Insights from the **Boardroom**

Herman Daems on *Corporate Governance*

LANNOO CAMPUS

Contents

What this book is about

What does the board of directors of a limited liability company or not-for-profit organisation actually do? What does the board chairman or woman do? What exactly is expected of a board member? And how is the role of a board of directors or, to use a more academic term, a governing body, likely to change in the future? These are all questions which I address in this book. I have in fact been wrestling with some of these points for many years and, to be perfectly honest, I still haven't entirely made up my mind about everything. However, I am far enough along the road with my thinking to be able to put forward some useful answers.

Due to a chain of circumstances and coincidences, I have for a number of years had the opportunity to sit on the boards of some 25 European and US companies and organisations, serving as chairman of the board for eight of these. They come from an extremely wide variety of sectors, ranging from finance to technology, infrastructure, manufacturing and the world of publishing. They include not only established corporations but also startups and organisations in the health and cultural sectors. The experiences that I've had have made me think hard about my real role as a director or chairman of the governing bodies of the various companies and organisations in which I served.

A board member or chairperson must certainly do 'something' that creates added value. This sounds reasonable enough, but what exactly does it mean? What is the added value of a governing body or an individual director who sits on it? And for whom should this added value be created? In order to answer these questions, I started to think about the role of a governing body and how it can be made to work well.

Entire libraries have already been written about what these days is generally known as 'corporate governance'. Many of these books are prescriptive, i.e. they set out what a board ought to do. They say very little about what board members really do or can do. Moreover, most of the books and articles on this subject are written by lawyers or other authors who have themselves rarely had the experience of sitting on a board. The lawyers tend to set out with hair-splitting precision what the law requires of a board and the individual directors, their duties and responsibilities, but they don't say what happens in reality. A governing body not only has to deal with legal questions but also with practical issues for the running of the organisation. However, corporate governance experts usually concern themselves primarily with what directors are required to do, not with what they actually do or don't do.

Let's take an example. In order to drive a car on the road, you need a good knowledge of the Highway Code. You need to know what the various road signs mean, how fast you're allowed to drive, who has right of way in what situation, and the conditions a person needs to fulfil in order to be able to drive a vehicle. All this is very important. Without the Highway Code, safe driving would be practically impossible. However, the Highway Code tells you nothing about how to actually drive a car. A person who knows the Code by heart will not necessarily be able to start the car engine, let alone drive the vehicle and park it without causing any damage. These skills have nothing to do with simply knowing the contents of the Highway Code.

A person who knows the Highway Code will not necessarily be able to drive a car. The situation in the boardroom is very similar.

It's clear, however, that the one is not possible without the other. And just as someone who has an excellent mastery of a car will not be able to drive it safely without a good understanding of the rules of the road, a person who has the appropriate skills for a board member will not perform well in terms of corporate governance unless s/he understands the duties and responsibilities of a director. You can't have one without the other.

This book is not about laws and codes. It's about what directors do or ought to do in practice. The book is based on what experience has taught me. But right away I have to disappoint anyone who's looking for revelations or exposés. My aim is not to write an account of my own experiences but to try to provide useful insights on the basis of those experiences.

I am, of course, fully aware that experiences represent only part of the truth and that laws and codes are also a vital element. In fact, I would be unlikely to have any other opinion on this, given that I'm a former chairman of the Belgian Commission on Corporate Governance which drew up the 2009 Belgian Corporate Governance Code. However, creating added value as a board member implies much more than simply obeying the law or following a code. It calls for insights into the real role and workings of a corporate governance body.

My insights are based on the experience that I've been gathering continuously from 1990 to the present day. This has been a significant period. When I first became a director at various enterprises and organisations in Belgium, the corporate governance movement was in full swing, resulting in the Belgian Corporate Governance Code for companies listed on the stock market and the highly influential Buysse Code – drawn up by Count Paul Buysse – pertaining to unlisted businesses. Governance codes have been fully applicable during the greater part of this period, but we were still working with the 'old' Belgian company law. Now there are new developments in the law and in the Belgian Corporate Governance Code, which are likely to lead to different experiences. Here I'm thinking mainly about the option for Belgian-based companies that wish to introduce a 'two-tier' governance system, i.e. with separate supervisory board and management board.

Nevertheless, I believe that the recent changes to the legislation and the Code make very little difference to the insights that I put forward in this book. There are two reasons why I believe this. First of all, as chairman of a large Belgian bank, I've had long experience of working with separate supervisory and management boards. Banks in Belgium have been required to work this way for decades. Moreover, as chair of the governing body of the University of Leuven, I'm perfectly accustomed to working with a two-tier board structure. I've also had the chance to experience the workings of a two-tier board system at Netherlands-based companies.

The second reason is of a different kind. Although Belgian companies now have the legal option of introducing a split board structure, I'm not yet convinced that the majority will actually choose to do so. In particular, when a business is in the hands of controlling shareholders who like to keep their fingers firmly on the pulse, there will be no great pressure to bring in a two-tier board. Nor do the professional managers in Belgium have the power or influence at this moment in time to impose a two-tier approach on their shareholders. It will however be interesting to see whether state-owned enterprises opt for a two-tier structure.

The new *Belgian Code of Companies and Associations* (BCCA)[1] provides that members of the board must direct all their actions towards achieving the purpose or object of the company or not-for-profit organisation. This is a clear duty, but the provision is so wide that it offers very little practical guidance. It's as if you were to tell a pilot that s/he must do everything to keep the aeroplane in the air. S/he clearly has a duty to do so, but this tells you nothing about what exactly the pilot can and must do in order to keep the plane

1 The term used in Belgian law – vereniging (NL) or association (FR) – confers a specific meaning on the word 'associations', relating to the fact that while these organisations may make profits, they are not owned by shareholders who have the right to appropriate the profits made and/or sell their rights to future profits in the form of stock or shares.

flying. I therefore intend to give more concrete form to the general duty *"to do everything necessary in order to achieve the object"*[2] of the company or organisation, by breaking it down into four core tasks: setting the course for the organisation; supervising/monitoring the management; setting standards and promulgating corporate values; and taking responsibility/being accountable for what happens at the firm or organisation.

There are factors other than legislation or the principles laid down in codes that determine why corporate governance bodies differ sharply in the way they carry out these four central tasks. For instance, regardless of what the legislation lays down, some boards are more geared to taking on a course-setting role, while others lean more towards the purely supervisory aspect. Why is this? Quite simply because the context in which boards work varies considerably. One important contextual factor is the shareholder structure. Later in the book, I'll explain the experiences I've had with different shareholder structures. It can make a very big difference whether you're a board member at an enterprise in which one family or a particular group has virtually total control or whether different branches of a single family or various other shareholders are involved. If the company is listed on the stock exchange, that of course also makes a difference, but the simple fact of being listed doesn't in itself explain everything. An additional question is whether or not a listed firm has controlling shareholders or a major shareholder among its stockholders. A further difference arises when the state holds a stake in the company. The shareholder structure is therefore certainly one factor that helps to determine the way the board works, but there are other factors as well. I'll be dealing with these in some detail in this book.

My main conclusion is that there isn't only one single type of governing body in existence. There are literally hundreds, differing widely from one another. This doesn't mean that every governing body is

2 The BCCA speaks of 'object' rather than 'purpose'.

carrying out an entirely different set of core tasks from all the others, but rather that there will be variations in the relative importance of the four core duties that I listed above. These variations help to determine the way in which each governing body works in practice.

So what are the foundations on which a governing body is built? What issues need to be settled and what agreements must be reached so that a governing body can work properly? The main factors here are, inter alia, the composition of the board of directors, the role and workings of the committees that advise the directors, the style of meetings, the allocation of tasks between the chair, the board members and the management, plus the way the chairperson and the chief executive officer (CEO) or general manager work together. In this book I'll be discussing these building blocks and showing how the context in which the company or organisation works is of crucial importance for the various components.

In the first three chapters, I'll describe the core tasks, the context and the building blocks of a governing body. In so doing, I'll try to show what a governing body actually is. In the following chapters, I'll attempt to clarify how a governing body works. I'll describe in turn the matters that a board discusses, decides and approves, what the chairman or woman does or can do, and how a board meeting is run.

A governing body or board is a meeting point where people representing various interests come together to make collective decisions about the course the company or organisation should take and the resources needed to do so, and also to assess whether the resources allocated are being properly used. Whenever different people and different interests confront each other, tension will always arise. Such friction is not necessarily a sign of failures in the organisation, though this cannot, of course, be ruled out. However, even in the most successful organisations, you can't avoid some blustery weather at the top. It's a simple fact that around the boardroom table you'll find a range of interests, opinions and characters. In my experience, friction surfaces when the various players at the top of the organisation don't stick to their appointed roles or don't perform those roles in a proper manner, for instance when the chair behaves like a CEO or board members act as if they were managers. Later on, I'll argue that you can avoid friction at the top of the organisation if everyone fulfils the role that s/he is supposed to play.

While most people usually know very little about what a board of directors does, they generally know even less about the role of the board chair. I therefore devote an entire chapter of the book to this subject, inter alia explaining the difference between a board chairperson and a chief executive. It must be clearly understood that the chief executive officer is the captain of the corporate ship. The task of the chair is then to ensure that the CEO is able to steer the ship properly and that the vessel stays on course in the event of a storm. In the United States, companies often prefer to have everything in the hands of one leader, appointing a single person to perform both these jobs with an impressive title such as Chairman & CEO. In Europe, these posts are usually allocated to two different people. I personally advocate this latter approach. I don't see any danger of dog-fights breaking out in the boardroom as long as the chair and the chief executive understand and accept the fact that each of them has a different role to play. It's perhaps not so different from the theatre; if one actor steals lines that belong to a fellow actor in the play, there's bound to be trouble!

One of the most difficult tasks of a board of directors is knowing what you need to know. There's a kind of paradox here. The directors are supposed to know everything in order to be able to fulfil their core duties but, quite obviously, they cannot know absolutely everything about what goes on in the organisation. The board has to wage a permanent struggle not to be left in the dark about what's happening. Governance is all about managing your ignorance. In this book I'll talk about the numerous tools that have been developed to keep the directors informed about the real issues facing the organisation. However, perhaps the most important factor here is trust between the directors and the management. If there's a

Governance is all about managing your ignorance.

high degree of trust, managers will spontaneously inform the directors about what's going well and what isn't.

So what exactly is expected of a board member and how can someone become a good director? The very least that can be expected of a board director is that s/he will form an independent opinion about the matters that the board has to deal with. Moreover, s/he must express that opinion: silence is not an option. At the same time, s/he should also understand that the discussions that take place in the boardroom on a given subject must lead to a decision. The company or organisation needs to move forward. Serving as a company director is something that appeals to a lot of people. Many think they fit the bill but not all of them grasp what the job is all about. As a director, you don't have the satisfaction of leading a group of people. You can't just roll your sleeves up and go to work. You make decisions, you give your approval, you assess, advise and encourage, but you don't get to taste the fulfilment that comes from hands-on implementation, because that side of things is the province of the CEO and the management. Being a supporter of a sports team is not at all the same thing as being a player.

In the final chapter, I speculate about how governing bodies are likely to evolve and how the directors' job is going to change. I foresee that both for-profit companies and not-for-profit organisations will in the near future undergo a transformation that will not leave their governing bodies unaffected. There are a number of reasons for these expected changes. First and foremost, our society is changing and there are calls for more transparency and greater engagement with society. Some companies and organisations will be expected to explain more clearly what they're doing and why they're doing it. There are now loud calls for corporations in the financial industry and the health sector, plus also digital technology and data companies and any business that has a high impact on the environment or the climate, to give a full account of their actions.

The disruptions brought about by digital technology are also bringing about quite a lot of governance-related changes within organisations. The need to have a clear 'purpose' – a key concept which I shall explain later in the book – is going to become of great importance for both for-profit companies and organisations without profit motive. Sometimes there will have to be a trade-off between purpose and profit, as several experts including Oxford economist Professor Colin Mayer, Larry Fink – the renowned CEO of Black Rock, one of the largest investment funds in the world – and Financial Times editor Andrew Edgecliffe-Johnson have argued in various books and opinion pieces. Readers will be aware that the famous dictum of the late Nobel Prize winner Milton Friedman that "the social responsibility of business is to increase its profits" has taken a hefty knock in recent years.[3]

Companies and organisations will increasingly have to deal with four basic issues: 1) how is control over the company organised? 2) who bears the risk arising from the decisions that are taken? 3) how is the supervision of a company or organisation that has raised funds from third parties organised? and 4) what is the purpose of the company or organisation? It has generally been standard practice to leave these four issues to the shareholders. Legal structures have been developed and introduced precisely for this purpose. Now we're seeing the start of a bifurcation. Especially in the United States, companies issuing non-voting shares are being set up. In such cases, some shareholders consequently have no say in the running of the business but they still bear part of the risks. We're also seeing company structures with similar effects being established in Europe. Once it becomes possible to confer multiple voting rights on some of the shareholders, that creates a dichotomy between having control and bearing risk,

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3 Collin Mayer – *Prosperity. Better Business makes the Greater Good.* Oxford University Press, 2018; Larry Fink – *Purpose & Profit. Larry Fink's 2019 Letter to CEOs*, BlackRock; Andrew Edgecliffe-Johnson – *Beyond the Bottom Line: should business put purpose before profit?*, Financial Times, 4 January 2019; Milton Friedman – *The social responsibility of business is to increase its Profits,* New York Times Magazine, 13 September 1970.

which then poses special challenges for the board of directors. On the one hand, the board has to cope with the fact that, in such cases, control over the company is more streamlined, while on the other hand the board needs to take care that non-voting investors, who bear some of the risks, are protected against any irresponsible or reckless behaviour on the part of the management and the shareholders who exercise control over the company. This will inevitably lead to boards becoming more professional.

In the financial sector some people envisage a sort of certification system for directors. The proponents of this approach see it as a logical extension of the existing procedures intended to subject directors of financial institutions to what are known as 'fit and proper' assessments – i.e. continuous assessment of whether a bank board member is a suitable person, from both a knowledge and behavioural point of view, to carry out his/her directorial duties. Will we see further expansion of this kind of requirement for directors? I don't know, but I wouldn't rule it out, given that the wider society would certainly like to see more governing bodies being able to perform their central duties in a more expert and standardised manner. However, this approach may well have its drawbacks. If companies and organisations are to work successfully, they need to be able to draw on diverse skills and experience. Creating a caste of professional board directors is unlikely to be conducive to meeting this need.

Acknowledgements

A large number of business leaders, heads of organisations and company shareholders have directly or indirectly contributed to the opinions that I have set out in this book. I'm quite sure that not all of them will agree with what I've written in these pages. I offer my sincere apologies to those whose ideas I haven't followed and to any who are taken by surprise by some of my more daring pronouncements. I can however assure them all that their ideas have profoundly influenced my views. I hope that the new ideas I'm putting forward here, especially in the last chapter, will make this book an interesting read, not only as an intellectual exercise but also as a practical guide to running a company or organisation.

Since 1990, I've served as chairman or board member of some 25 companies and organisations in Europe and the United States and have consequently been involved in a good number of business sectors, including chemicals, glass, high tech, software, publishing, as well as banking and insurance, private equity and venture capital. Five of those companies were listed on the stock exchange or launched on the stock market while I was chairman or a director. Meanwhile, the not-for-profit organisations on whose boards I sat brought me into contact with healthcare, the cultural sector and higher education. The average period during which I served as a director at these organisations has been six and a half years, my 15-year tenure of the board chair at a listed technology corporation being the outlier here. In total, I have been – or still remain – chairman of the governing body of eight companies or not-for-profit organisations.

I'm also familiar with the workings of committees reporting to governing bodies: I've chaired audit committees, remuneration committees and hiring committees and served as a member of strategy committees and risk committees. All in all, I've had the opportunity to build up broad experience, in terms of both the number of companies and the number of different sectors in which I've served as a director.

The people whom I'd like to thank first are the chairs of businesses and organisations that gave me the opportunity to sit on their boards. Next, I'd like to thank those chief executives of Belgian and foreign companies and organisations who placed their trust in me, firstly as a director and later on as chairman. I sincerely hope that I've never betrayed their trust and that I've been able to give them some useful support. In addition, I owe acknowledgement and a large debt of thanks to the members of the governing bodies which I've chaired. I very much hope that our board meetings have borne their fruit in building up those enterprises. My sincere thanks also go to the shareholders of family businesses for whom I served not only as a board director or chairman but also as a reliable confidant.

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Last but not least, my thanks go to KU Leuven, where I've had the opportunity to do practically everything – study, teach, publish and latterly also to chair the governing body.

I also gained considerable experience and picked up a lot of ideas during my chairmanship of the Belgian Corporate Governance Commission from end-2008 to 2013. A big thank-you to all the members of the Commission for what I learned from them.

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Barcelona and at the joint Harvard Business School/ IESE programme for company directors. The questions, remarks and real cases that so many international participants have brought up over the years have really helped me to formulate my opinions. Sincere thanks to all of them, and especially to the IESE management, who have always supported me and involved me in their international initiatives.

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Moreover, I have to acknowledge a considerable intellectual debt to the hundreds of board chairpersons and chief executives who took part between 2010 and 2017 in the annual Corporate Governance Summit run by the Deloitte professorial chair at KU Leuven.

If you want to publish a book, you need ideas. However, those ideas will turn into a readable book only when you've written a readable text. In this process, I've benefited enormously from the support of a small but dedicated editing committee, whose members have undertaken a critical reading of the text. I'll never forget the intense discussions we've had at the Ducale House in Brussels. Many thanks to this loyal and highly committed editing team. They have done their utmost to prevent me from making any errors, whether in my thinking or spelling and grammatical constructions. If any uncorrected inaccuracies remain in the text, these are entirely my own responsibility.

Sincere thanks also to my personal assistant at the Bank and the excellent team working at my publishers, LannooCampus. Without their dedication, patience, encouragement and professional support, this book would never have seen the light of day.

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Herman Daems

CHAPTER 1

The core duties of a board of directors

Little-known and poorly understood

What the governing body of a for-profit company or an organisation without profit motive does is not generally well understood. Many people are simply unaware of the contribution these directorial bodies make to the workings of the economy and the wider society. However, they have a far-reaching remit and carry considerable responsibility. Below, I provide an outline of the core tasks of a board of directors.