allowed to act in shareholder interest, which can lead to misallocation of resources and cause harm to other stakeholders
- UK Companies Act 2006; US Constituency Statutes do not help.
- Historically, companies are not solely for shareholders (see HC Adams)

"Corporation originally were regarded as agencies of the state. They were created for the purpose of enabling the public to realize some social or national end without involving the necessity of direct governmental administration. They were in reality arms of the state, and in order to secure efficient management, a local or private interest was created as a privilege or property for corporation. A corporation, therefore, may be defined in the light of history as a body created by law for the purpose of attaining public ends through an appeal to private interest."

- Henry Carter Adams, Quoted in R Nader, Taming the Giant Corporations at 63.

- Various statutes protecting stakeholders to internalize the costs, but there are gaps in law and enforcement problems.
- One way to internalize cost is to have single tier stakeholders board
- This draws on the theory of Adam Smith’s invisible hands: people are selfish but this leads to greater wealth for the society through invisible hand

Difficulties of SRB

- How to determine the precise percentage of board representations? 50-50? Or should shareholder directors be in the majority? Or proportionate?
- who should represent the consumer and the community?
- decision-making process taking longer, more complicated, contentious, and ultimately slower in responding to the fast changing business environment

- Only applies to MNC in developing countries
- MNC with history of abuses
- only matters affecting stakeholders require approval of SRB
- UN, World Bank, OECD, IOSCO should take lead

"If a board is to truly fulfill its mission—to monitor performance, advise the CEO, and provide connections with a broader world—it must become a robust team—one whose members know how to ferret out the truth, challenge one another, and even have a good fight now and then."

-- Jeffrey A Sonnenfeld, What Makes Great Boards Great, Harvard Business Review (2002), Senior Associate Dean, Yale School of Management; President, Yale's Executive Leadership Institute