



## More effective corporate governance

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Moderator: **Anne-Catherine Husson-Traore**, CEO, Novethic

**John Evans**, General Secretary, TUAC

**Grant Kirkpatrick**, Senior Economist, Corporate Governance, OECD

**Anne Molyneux**, Member, BIAC Task Force on Corporate Governance

A panel of business leaders and experts discussed the ramifications of the financial crisis for corporate governance and how past shortcomings could lead to better practices. Following recent public uproar over executive pay in the run-up to the credit crunch, panel members assessed corporate governance's possible shortcomings and examined how addressing the role of executives, corporate boards and stockholders could help prevent a similar crisis from happening in future.

**Anne-Catherine Husson-Traore** pointed out that the current crisis has highlighted three key corporate governance issues. First, many companies suffered from insufficient risk management. Second, rising dissatisfaction with ever-increasing levels of executive pay has given rise to anger among both shareholders and society at large. Third, with a past preference towards self-regulation now having yielded clearly unsatisfactory results, tougher regulation for corporate governance may be required. However, the evidence for the greater efficacy of government regulations remains inconclusive.

**Sophie de Menthon** argued that more ethics are needed for corporate governance, notably in areas such as bonuses, excessively high executive pay and "golden parachutes". According to Ms de Menthon, loose corporate governance was a continuation of the "American dream" and is no longer sustainable. Addressing executive pay, she pointed to the marked absence of regulation as well as the abuse of stock options. She mentioned that some form of global rules or legislation might be needed to ensure that executives adhere to common standards.

As a solution, she urged a move from financial capitalism towards "consumer-oriented" approach. From this point of view, she says, more personal responsibility would be required. Here, companies should restore order to executive remuneration and pay more attention to public relations. She mentioned the success of her own organisation's campaign, "J'aime ma boîte" (I love my firm).

**John Evans** represented workers' points of view, and those that have "lost jobs, pensions and homes" as these groups will be the most affected by the unfolding "social

crisis.” He mentioned that the OECD promoted globalisation as a way to spread risk, which according to Mr Evans, simply spread a “virus.”

With the boom and innovation of financial technology, firms became divided up into several parts, and this undermined corporate governance of the whole. Mr Evans also mentioned that self regulation is not enough for corporate governance, because management finds opportunities and exploits them.

Mr Evans added his own perspective to the hotly contested executive pay issue, citing statistics showing that **income inequality has reached 1929 levels**. He also added that while 25 years ago a CEO was paid 60 times more than one of their employees, in 2008 they were paid 500 times more.

According to **Anne Molyneux** we are presently facing three separate major events. First, the financial crisis, caused by deficiencies in the credit system, is leading to the re-conceptualisation of finance. Second, a cyclical slowdown of the global economy is stunting real economic growth. Third, there is a transition from a system of a single dominant economic player, in this case the US, to a system where no single country has clear dominance.

In today’s environment, Ms Molyneux maintained that businesses are most concerned about board effectiveness and risk management, although she stressed that this should not be taken to suggest a lack of concern about the issue of pay packages. The business community fully understands the anger about unreasonable remuneration for senior executives – compensation packages are down by 7% this year, even as profits have increased by 6%. Furthermore, she argued that the issue of excessive executive pay would be adequately handled by recent moves to give shareholders greater say on pay at annual meetings.

However, it would be more efficient, she noted, if shareholders were encouraged to voice their opinions on tying compensation packages to long-term value creation, rather than on specific figures, as the “going rate” for top global talent is complex to understand and difficult to determine. Ms Molyneux concluded that formal regulation on pay must therefore be light but clearly defined. To balance this, companies must be encouraged to seek independent expert advice on pay packages. This greater empowerment of corporate boards would, according to Ms Molyneux, also allow for the better handling of risk. Risk is best determined as close to source as possible, but the top decision makers should, nevertheless, be better informed.

**Grant Kirkpatrick** presented an overview of the OECD Principles of Corporate Governance. Created in response to the Asian financial crisis of 1997 and amended to reflect the weaknesses highlighted by the scandals of Enron, Worldcom and Parmalat, the principles are becoming a worldwide standard, adopted by over 50 countries as well as the Financial Stability Forum.

Now that the “receding tide” of the financial crisis has revealed further significant deficiencies in corporate governance policies, Mr. Kirkpatrick stated that the OECD has

the duty to reconsider its recommendations. He argued that while greater say on pay is important, more needs to be done. For instance, the performance measures used for evaluating executives need to be outlined with more transparency and enforced more strictly. Furthermore, high-powered incentives should be evaluated against the risks that generate them. When risk management fails, the incentive is to risk it all, take the money and run. Indeed, even significant stock holding in the company has failed to sufficiently counteract this, suggested Mr Kirkpatrick. The short term incentives may be so high that they outweigh the benefits of not yet realised gains in stock value. This is further exaggerated by the moral hazard associated with government bailouts. The highest paid often benefit from all of the upside while having no responsibility for any of the downside of their actions. With the situation so complex, and incentives so easy to get wrong, regulators should be careful, with greater responsibility given to company boards.

Following the panel presentation, **Serena Lillywhite**, representing an international network of NGOs concerned with corporate accountability, added that voluntary self-regulation is not enough and more efforts needed to be made to link corporate governance with corporate accountability. She also proposed including the social and environmental impact of corporate actions in the performance evaluations of senior executives when determining their compensation packages. She went on to say that she was encouraged by news of the re-evaluation of the OECD corporate governance principles and their consideration to revising the OECD's multinational enterprise guidelines, and asked Mr Kirkpatrick what changes the OECD would be ready to propose. Mr Kirkpatrick expressed his agreement with the need for greater transparency but pointed out that these are public policy issues, and thus best dealt with by governments.

**Paul Sweeney** of the Irish Congress of Trade Unions then expressed his strong disappointment with the views on corporate governance taken by Mr Kirkpatrick and Ms Molyneux. "Do you not realise the world is in a serious crisis", Mr Sweeney said, and the cause of that crisis lies in the failure of corporate governance and greed. He dismissed a point a panellist made on the need to retain talent, by saying "value had been destroyed like never before on planet earth" by incompetence, not talent. Rather than concern themselves exclusively with maximising shareholder value, the directors and senior executives companies should also consider their responsibilities to their employees, their creditors, and small businesses affected by the actions of their company. Mr Kirkpatrick responded that many of the issues raised by Mr Sweeney are actually addressed in the recommendations of the OECD, and were not explicitly discussed during the session due to time constraints.

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