

BOARDROOM SECRETS

CORPORATE GOVERNANCE
FOR QUALITY OF LIFE

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All virtue is summed up in dealing justly. - Aristotle

- Trust is the foundation of development both in relations among humans and institutions
- Gaining the trust of others is a valuable but difficult endeavor
- Achieving the status of being trustworthy is a long process, but trust could be lost very quickly
- In gaining trust, actions speak louder than words, as consistency of actions is a more dependable indicator of intent
- Corporate governance is the foundation of corporate trust
- The most important element of organizational infrastructure is the Board of Directors
- The boards do not run companies but rather guide and advise the management
- Governance is much more than compliance.

Good corporate governance is a culture and a climate of;

Consistency,
Responsibility,
Accountability,
Fairness,
Transparency and
Effectiveness that is
Deployed throughout
the organization.

The quality of a board depends on the quality of its members, its structure, and its processes.

PEOPLE

TEAM

PROCESS

CULTURE

INFORMATION

GUIDANCE

OVERSIGHT

Structure

Internal Processes

Responsibilities

 MARGE

P T PR C I G O

Independent members should be competent and sufficiently informed to make judgments for sustainability of the company.

Role of Independent Board Members

- Handle ‘the agency problem’ between the shareholders and the management
- Evaluation of the risk-reward balance, short term – long term returns, stakeholder interests, and potential conflicts of interest.
- Prevention of preferential treatment of any stakeholder.

Components of Independence (*)

- Financial: Corporate governance codes mostly define independence in terms of the financial interest of the member
- Intellectual
- Political
- Group Independence
- Emotional

(*) Independence argument should not be carried too far to eliminate qualified candidates who may serve the corporation well and go for people who do not have relevant experience.

The key to a successfully functioning board is the character and competencies of the people who make up that board.

General
Characteristics
of Board
Members

1. Integrity and high ethical standards,
2. Understanding of fiduciary responsibility,
3. Financial literacy,
4. Conformity with the corporation's values,
5. Ability to make judgments on decisions with implications on numerous dimensions,
6. Independent thinking, ability to express thoughts,
7. Exhibiting a constructive approach,
8. Having internalized the principles of corporate governance,
9. Believing in and applying standards of stretch performance,
10. Being prepared to devote sufficient time and attention,
11. Willing to take initiative to be proactive, challenge the management, and when needed take action.

Individual
Competencies
of Board
Members

1. Sector experience
2. Stakeholder experience
3. Senior management experience
4. Senior-level relationships
5. Geographic or issue based experience

The basic member choosing criterion "What value they will add to the board."

Board members should demonstrate certain behaviors in fulfilling their duties.

1. Knowing the corporation and the market well
2. Implementing a challenging and constructive questioning process
3. Having a good understanding of the corporation's cash flow
4. Having an understanding of benchmarks
5. Focusing not only on the performance of the current term, but also about the indicators for the future performance
6. Inorganic growth opportunities
7. Succession planning
8. Potential off-balance-sheet liabilities
9. Reputational risks, whistle blowing process in identifying potential fraud risks
10. Understanding customer expectations
11. Understanding of the value chain
12. Effective oversight for CSR activities
13. Being aware of potential regulatory and legislative changes
14. Understanding of the priorities and concerns of the investment community

Pearls are not found in shallow waters, if you want one, you must dive deep - Chinese Proverb

The key to a successfully functioning board is the character and competencies of the people who make up that board.

- General characteristics of Board Members.
- Individual competencies of Board Members.

Traditionally, members of board of directors are picked by the largest shareholder, Chairperson, or CEO., but....

- “Acquaintances” that may hesitate to challenge the CEO.
- Limitation to the diversity of joint experience of the board.

Independent members should be competent and sufficiently informed to make judgments for sustainability of the company.

- Financial Independence
- Intellectual Independence
- Political Independence
- Group Independence
- Emotional Independence

Board members should demonstrate certain behaviors in fulfilling their duties.

- Knowing the corporation and the market well
- Focusing current, but also future performance
- Succession planning
- Potential off-balance-sheet liabilities
- Risk evaluation and trade-offs

Chairperson should ensure the effectiveness of the board and sustainable increase of the corporation's value.

- Integrity and high standards for ethical conduct
- Openness, transparency and accountability
- Common sense and strategic thinking skills
- Team building
- Experience and knowledge

A collection of excellent players do not always make a great team, especially if they all excel at the same skills.

- Building successful teams / successful boards is an important entrepreneurship skill.
- Effectiveness of boards determine the effectiveness of the corporation.
- **In Order to Create a Successful Board;**
 - Mutual respect, trust, and candor must be attained between all board members.
 - Different skills and competencies of the members must cover company needs like;
 - Risk profile
 - Stage of life cycle
 - Geographic experience
 - Industry experience
 - Stakeholder experience
 - Team members must spend time together and exchange ideas and views.
 - The board has to work as a unified team, not as individual stars.
 - Great care should be taken to ensure that the team is formed properly from the outset.
 - Corporate incentive systems should be set up so as to increase team performance.
 - Sufficient time has to be invested up front to ensure agreement on a common vision.
 - Planned changes are necessary to ensure lasting team success.

If everyone thinks the same, no one is thinking. – Walter Lipmann

A well functioning board needs to balance; ability to provide guidance and oversight and ability to bring different experiences and perspectives.

- Ability to Think Strategically
- Industry Experience
- Top Management Experience
- Senior-Level Relationships

Building successful teams / successful boards is an important entrepreneurship skill.

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Adherence to corporate governance principles is not enough, the expectations of stakeholders are more than that.

- “We have the best run company”
- Delaying disposal decisions due to stigma of failure
- Difficulty of overcoming the investment momentum
- Treating costs in different areas with different criteria
- Being overly influenced by most recent developments
- Group Thinking

The number of board members influences the effectiveness of decision-making.

- Circumstances
- Complexities of the corporation
- Geographic scope

To open a shop is easy, keeping it open is an art. – Chinese Proverb

The main goal of board meetings is twofold; to provide guidance and to provide oversight.

- Attendance
- Annual work agenda
- Effectively utilized time
- Additional less formal meetings
- Fully informed
- Annually 5-7 regular board meetings

The meeting notes are an important tool for internal communication and they serve as a legal record.

- Who attended and how
- When and at what time the meeting took place
- What basic agenda topics were discussed
- What information was shared with attendees, was it sufficient
- Which alternatives and dimensions were considered
- Which decisions were taken
-

Committees do not replace the role of the board but present their findings and recommendations to the full board.

- Audit
- Nomination and Governance
- Compensation
- Safety and Social Responsibility
-

For successfully functioning boards; selection, evaluation, remuneration and development processes must be structured.

- Member Selection
- Performance Evaluation
- Compensation Package
- Development and Orientation

The tone at the top sets the corporate culture.

Structural and procedural issues are not sufficient for good governance. Good governance needs people who understand the spirit of governance, internalize principles, and reflect them in all their actions

Examples of Behavior Expected in an Organization with Good Governance

- Management should not benefit personally from the corporation's activities or assets, except for their stipulated compensation and reward packages.
- There should be no transactions with the corporation or its affiliates that is not in line with market prices.
- The management should not assume too much risk on behalf of the shareholders with the hope of inflating short term performance of the company.
- The management should not use the corporate resources to build an empire for themselves.
- No tendency for nepotism.
- Avoiding Insider trading
- No hindrance to effective operation of internal control systems
- Management should take all the necessary precautions to train all employees with respect to avoiding conflicts of interest with the corporation,
- Management should see to it that all employees observe all legal and ethical stipulations, and that there is an effective whistle blowing mechanisms to identify violations.
- The independence of external auditors should not be endangered by giving them too many other assignments.
- There should be a competitive compensation system to ensure that competent individuals with the right qualifications are attracted to the corporation and rewarded for performance.
- No shareholder should be given preferential treatment and commercial transactions made with shareholders should be conducted on an arms length basis,
- Unethical conduct such as bribery should be a cause for dismissal.
- To ensure that management behaves fairly towards all stakeholders, such as employees, suppliers, and distributors.
- Over confidence in internal capabilities has to be avoided, in order to be able to utilize third party resources for improving the corporation's performance.
- Reductions in investments endangering the future of the company should be avoided to meet short term goals. In particular, investments in intangibles such as the brand has to be watched carefully, as it is difficult to measure the damage in the short term.
- Continuous improvement and benchmarking with best-in-class examples should be encouraged.
- Strict adherence to public disclosure requirements about developments that may have an effect on the value of the company should be observed.
- The systematic assessment of risks and opportunities concerning the corporation's future should be conducted.
- Corporate social responsibility towards the society and future generations should be taken seriously.

Whenever everyone agrees with me, I always feel I must be wrong. — Oscar Wilde

What is Critical Thinking

- Challenging all assumptions, information and judgments, and evaluating different aspects of the issues at hand before coming to a conclusion.
- Critical thinking involves making judgments about relevance, significance, fairness, and logic of the issue at hand.

Skills of A Critical Thinker

- Systematic thinking
- Working discipline
- Flexibility
- Openness to new ideas /change
- Integrity
- Perseverance
- Courage
- Autonomy
- Self-confidence.

Behaviors of A Critical Thinker

- Gathers and assesses relevant information
- Thinks open-mindedly considering alternative perspectives
- Recognizes and assesses their assumptions, implications, and practical consequences;
- Raises vital questions and problems
- Formulates them clearly and precisely
- Comes to well-reasoned conclusions and solutions
- Communicates effectively with others in figuring out solutions to complex problems

(*) Absence of critical thinking at the board results in unhealthy decisions, the chairman of the board has to encourage critical thinking and to create an environment conducive to challenge.

Positive and constructive thinking is the key to emotional intelligence which promotes participation and sharing of ideas.

Each mistake is a learning opportunity

- People tend to hide mistakes
- But innovation requires acceptance of mistakes (Edison)
- Mistakes are to be expected, not avoided
- Each opportunity to learn is worth its weight in gold
- Effectively conducting an analysis of a failure requires self-confidence, a spirit of inquiry and openness, patience, and a tolerance for ambiguity.
- Success in innovation does not come with worries or withdrawal, but with persistence, perseverance, and tenacity to continue

Creating an appropriate climate for learning is a critical leadership challenge

- Leaders should share their own mistakes
- Leaders should ensure that the corporate culture embodies an understanding of “to win we have to make calculated experiments” rather than “not doing anything for fear of making a mistake.”

The ability to think positively and constructively can be learned

- Learn from the experience of others.
- At peace with oneself, consistency of thought, expression, and behavior is the enabler of self-confidence, peace, and winning the trust of others.
- The harshest form of criticism is often the kind we evoke upon ourselves.

The only man who makes no mistakes is the man who never does anything. – E. Roosevelt

One of the keys to a successful board is a good understanding of the differentiated roles of the management and board.

- Guidance and oversight vs. initiation and implementation
- Ensuring systems vs. timely and open communication

The tone at the top sets the corporate culture.

- Not benefiting personally from the corporation's activities / assets
- No transactions with the corporation or its affiliates that is not in line with market prices. (Related party transactions)
- Not assuming too much risk on behalf of the shareholders
- No tendency for nepotism
-

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- Critical Thinking

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The most important expectation from the board is ensuring compliance to ethical rules, beyond laws and regulations.

- Corporate Social Responsibility
- Fair Investigation
- The Responsibility to Protect the Environment
- Avoiding Misrepresentation in Public Disclosures
- Effectiveness of Internal Controls
- ...

Balanced information regarding the corporation must be shared with each member systematically and timely.

Characteristics of Information

- Only necessary and sufficient information
- Comparisons
- Current and presented in a timely fashion
- Derived from best available sources
- Simple and easy to understand
- Clearly identified main assumptions

Details of Information

- Information required to support board decisions, particularly investment and strategic issues
- Information about the industry trends, developments, and company's positioning
- Information that will allow a sound assessment of risks the corporation may face
- Information necessary to assess the corporation's performance
- Legal and regulatory developments and compliance issues
- Information related to developments at stakeholders, and relationships with them.
- Information about the internal control systems
- Key potentials within and outside the company about their competencies, experiences, and performance.
- The development plan for key executives

Dimensions of Board Information

- Context / Relevance
- Satisfaction review
- Benchmarking / Variance Analysis
- Ample time to review and study

However, most of the board decisions are made for the future, therefore access to lead indicators is important.

- **No attention to lead indicators – Late realized problems**
- **Lead indicators such as perception, satisfaction, learning and innovation are harder to measure**
- **Attention must be given to lead indicators just as the business results**
 - **Decline in customer satisfaction today - Decline in profits in the future**
 - **Decline in market share in a particular niche - Diminishing innovation capability of the company**

Examples of Lead Indicators

- **Customer complaints (Failing to learn from them, may cause bigger problems in the future)**
- **Proportion of income coming from products/services introduced in the last few years**
- **Performance at new markets**
- **Increasing or decreasing profits and variance analyses with the past performance**
- **Tendency of top management to silence people with opposing views.**
- **Indication for overconfidence of the management and underestimating the competition**

The quality of the process by which the decisions are made is as important as the quality of information feeding into this process.

Decision Making Process

- The boards should evaluate whether or not it is important or urgent and require board decision.
- The board must ensure that the alternatives presented by the management are comprehensive and that their costs, benefits, risks, and impacts are well understood.
- Often, decisions have to be made before resolving all the uncertainties. The board should identify the type of uncertainty and approach.

1. **Distinct variability** : Variability due to a number of small effects that are difficult to control are generally managed using statistical control methods.
2. **Foreseeable uncertainty**: Potential outcomes are known, but not the probability of their occurrence. Foreseeable uncertainty can be managed by utilizing “decision trees.”
3. **Unforeseeable uncertainty**: The number of potential paths and outcomes will be too numerous to be handled by decision trees, therefore in this situation, the most effective methodology to utilize is scenario analysis.
4. **Chaos**: Is usually faced only for a limited period of time. In this type of uncertainty where risks are at their peak, those players who have sufficient resources can commit them to build momentum on their preferred outcomes to shape the future.

Time stays long enough for anyone who will use it. – Leonardo Da Vinci

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- Lead indicators are relatively harder to measure
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- Is it important or urgent and require board decision.
- Alternatives presented by the management are comprehensive and that their costs, benefits, risks, and impacts are well understood.
- Identify the type of uncertainty and approach.

Vision without action is a daydream. Action without vision is a nightmare. - Japanese Proverb

Strategic thinking is the ability to differentiate on a consistent manner.

- Fit between the strategy and the resources
- Clarity of focus
- Dynamic
- Holistic

As the boards increasingly faced with choices about where to compete, managing the portfolio of businesses becomes critical.

- Monitor corporate transactions and closely follow others' actions.
- Mentally prepared for corporate transactions
- Watch the valuations and firing power
- Focus on relations with current and potential investors /creditors
- Identify which new businesses to develop or enter

One of the key responsibilities of the boards is to ensure that the organization has the right leadership, people, systems, and policies.

- Structuring the organization
- Approaching to Human Resources
- Approaching to Performance Management and Reward Systems

An appropriate choice of the CEO, needs deep understanding of the company, the environment and potential candidates.

- Ability to set a vision for the company
- High ethical standards
- Communication skills,
- Make tough decisions under uncertainty
-

Effectiveness of boards are directly linked to the quality of the communication.

- Make collective decisions
- Avoid lack of sincerity
- Separate data from opinions
- Keep the opinions from personalizing them
- Have a unified voice in communicating with the stakeholders
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Risk management is the essence of management.

What do Boards need to manage risks

- Mental preparation
- Risk sharing
- Diversification
- Financial prudence

An established risk management brings;

- A healthy corporate governance structure
- Taking controlled risks consciously without losing the entrepreneur character of the company
- The consistency of the information presented to regulatory agencies
- Creation of trust among different stakeholders
- High corporate reputation
- Not losing the focus on achieving strategic goals with the appearance of risks
- The ability to create long term value

Expectations from the board toward risk management

- a crises management plan
- these plans should be assessed at least once a year
- the plans should be checked whether they are consistent with the size of the company and the potential risks it faces
- these plans should protect the security and integrity of the corporate records
- plans for the continuity of the systems of critical importance should be established
- the precautions should be set to identify and control financial and operational risks
- systems that involve company's customer, employee, supplier, regulatory, and other stakeholder data should have a backup
- potential risks for other stakeholders should be assessed.

Power corrupts. Absolute power corrupts absolutely.

– Lord Acton

One of the key responsibilities of the board is to ensure that there is an effective oversight and internal control.

- Result oriented system vs. control oriented mechanism
- A supportive and value creating manner
- Record keeping and explanation process
- Timely provision of accurate information
- An internal audit department
- ...

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The primary function of the audit committee is to assist the board in fulfilling its oversight responsibilities.

- Assuring the quality and integrity of financial statements
- Assuring the quality and integrity of internal controls
- Assuring compliance with legal and regulatory requirements
- Implementing a dependable whistle blowing procedure
- Addressing any material violations of code of conduct
- Discussing corporate disclosures with the management
-

The effectiveness of a board depends at a minimum, on the way it addresses the following issues.

- Adoption of a strategic planning process
- A process for identifying major risk areas and ensuring adequate mitigation strategies and systems are implemented
- Succession planning, including development plans for senior management and monitoring progress as well as compensation policies to ensure ability to attract and retain high quality management team
- Communication and disclosure policies with authorities, investors, analysts, and press
- Integrity of internal control and management information systems, including assurance of the independence of the outside auditors and availability of a fair and independent whistle-blowing process
- Adoption of a self evaluation process for the board covering the composition, processes, timely and relevant information availability, culture and climate, and learning for continuous improvement areas.



Thanks for joining the debate...

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Dr. Yılmaz ARGÜDEN - Strategist

Dr. Yılmaz Argüden is a leading strategist, advisor, and board member of major public and private institutions, and NGOs. He is the Chairman of ARGE Consulting, a leading management consulting firm based in Istanbul. ARGE has been recognized at the European Parliament as one of the best three companies “shaping the future” with its commitment to corporate social responsibility and is the first Turkish signatory of the Global Compact.

He is also the Chairman of Rothschild investment bank in Turkey; Chairman or member of corporate governance committees of Coca Cola Icecek, Vestel, Yazıcı Holding, and Inmet Mining based in Toronto; an Adjunct Professor of Business Strategy at the Bosphorus University and the Koç University; an author of numerous books and a columnist focusing on business and strategy issues.

He is the National Representative of the Global Compact and a member of the Private Sector Advisory Group of the Global Corporate Governance Forum. He is a recipient of numerous leadership, distinguished citizenship, and career awards; and was selected as a Global Leader for Tomorrow, by the World Economic Forum for his commitment to improve the state of the world.

He has a Ph.D. in policy analysis from the RAND Graduate School. He is an Eisenhower, Fulbright, NATO, and Tubitak fellow.

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