Future of Governance and Leadership Post-Financial Crisis

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What is Corporate Governance?

Corporate governance involves a set of relationships between a company’s management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring.

OECD Principles of Corporate Governance, 2004
What is Corporate Governance?

Corporate governance refers to the processes and structure by which the business and affairs of the company are directed and managed, in order to enhance long term shareholder value through enhancing corporate performance and accountability, whilst taking into account the interests of other stakeholders.

Report of the Committee and the Code of Corporate Governance (Singapore), 2001
What is Corporate Governance? – A Public Sector Definition

...corporate governance generally refers to the processes by which organizations are directed, controlled, and held to account, and is underpinned by the principles of openness, integrity, and accountability. Governance is concerned with structures and processes for decision-making, accountability, control and behavior at the top of organizations.

The Anglo-American Corporate Governance Framework for a Private Sector Corporation
The Two-Tier Board Structure
What is Leadership?

the lifting of people’s vision to a higher sight, the raising of their performance to a higher standard, the building of their personality beyond its normal limitations (Drucker, 1985).

wps.prenhall.com/wps/media/objects/213/218150/glossary.html
What is Leadership?

The ability to lead, including inspiring others in a shared vision. Leaders have clear visions and they communicate these visions to their employees. They foster an environment within their companies that encourages risk taking, recognition and rewards, and empowerment allowing other leaders to emerge.

strategis.ic.gc.ca/epic/internet/
instco-levc.nsf/en/
hqw00037e.html
What is Ethics and Integrity?

- What is ethics? Motivation based on ideas of right and wrong (WordReference.com)

- What is integrity? Doing the right thing when nobody is watching and even if it costs you personally

- A person with integrity will behave consistently at home, work and at his place of worship

- Integrity is something you either have or you don’t. It is significantly determined by how a person is brought up.
What is Ethics and Integrity?

- What integrity is **not**:
  - it is **not** just about obeying rules
  - it is **not** about doing things right
  - it is **not** just about doing the right thing
Myths about Governance, Ethics and Leadership

• Myth 1: Governance Stifles Leadership/Entrepreneurship

• Myth 2: Ethics and Governance are Bad for Business

• Myth 3: We Should Not Expect Our Leaders to Have Both Integrity and Competence
Myth 1: Governance Stifles Leadership/Entrepreneurship

• Justification for the US model of a single Chairman of the Board and CEO is that there is a need for a unified leadership, and that this explains the superior performance of US companies

  – the US financial crisis has at least partly discredited this
  – more US companies are separating the two roles
  – globally, having a separate Chairman and CEO is accepted as best practice
Myth 1: Governance Stifles Leadership/Entrepreneurship

Wondering aloud how “the board of directors allowed itself to be almost completely captured by the former CEO,” he said: “No organisation can leave just one man to make decisions. Like in old China, when the emperor says this, and that’s it, things are done.”

Health Minister Khaw Boon Wan, on the old NKF Board (The Straits Times, December 4, 2005)
Myth 1: Governance Stifles Leadership/Entrepreneurship

“In my family, my husband makes all the major decisions. So far, there have been no major decisions.”

Anonymous (not my wife)

This is not a good way to run a company!
Myth 1: Governance Stifles Leadership/Entrepreneurship
Myth 1: Governance Stifles Leadership/Entrepreneurship

Corporate governance codes expect boards to provide entrepreneurial leadership, but to ensure that there are prudent and effective controls in place to assess and manage risks.

You cannot run a successful business if you do not have good risk management in place.
Myth 2: Ethics and Governance are Bad for Business

• Johnson & Johnson’s Credo, crafted in 1943, states its priorities in doing business:

  – “We believe our first responsibility is to the doctors, nurses and patients, mothers and fathers and all others who use our products and services…”

  – “We are responsible to our employees, the men and women who work with us throughout the world…”

  – We are responsible to the communities in which we live and work and to the world community as well…”
Myth 2: Ethics and Governance are Bad for Business

– Our final responsibility is to our stockholders…When we operate according to these principles, the stockholders should realise a fair return”

• Johnson & Johnson was ranked No. 1 in the 2008 Barron’s World’s Most Respected Companies list, a survey of top investors (and was No. 1 in 3 of the last 4 years)

• It is consistently ranked the most admired pharmaceutical company and top 10 of all companies in the world in Fortune’s list of Most Admired Companies
Myth 2: Ethics and Governance are Bad for Business

• Undoubtedly, there is a “cost” to behaving ethically, especially when one is competing in markets where ethical practices are the exceptions rather than the norm

• But to build a sustainable business, ethics and governance are fundamental
Myth 3: We Should Not Expect Our Leaders to Have Both Integrity and Competence

"Somebody once said that in looking for people to hire, you should look for three qualities: integrity, intelligence, and energy. And if they don't have the first, the other two will kill you. You think about it; it's true. If you hire somebody without the first, you really want them to be dumb and lazy"

Warren Buffett
Myth 3: We Should Not Expect Our Leaders to Have Both Integrity and Competence

- 3 C’s (required of directors and managers):
  - Character (which includes integrity)
  - Competence
  - Commitment
Myth 3: We Should Not Expect Our Leaders to Have Both Integrity and Competence

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Examples of Ethical and Governance Scandals

- China: scandals involving tainted pet foods, toys, and milk powder
- Hong Kong: Global Tech, CITIC Pacific
- India: Satyam
- Singapore: Citiraya, CAO
- South Korea: Hyundai Motor, Samsung
- Australia: ABC Learning Centres
- US/Europe: Enron, WorldCom, Parmalat
Examples of Ethical and Governance Scandals

• All the scandals involve one or more of the following individuals:
  – Controlling shareholder
  – Chairman
  – CEO

• Poor tone at the top
Examples of Ethical and Governance Scandals

K, the executive chairman of Company S, was charged with 125 counts of insider trading, non-disclosure of shareholding changes and destroying documents that could have been used as evidence. The company said that the chairman will continue with his current duties as executive chairman and managing director. `The board wishes to emphasise that the charges pertain to K in his personal capacity and do not affect the operations of Company S which is not under any investigation,’ it said.

www.cgfrc.nus.edu.sg
Examples of Ethical and Governance Scandals

Y is the CEO of Club M. Company P, an IT company, had business dealings with Company N - a wholly-owned subsidiary of Company O, which is the investment arm of Club M. Y is a director of Company N. Y became a director in Company P when Club M acquired a majority stake in Company P. Y became a shareholder of Company P when he bought over 14.27% of Company P shares at $0.02 apiece. Later, Company N gave over $1 million to Company P for supplying cards and card readers, which were used in amusement arcades and computer games centres. Y did not declare his interest in the transactions involving Company P to the other board members of Company N, despite being required to by the Companies Act. Y was fined the maximum $5,000.
Examples of Ethical and Governance Scandals

• “Lawyers say the charges against Y are ‘minor’ and it seems unlikely that the former MP would be jailed, or disqualified from acting as a director, even if he is convicted’ (ST, 20 April 2007)

• Y remains as CEO of Club M and sits on 8 listed boards, including those he joined after his conviction
Examples of Ethical and Governance Scandals

`She is the only one, at this point, who can effectively handle relations between CAOHC and the Singapore team - a matter which is key to CAO's future survival,’ …. Sources, however, also told BT that Gu may not be appointed chief executive immediately or in the near future as she still faces criminal charges relating to the CAO scandal. She was charged in June for breaching her fiduciary duties as a director and for failing to disclose CAO's huge options trading losses of US$550 million … Sources say it's likely that an interim CEO will be appointed first, with Gu taking over only when her charges are resolved - even if that means she will only become CEO a year from now.

Gu Yanfei tipped to be new CAO head
[Business Times, 19 October 2005]
Examples of Ethical and Governance Scandals

SEE Hup Seng yesterday said its board has 'unanimously' decided to retain the services of its CEO and executive director, Yap Sew, who was ordered by the Monetary Authority of Singapore (MAS) on Monday to pay a civil penalty of $50,000 for insider trading…See

Hup Seng said its board, after considering several factors, 'unanimously decided that it would be in the best interests of the company that Mr Yap Sew be retained in his current capacity'.

It added that, after some deliberation, the board took into consideration that the incidents had taken place in 2006 when Mr Yap was not a director or employee of the company. he has been instrumental in rationalising the company, including successfully implementing key business strategies which helped transform the company from six years of losses to healthy profitability since 2006.

Business Times, 4 September 2008
Examples of Ethical and Governance Scandals

Boeing has ordered its Chief Executive Harry Stonecipher to step down because of what the U.S. aircraft giant said was an improper relationship with a female executive. The company said the female executive, who has not been identified, did not report directly to Stonecipher and that the relationship was consensual and had no effect on the conduct of the company's business. But it said the relationship violated Boeing's code of conduct… "the board concluded that the facts reflected poorly on Harry's judgment and would impair his ability to lead the company,“…
Examples of Ethical and Governance Scandals

"The resignation was in no way related to the company's operational performance or financial condition, both of which remain strong," Boeing said in a statement. "However, the CEO must set the standard for unimpeachable professional and personal behavior. And the board determined this was the right and necessary decision under the circumstances..

Boeing fires CEO over relationship
(www.cnn.com, 7 March 2005)
Examples of Ethical and Governance Scandals

John Browne has resigned from the board of Wall Street bank Goldman Sachs weeks after stepping down as the chief executive of British energy group BP amid revelations on his personal life. Browne stepped down suddenly from BP's helm after conceding that he had lied to a British judge in witness statements about how he met Canadian Jeff Chevalier, his former partner of four years. Browne had been due to retire from BP in July, but advanced his retirement after it emerged he had not been truthful in his court submissions.

AFP, 11May 2007
What Sort of Standards Should Business Leaders Be Held To?
Tone at the Top

• Companies, especially SMEs, are often highly dependent on a founder/controlling shareholder.

• Dilemma when founder/controlling shareholder behaves illegally or unethically. Removing him may threaten the survival of the company, but not removing him may create an poor ethical culture within the company.

• Companies may put competence/performance above ethical conduct
Tone at the Top

• In Asia, individuals who have behaved illegally or unethically often do not face sanctions beyond what is punishable by law – further, the range of legal sanctions is often limited.

• In some cases, individuals who appear to have committed serious breaches also did not face legal sanctions, possibly because of difficulty of proof in criminal actions and cost of private actions.

• This creates difficulty in raising ethical and governance standards in many companies.
You will almost certainly face situations where you will be pressured to behave unethically or come across wrongdoing during the course of your career. Would you sacrifice your career to do the right thing?
Responsibility for Improving Ethics

• **Individuals and companies**
  • for example, by imposing minimum standards on suppliers and other business partners

• **Governments/regulators**
  • must take action for legal breaches
  • poor public governance, conservative approach to enforcement, lack of enforcement capacity, jurisdictional issues all hinder enforcement actions

• **Investors**
  • need to move away from excessive focus on short-term performance
Future of Governance and Ethics

- High standards of governance and ethics are likely to become a business imperative because of the following:
  - global financial crisis
  - tainted milk, pet food, toys, etc.
  - Satyam and other scandals

- Long-term investors, including institutional investors, are likely to focus more on environment, social and governance (ESG) perspective in their investments
Future of Governance and Ethics

- Multinationals are likely to focus more attention on ethics and governance risks across the value chain.

- Impact beyond listed companies – SMEs doing business with multinationals will also have to raise standards.
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Slides can be downloaded from www.cfgrc.nus.edu.sg