



An increasingly rare breed

'Board balance has shifted dramatically ... Today, half of all FTSE 100 companies have only the chief executive and finance director as management members of the board. In the FTSE 250 index, about two-thirds of companies have only those two officers serving as directors.'

Kit Bingham, Partner and Head of the Chair & Non-Executive Director Practice, Odgers Berndtson

Conclaves

'According to [Brazil's] major custodian of foreign investors, approximately 30 per cent of all voting instructions received are made void because of expired proxies. Additionally, the lack of a stamp can be used as the reason to contest a specific shareholder – usually the one that wants to vote against the Board of Directors' decisions.'

Mauro Rodrigues da Cunha, CEO, AMEC

Content

News	3	Women on Boards 2013 The latest update of the Davies Report into gender diversity on the boards of the FTSE 350 shows that progress towards the 25 per cent target appears to be losing momentum and highlights the differences between the appointment of women as non-executives as opposed to executives
	4	International Integrated Reporting Framework The IIRC has released the Consultation Draft of its proposed International Integrated Reporting Framework. The Framework does not seek to replace financial reporting but to build on it by broadening the key concepts disclosed and embedding integrated thinking into the organisation
International	5	EC changes to non-financial reporting The European Commission (EC) has adopted a proposal for a Directive to improve the transparency of non-financial reporting within the annual reports of certain large companies
Features	6	Collaborative leadership in the boardroom David Archer and Alex Cameron look at the importance of all board members having the skills associated with collaborative leadership to optimise board performance
	8	An increasingly rare breed Kit Bingham considers the tendency to have only the CEO and CFO sitting on UK listed company boards and looks at the pros and cons of increasing the number of executive directors
	10	Conclaves Mauro Rodrigues da Cunha looks at current issues affecting shareholders' ability to engage with the Brazilian companies they invest in

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News

Women on Boards 2013

Two years on from Lord Davies' report, *Women on Boards*, a second annual review has been published tracking progress in increasing the number of women on company boards. This latest annual report shows that progress continues to be made with more women in decision-making roles, greater female representation in the boardrooms of the UK's top companies and a growing recognition of the benefits gained by business, the economy and wider society.

However, whilst the report supports a voluntary-led approach, 'quotas are still a real possibility if [the] 25% target of women on boards of FTSE 100 companies [is not met] by 2015', according to UK Business Secretary, Dr Vince Cable.

The review also describes the recognition and importance of:

- promoting gender equality on the boards of UK listed companies, and
- making use of the talents and skills of the whole population.

Current status

As at 1 March 2013 the figures show within the FTSE 100:

- women now account for 17.3 per cent of all directorships, up from 10.5 per cent in 2010,
- women have accounted for 34 per cent of all board appointments (45 out of 134 appointments) since 1 March 2012,
- there are currently 94 boards with female representation,
- there are now 192 women directors on FTSE 100 boards out of a total of 1,110;

and within the FTSE 250:

- women now account for 13.2 per cent of all directorships, up from 6.7 per cent in 2010,
- women have accounted for 26 per cent of all board appointments since 1 March 2012,
- there are currently 183 boards with female representation,
- for the second year running, all-male boards are in the minority at 26.8 per cent.

Whilst some progress has been made – 94 of FTSE 100 and a third of FTSE 350 companies now have women on their boards – the momentum seems to be slowing. There has also been less progress in executive appointments at the top.

Only six all-male boards remain in the FTSE 100, down from 21 in 2010, and there are only 67 all-male boards in the FTSE 250 (26.8 per cent, down from 52.4 per cent in February 2011). Vince Cable has written to these remaining all-male FTSE 100 and FTSE 250 boards asking them what steps they are taking to increase the diversity in their boardrooms.

Executive pipeline

The executive pipeline continues to remain a challenge. Women currently hold 21.8 per cent of FTSE 100 non-executive directorships and 6.1 per cent of executive directorships, whilst in the FTSE 250 women hold 16.4 per cent of non-executive and 5.4 per cent of executive directorships. This translates, in numerical terms, to just 18 female FTSE 100 executive directors compared to 292 males, and just 32 female FTSE 250 executive directors compared to 558.

A genuine risk that has been reported is that of women opting out of executive careers in favour of a plural non-executive career route. When the average board is made up of just three executive positions and around eight non-executives, there are many more opportunities for individuals to attain a non-executive role rather than an executive one. This is a new challenge that must be addressed to prevent women becoming side-lined into supervisory non-executive roles whilst the active day-to-day business of running companies is left to their male counterparts.

The Report recommends that companies release executive committee members to serve on the boards of other companies as part of the overall executive development plan, thus allowing executive committee members to gain experience and show their credibility at board level whilst sharing best practice amongst the top companies.

The recommendation that FTSE 350 chief executives set out the percentage of women they aim to have on their executive committees, including senior management levels within their organisation, in 2015 is reiterated and it is suggested that those who have not done this should do so by the end of September 2013.

Future actions

- Chairmen should review their targets for 2015 and encourage other companies that have not yet set targets to do so.
- FTSE 250 companies should also set targets for the number of women they aim to have on their boards in 2015, aiming for a minimum 25 per cent target.
- FTSE 350 chief executives should set out, by the end of September 2013, the percentage of women they aim to have on their executive committees and in senior management levels within their organisation in 2015.
- Executive committee members should be released to serve on the boards of other companies as part of the overall executive development plan.
- Companies should conduct a pilot for advertising director opportunities to test the benefits and pitfalls of advertising.

To see the full report go to: www.gov.uk/government/uploads/system/uploads/attachment_data/file/182602/bis-13-p135-women-on-boards-2013.pdf

News

International Integrated Reporting Framework

The International Integrated Reporting Council (IIRC) has released the Consultation Draft of its proposed International Integrated Reporting (<IR>) Framework. The draft Framework seeks to create the foundations for a new reporting model which will enable organisations to provide concise communications of how they create value over time.

Features of the Framework include:

- fundamental concepts, such as capitals, business model and value creation;
- guiding principles, such as strategic focus and future orientation, connectivity and materiality; and
- content elements including organisational overview, governance, opportunities and risks, strategy, performance and future outlook.

The draft Framework is intended primarily for the companies in the private sector, but the Consultation Draft indicates that it 'can also be applied, adapted as necessary, by public sector and not-for-profit organisations'.

Objective

The purpose of the Framework is to assist organisations with the process of <IR>, in particular helping organisations determine how best to express their unique value creation story in a meaningful and transparent way.

The Framework does not, however, set benchmarks for things such as the quality of an organisation's strategy or the level of its performance.

Fundamental concepts

The Framework outlines three fundamental concepts underpinning <IR>:

Capitals – stores of value that an organisation depends on for its success as inputs to its business model, which are increased, decreased or transformed through its activities and outputs. These broaden the current focus on financial and manufactured capital, including intellectual, human, social and relationship capital (linked to human activity), and natural capital, which provides the environment for the other capitals. Not all of these capitals would be relevant to all organisations and organisations may define additional capitals, or consider some items to be across capitals.

Business model – how an entity creates value, through a chosen system of inputs (resources), business activities, outputs (products and services) and outcomes (internal and external consequences both positive and negative).

Value creation – the concept of 'value' for <IR> purposes is broader than traditional meaning of value focused on financial performance, and includes other forms of value that are created through the increase, decrease or transformation of capitals, each of which may ultimately affect financial returns. Accordingly, value is broad in concept, encompasses different time horizons for different stakeholders and requires a focus on all relevant capitals.

The Framework also promotes the alignment of external and internal reporting, particularly at the top level of an organisation, as being 'nearly always appropriate, even for the most complex of organisations'.

Building blocks

The Framework develops the requirements for an integrated report through:

- *Guiding principles* – underpinning the preparation of an integrated report, these are: strategic focus and future orientation, the connectivity of information, stakeholder responsiveness, materiality and conciseness, reliability and completeness, and consistency and comparability.
- *Content elements* – categories of information required to be included in an integrated report under the draft Framework, presented as a series of questions rather than a prescriptive list of disclosures.

The Framework does not seek to replace financial reporting but to build on it by broadening the key concepts disclosed and embedding integrated thinking into the organisation.

The Framework also acknowledges that technological advances 'enable innovative approaches to reporting' and that web-based media and XBRL (eXtensible Business Reporting Language) may be useful for <IR> in linking a concise integrated report and detailed and other information.

Differentiation

Although <IR> builds on developments in financial and other reporting, an integrated report differs from other reports and communications in a number of ways. In particular, it has a combined emphasis on: conciseness, strategic focus and future orientation, the connectivity of information, the capitals, the business model, the ability to create value in the short, medium and long term, and providers of financial capital as the primary audience.

It also provides guidance on the reporting boundary used for integrated reporting, explicitly linking it to the boundary used for financial reporting purposes (ie, financial information about subsidiaries, joint arrangements and associates). The draft Framework requires information provided in an integrated report to be prepared on the same basis as, or reconciled to, information in financial statements.

The way ahead

The IIRC hopes to publish a first version of its finalised Framework by the end of 2013 and to update it periodically as <IR> evolves. The adoption of <IR> will depend upon legal, regulatory and other developments, although individual organisations may choose to adopt the Framework voluntarily.

The deadline for comments on the Consultation Draft is 15 July 2013: the IIRC hopes to receive comments via the form on their website, but will accept responses in alternative formats.

To see the Consultation Draft go to: <http://www.theiirc.org/consultationdraft2013/>

International

EC changes to non-financial reporting

The European Commission (EC) has adopted a proposal for a Directive to improve the transparency of non-financial reporting within the annual reports of certain large companies.

Under the Directive, companies will be required to disclose information on policies, risks, and results relating to environmental matters, social and employee-related aspects, respect for human rights, anti-corruption and bribery issues, and diversity on the boards of directors. The Directive proposes a combined approach, setting minimum disclosure requirements in annual reports, but permitting companies to provide more comprehensive reports if they wish.

The requirements will only apply to European Union (EU) companies with more than 500 employees and whose balance sheet exceeds a total of 20m euros or whose net turnover exceeds 40m euros (estimated to be around 18,000 companies), thus avoiding placing an administrative burden on small and medium-sized companies.

Key objectives

The proposals have the following key objectives:

- to increase the transparency of certain companies and to increase the relevance, consistency, and comparability of the non-financial information currently disclosed, by strengthening and clarifying the existing requirements;
- to increase diversity in the boards of companies through enhanced transparency in order to facilitate an effective oversight of the management and robust governance of the company; and
- to increase the company's accountability and performance, and the efficiency of the Single Market.

Disclosure requirements

Instead of a fully-fledged and detailed sustainability report, concise information necessary to understand a company's development, performance or position will need to be published. If reporting in a specific area is not relevant for a company, it will not be obliged to report but will have to explain why this is the case.

The new Directive does not require comprehensive reporting on environmental and social aspects or compliance with integrated reporting but does require the disclosure of certain information on policies, results and risks.

Flexibility

The Directive is concerned with disclosing material; useful and valuable information for proper management and understanding of a company. Companies will not be required to disclose information that is not relevant or necessary in order to understand their development, performance or position and they will be given

significant flexibility to disclose relevant information in the way that they consider most useful. They will be able to use international or national guidelines according to their own characteristics or business environment.

Whilst the Directive sets out requirements, as with the UK Corporate Governance Code these are on a 'comply or explain' basis.

Diversity

With regard to transparency on boardroom diversity, large listed companies will be required to disclose their diversity policy including information covering age, gender, geographical diversity, and educational and professional background. Disclosures should set out the objectives of the policy, how it has been implemented and the results. Companies that do not have a diversity policy will have to explain why not, an approach in line with the general EU corporate governance framework.

Company size

Only a limited number of EU large companies regularly disclose non-financial information. The majority fail to meet adequately the growing demand from stakeholders (including investors, shareholders and employees) for non-financial transparency and the quality of the information disclosed varies, often lacking balance, accuracy and timeliness, making it difficult for investors and stakeholders to understand and compare companies' position and performance. Currently, fewer than ten per cent of the largest EU companies disclose environmental and social information regularly.

In order to limit the administrative burden for larger companies, the disclosure requirements may be fulfilled once at group level, rather than by each company in the group. Auditing and insurance aspects are limited to a check of consistency between the environmental and social disclosures and the financial information.

Implementation

Some large companies may need time to adjust, build skills and implement their transparency on environmental and social matters effectively. Significant flexibility has been built in so that companies report in the way that they see most useful, according to their characteristics. The Directive is not expected to be approved by the Council and European Parliament and implemented by Member States until 2016, with first reports published in 2017. Member States may grant non-listed companies, currently less used to reporting practices, an additional transition year.

For further information go to: http://ec.europa.eu/internal_market/accounting/docs/non-financial-reporting/com_2013_207_en.pdf

Feature

Collaborative leadership in the boardroom

David Archer and **Alex Cameron** look at the importance of all board members having the skills associated with collaborative leadership to optimise board performance.

According to the New York Stock Exchange Commission on Corporate Governance¹, the fundamental purpose of a board is to 'build long-term sustainable growth in shareholder value for the corporation, and the board is accountable to shareholders for its performance in achieving this objective'. This seems clear as it is described here, but perhaps this understates the complexity of the role of the board in practice. There are significant tensions that can occur in any PLC board. These tensions can be driven by the unique constitution of the board. To simplify the situation somewhat, the executives want to implement the strategies that they have developed themselves for the business as they see it, but they still need to get them agreed with the board. On the other hand, the non-executives want to scrutinise and sometimes challenge the decisions of the executives in order to get the best strategy for the business and its shareholders.

To achieve agreement between these groups, it is clearly important that the whole board operates effectively as a collective decision-making body and this is the responsibility of the chairman. In order to achieve this, it is generally agreed that the mix of directors is critically important, but even with the right blend of experience and expertise, if the dynamics of the board don't work then the outputs and decisions of the board will be sub-optimal. The chairman has the accountability to ensure that appointments to the board create the right blend of capability for the business and, in turn, board discussions use this capability effectively to deliver constructive challenge and avoid ending up as 'group think'.

Together, the board and its committees have a complex constitution and it is therefore no surprise that bringing all the parties together to create an effectively operating board is a significant collaboration task. Because of the potential tensions that can occur in such a structure, there is a need for boards to pay attention to:

- The right governance to ensure that roles and accountabilities are clear. This means meeting the requirements of any relevant governance code: in the UK it is the Combined Code² produced by the Financial Reporting Council (FRC).
- The best board operation to ensure that the right information is available and shared appropriately. This includes ensuring that the board committees (Audit, Finance, Nominations, and Remuneration) operate seamlessly as part of the overall board governance process.

- The most constructive behaviours to ensure that the board can manage any tensions but also encourage constructive challenge and deliver the best decisions for the future of the business.

Like most top teams, if the board is operating well then the shareholders will have confidence in its decisions. In addition, good cooperative and collaborative board operation can set the tone for effective and appropriate leadership behaviour throughout the business. Naturally, if the board becomes dysfunctional, then this can become visible to stakeholders inside and outside the business. In these circumstances board members individually as well as collectively can see their reputations damaged – so demonstrable collaborative behaviour matters.

Some of the classic tensions that have to be addressed (often by the chairman) to make the board able to deliver full value and to ensure that it can carry out its statutory accountabilities include:

- Board challenge and scrutiny is perceived as limiting the freedom of the executive directors.
- Non-executive directors perceiving that their scrutiny and input is being overlooked in board decision-making.
- Tensions between the CEO and the chairman.
- Poor communication between the board committees and the whole board.

But even in boards where they perceive that all members of the board are working well together and board operation appears sound, things can go wrong – and shareholders are becoming more demanding, so regulation of board operation is increasing through the use of principles enshrined in documents such as the UK Corporate Governance Code. But although the act of making a board operate effectively can be influenced by Codes of good governance, the focus on principles over tight rules recognises that the effectiveness of any board is linked to how the parties involved treat each other and work together.

In the US the Commission on Corporate Governance set up by the New York Stock Exchange in 2010 in the wake of the financial crisis laid out a set of principles which aimed to influence the behaviour of directors, management and shareholders. But critically the Commission recognises the interdependence and inter-relatedness of the board,

the management and shareholders and it is making these principles work in such an interdependent system that is the work of the collaborative leader.

The UK Corporate Governance Code sets out the principles of good corporate governance with a 'comply or explain' approach. The FRC make it plain that their Code 'cannot guarantee effective board behaviour because the range of situations in which it is applicable is much too great for it to attempt to mandate behaviour more specifically than it does.'² This means that once again, these principles are used as guidelines: non-compliance is acceptable if it is rationally and acceptably explained. Again this focus on principles enhances the flexibility of the Code, but puts pressure on the members of the board to justify their behaviour to others.

How collaborative leadership contributes to board performance

Sometimes boards are referred to as 'teams'. This can be shorthand for an effective decision-making group where the participants get on well together. The danger with this definition as we have already seen is that it does not adequately describe how board members need to work together to be collectively effective as the ultimate decision-making body for the business. If 'getting on well together' really means a 'cosy club', we have missed the point of the true collaborative structure of the board.

Each of the members of the board has a contribution to make to the effective collective operation of the whole based on the role the individual holds. Executives, non-executives, chairman, SID, CEO and company secretary all hold personal accountabilities based on their individual role and the collective accountabilities as a member of the board. As such, these roles have a significant amount of interdependence, but also a need to be separate from each other so that each person can demonstrate their own independence and personal accountability when this is necessary.

The independence of non-executive directors is an essential component of effective board operation. The tension that often occurs between the executive and non-executive roles can be a necessary part of the board decision-making process. This can be similar to the leaders from different businesses trying to collaborate on a joint project, so it is our contention that all members of boards need to demonstrate the attributes of collaborative leadership, and it is the demonstration of these attributes by all board members that will allow the board to manage these tensions constructively. The critical attributes are described below.

Mediation – the ability to address conflict situations as they arise is critical to all board members but especially the

chairman and sometimes the SID who have the responsibility to resolve issues between members and ensure that the board process is effective.

Influencing – the ability of the individual to match their method of influence to the needs of the situation is particularly important for executive directors who know that they need to support of their non-executive colleagues when board approval is being sought for their proposals.

Engaging others – building relationships and communicating with clarity is essential for any senior board roles when dealing with shareholders and other stakeholders who need to support board decisions.

Agility – quickly assimilating facts and asking incisive questions is necessary for all non-executive, part-time roles where the individual needs to be able to quickly get to the heart of the issue being discussed without necessarily being part of all the preparatory discussions.

Patience – taking a calm and measured approach is often cited as the essential attribute of a good chairman, however, the SID, and CEO also need to be able to lead their constituencies within the board in a measured fashion, often taking the long view on what is best for the business.

Empathy – truly listening, understanding their personal impact and taking an open-minded attitude to the views of others applies to all board members. In such a complex group, all participants have to be able to listen if they are to fulfil their responsibility to contribute positively to effective collaboration.

The skills and attitudes of collaborative leadership, as much as any rules and procedures, are the essential elements of effective board operation: hence the need to evaluate board operation from the perspective of group dynamics, robust relationships and decision-making. Without this focus there is a danger of the 'cosy club' or the 'dysfunctional group' emerging. Demonstrable collaborative behaviours are necessary from all parties who aspire to make an effective contribution to board operation.

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David Archer and Alex Cameron are both directors at Socia (www.socia.co.uk). They are the authors of the new book, Collaborative Leadership: Building Relationships, Handling Conflict, Sharing Control (Routledge, March 2013).

¹ Report of the New York Stock Exchange Commission on Corporate Governance – September 2010.

² FRC – the UK Corporate Governance Code – June 2010.

Feature

An increasingly rare breed

Kit Bingham considers the tendency to have only the CEO and CFO sitting on UK listed company boards and looks at the pros and cons of increasing the number of executive directors.

The UK unitary board is so called because, in contrast to the two-tier board structure popular in continental Europe and elsewhere, it unites both executive and non-executive directors within a single decision-making body.

For this structure to work, there must be a sufficient complement of executive directors to ensure that the full board is well informed about the operation of the business, and to subject the senior management team to regular and healthy challenge.

While the UK remains committed to the concept of the unitary board, in reality board structure has changed radically in the two decades since the Cadbury Code took effect. Until the Cadbury governance reforms of 1992, executive directors typically made up half the board, and indeed were often in the majority.

Board balance has shifted dramatically since. Today, half of all FTSE 100 companies have only the chief executive and finance director as management members of the board. In the FTSE 250 index, about two-thirds of companies have only those two officers serving as directors.

Of the 189 executive directors on the boards of the 350 largest companies who are neither the chief executive or finance director, most are divisional managing directors. Chief operating officers are widely represented, while there are 12 company secretaries, four chief investment officers, three human resources directors and two chief technology officers.

The fact that the ranks of executive directors have thinned so substantially in the past 20 years owes much to the increased focus on boards' governance responsibilities and the 'professionalisation' of the role of non-executive directors. But has something been lost along the way?

This article explores the critical ways in which executive directors add value to the board, addresses the obstacles to appointing multiple executive directors and asks how, in an era of smaller and more heavily non-executive boards, the most valuable aspects of the unitary structure can be preserved.

Executive director – the emphasis is on *director*

The Companies Act draws no distinction between executive and non-executive directors. Both are equally responsible and liable for the long-term success of the business.

In practice, this means that executive directors must take a view of the whole company when entering the boardroom, as opposed to limiting their perspective to either their divisional or functional role.

This point was echoed by one FTSE 100 executive director we spoke to: 'A board role takes up time and requires executive directors to think about the business in ways that they didn't have to before. When they meet the investors, they have to be able to talk about the plc as a whole.'

Another executive director told us: 'As a senior executive, you get used to speaking on the basis of your divisional expertise. When you join the board, however, you are expected to add value and take a strategic, company-wide view.'

Multiple executive directors – the advantages ...

The chief advantage of appointing additional executive directors to the board beyond the chief executive and the finance director is to give the board additional insight into the operation and performance of the business, especially in a complex, multinational company.

A current chair (and former group chief executive) we spoke to concurs: 'I always thought that a chief executive and a finance director was the right mix. But I was persuaded that there are some very big bits of the business that need to be present on the board.'

A broader range of executive directors on the board can allow the non-executives to read patterns of speech and body language that might reveal tension or disagreements in the ranks of management. This can be critical in terms of judging the ability of the chief executive to lead his team, and the confidence in which she is held among the top echelon.

As one of our commentators put it: 'A large executive team keeps the chief executive honest – there's no telling one thing to the non-executives and another to the executive committee.'

Widening the pool of executive directors is also valuable from the perspective of professional development and succession planning. One FTSE 100 chair re-iterated this point: 'In terms of CEO succession, you're in a difficult position if there is no internal candidate who has served as an executive director on the board.'

A second added: 'If you have a high-flying manager, you may need to give him a board seat for retention reasons. If you don't, he can be lured away for an executive job elsewhere.'

A board seat is also valuable from the perspective of the individual executive. Not only does a board seat confer prestige and prominence, it also enhances the possibility of a non-executive directorship elsewhere and perhaps a fruitful 'plural' career in due course.

... and the disadvantages

Of course, identifying the lead internal candidate to be the chief executive's successor may not always be clear-cut. And what of those senior managers who are not promoted to the board? Selecting some individuals for a board seat while not affording the same preferment to colleagues with roughly equal responsibilities can be divisive.

From our conversations, it is precisely to avoid being forced to choose favourites that many companies have opted to restrict executive board seats to the chief executive and finance director.

Executive directors who join the board may also find it is difficult to be critical of other divisions. 'You don't want to seem like you are sticking your nose in to the day job of your executive colleagues,' says one former FTSE 100 executive director. Likewise, non-executive directors may hesitate robustly to challenge the chief executive in front of other executive colleagues for fear of undermining her.

Appointing a large group of executive directors can also prompt an 'us v them' culture, with executives and non-executives lined up on either side of the boardroom table. An executive team that thinks and speaks 'en bloc' is hardly conducive to good debate.

There may of course be a simpler reason for limiting the number of executive directors – board size. Although larger executive teams can provide the board with greater coverage of different divisions within the business, there comes a point when larger boards can suffer from coordination and communication problems and board effectiveness may decline.

Given the obligations of the UK Corporate Governance Code, every executive director needs to be matched by a further non-executive. If the preference of the chair is for a relatively small, cohesive board of 7–8 people, then it becomes difficult to widen the pool of executive directors.

For those companies that prefer to keep the number of executive directors at board meetings to a minimum, an essential counterbalance is to ensure the chair and non-executive directors are in regular contact with those senior managers who do not serve on the board or attend board meetings.

Whether joining for board dinners, presenting regularly to the board or merely observing board or committee meetings, senior managers can gain plentiful executive development and 'board readiness' without necessarily having a formal seat at the table.

Preparing executives for life in the boardroom

If the position of executive director is viewed as separate and discrete from that of executive manager, it follows that individuals should be properly prepared for and inducted into the role.

Again, what is viewed as standard practice for bringing non-executive directors on to the board is often overlooked when it comes to their executive colleagues.

In researching this paper, we found evidence of excellent planning and succession. One FTSE 100 executive director told us that he'd been given two years' notice of his potential promotion to the

board, time that was then used to develop his relationships with the non-executive directors, introduce him to large investors, and broaden his understanding of the parts of the business he knew less well.

At the other end of the spectrum, another former executive director told us he was informed by his chief executive that he'd been promoted to the board but that he was not welcome to attend board dinners and should refrain from speaking in the board meeting unless absolutely necessary.

At a minimum, newly-minted executive directors should be made aware of the specific duties and liabilities that come with a board seat. A session with the general counsel or external legal advisers on directors' duties is a must.

Likewise, a detailed conversation with the company secretary on how the chair structures the board agenda through the year, the balance of responsibilities between the board and the various committees and perhaps some de-personalised highlights of the most recent board evaluation will give a new director a sense of the board's culture, style and preferred way of working.

The chair should be sure that any new director is properly prepared. This point is echoed by one former FTSE 100 executive director: 'Before joining the board, I had a long session with the chairman and one of the non-executive directors where we went through their expectations of me in the role.'

Executive directors should recognise that board debates, and the questioning and areas of challenge they can expect from non-executive directors, may be quite different to what they are used to at executive committee.

One board director told us: 'You have to learn to listen. If something's going away from you, don't jump in emotionally. You have to appreciate the point of view that the non-executives are coming from.'

Another adds: 'Executive directors have to understand that non-executives understand half of what you think they do. Probing and challenging questions from non-executives should not be confused with criticism or considered a test of their knowledge.'

The chief executive relationship

Executive directors face a potentially awkward conflict of loyalties. As directors, they have statutory duties to the company; as a manager, however, they owe direct, personal loyalty to their immediate boss, the chief executive.

Chairs and non-executive directors should be alive to this potential for tension, looking out not only for signs that the chief executive has become over-mighty or other symptoms of dysfunction but also for evidence of too much 'cosiness' within management ranks.

One executive director we spoke to shared this view: 'Within the executive team, my loyalties are clearly to the chief executive and

my colleagues. If you're an executive director, and you're not loyal to the chief executive, it is hard to see how you can help deliver the strategy.'

An executive team that presents a common front, but is also capable of open and healthy differences of opinion, suggests a chief executive confident in their abilities and those of their team. Conversely, a chief executive who brooks no disagreement from executive colleagues may struggle to build long-term relationships of trust.

As with boards of directors as a whole, management teams should operate on the basis of open debate and challenge, coupled with a commitment to collective responsibility when a decision has been reached.

One executive director echoed this sentiment: 'We'll certainly have healthy debates, but by the time we get to the board, we'll have an agreed position. If there are disagreements, the chief executive will be aware of what they are and will be happy to share it with the board. The key is no surprises.'

An accomplished chief executive adds: 'Executive directors should be broadly aligned on strategic issues, but it is not a requirement. If you have a different view, put it across.'

Conclusion

As boards have become smaller over the past decade and governance reforms have served to increase the complement of non-executive directors, executive directors are an increasingly rare breed.

But diminishing numbers should not detract from the critical role of executive directors – as directors, not as managers – in ensuring board effectiveness.

It is the executive directors, after all, who know the business best, understand the day-to-day challenges of delivering the strategy, and represent the strongest internal candidates for any chief executive succession.

At the very least, executive directors represent a vital resource on which the chair and non-executive directors may draw.

Of course, senior managers do not need to be directors to engage productively with the board. It is increasingly common practice for the board to range widely in terms of the executives it invites to observe or present at the board, or to attend board dinners.

But the UK remains committed to a unitary structure that brings both executive and non-executive directors together in the same body, and there appears little appetite for following the US model where the chief executive is frequently the only management director.

While that remains the case, the role of the executive director should be more widely understood and discussed. We hope this article helps to open the debate.



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Feature

Conclaves

Mauro Rodrigues da Cunha looks at current issues affecting shareholders' ability to engage with the Brazilian companies they invest in.

April 30th marked the deadline for Brazilians to settle their accounts with the Federal Internal Revenue by filing their tax returns. But, in addition to the appalling meeting with the 'Lion', the date also represents another milestone: the end of the season of shareholders' meetings in Brazilian companies. It's a fact that only a minor portion of Brazilians are concerned with this latter event, but this has been changing.

Shareholders' meetings are – or should be – the most important moment in the lives of publicly-traded companies. It is when Boards of Directors submit the companies' results to shareholders, and when shareholders vote on important questions that will define the future of the business. However, it is not necessary to be an activist to know that, in practical terms, things do not work exactly like that in Brazil. Until recently, most Brazilian shareholders meetings were quite a 'little theatre play' when, to complete the agenda, half a dozen lawyers used to get together to have a cup of coffee and pass on the decisions that had previously been taken.

Little by little, these events started to count on the presence of people unknown to the companies and to their Boards of Directors. Some companies started to realise that these 'anonymous attendees' were, in fact, the companies' partners – something very different from the 'minority shareholder' concept broadly known by then. It would not be unfair to say that Brazilian businessmen followed Baron Karl Von Furstenberg saying, 'according to which shareholders are both stupid and arrogant, ... stupid because they give us their money, and arrogant because they want dividends'. But, as already mentioned, this has been changing.

Today, Brazilian companies' typical shareholders meetings are a bit more exciting. Now and then, there are heated debates, interesting election disputes and embryos of the minority shareholders' influence on the companies' goals. As of 2001, the Law 10.303 has facilitated the effectiveness of minority shareholders' voting, making them become more interested in and accountable for getting involved with the companies they invest in. A real laboratory of new shareholders' meetings practices has been arising in companies with no controlling shareholders¹. However, it is a minor portion (less than five per cent) of another small portion (450 publicly-held companies among hundreds of thousands of companies in the country).

But this is not enough. Not enough at all.

Today, we reached the 'ceiling' of what is feasible to expect from our shareholders meetings within the current regulatory and institutional apparatus. As the number of publicly-held companies increases and as they have more and more market investors, making shareholders meetings become more dynamic and relevant for the corporate life is of utmost importance. This is the only way to assure that Brazilian companies are efficiently managed, contributing to the improved productivity of our economy.

These are the reasons that have led AMEC to choose shareholders' meetings as the topic to be the focus of its 2013 agenda. In March, the Association submitted to CVM (Brazilian Securities and Exchange Commission) a set of suggestions to improve shareholders meetings, based on what is possible according to the Brazilian laws and, at the same time, compatible with international practices. Although we say that we have more advanced practices compared to those in some countries in the Central region, they are of very little use if not inserted into global proxy voting systems. When it comes to companies with most of their capital retained by foreigners, this is an even more urgent need. In other words, we cannot keep on trying to reinvent the wheel.

The core of AMEC's recommendations comprises the understanding of these global practices. Shareholders have been increasingly adopting proxy voting, which means votes must be sent to the company in advance. For that, it is essential that ideas and proposals are freely communicated and that voting instructions are sent in a timely fashion.

Of course shareholders who opt to vote by proxy are giving up the possibility of participating in the debates *in loco*. However, if the premise of free flow of information is observed, distance voting can be virtually the same as voting in person.

Today, the Brazilian system is characterised by bureaucratic issues. To be represented in a shareholders' meeting, shareholders need to submit countless documents and stamps. When it comes to foreigners, the process is even more complex, involving the circulation of documents across the entire chain up to the final decision-maker. The cherry on the cake is the need to renew the proxy every year. Maybe it should be called the *jabuticaba* on the cake since it is something that exists only in Brazil.

According to the country's major custodian of foreign investors, approximately 30 per cent of all voting instructions received are made void because of expired proxies. Additionally, the lack of a stamp can be used as the reason to

contest a specific shareholder – usually the one that wants to vote against the board of directors' decisions.

It is an expensive and asymmetrical process. The companies' board of directors have the shareholders list (minority shareholders do not have it), receive the votes by proxy in advance and have the final decision on whether the documentation is valid or not. In addition to that, they have the power to prevent any communication of interest of dissenting minority shareholders from being announced. Even the powerful changes to CVM Instruction No 481 have been shown not to be enough in more critical situations, as we saw in the last two seasons of shareholders' meetings.

Strategies with the sole purpose of postponing decisions eventually make the exercising of shareholders' rights unfeasible.

CVM has been demonstrating a great willingness to listen to ideas aimed to improve our shareholders meetings. Today, the Commission is also responsible for regulating the distance voting process, as recently established by the National Congress. This opportunity must be used to assure that shareholders' meetings are useful and relevant, to circumvent current obstacles and to adjust this essential resource in publicly-held companies' daily lives to today's digital era.

However, CVM is not the only one with the ability to change this situation. Companies can and must analyse ways to improve the process. Companies that eventually transform their shareholders' meetings into relevant events will earn the respect of investors.

There are already a number of companies that go 'beyond the law' to meet their shareholders' needs – and benefit from a differentiated appreciation of their stock – and, consequently, from lower capital costs. Two examples we can mention are valid – winner of AMEC's 2012 Award of Corporate Events – and Natura, which subjects its board of directors to a constructive dialogue with shareholders in its shareholders meetings. These examples must be analysed and copied since they benefit both shareholders and companies.

Finally, nothing of the above is worthwhile if investors do not play their role. Shareholder absenteeism has been decreasing in our shareholders' meetings, but it continues to be very high. As investors' opinions become more relevant for companies, it is essential that their voices are heard – and the first step is to attend the meetings.

In a nutshell, there is work for everybody. If we want to build a healthy capital market that is really able to help our companies



to invest and produce, we must transform the most important relationship event among companies and their shareholders into something relevant for all society.

Mauro Rodrigues da Cunha, CFA, is the CEO of AMEC, the Brazilian Association of Capital Market Investors, and an independent director at certain Brazilian companies. AMEC is a non-profit organisation that aims the protection to the minority shareholders rights in listed companies. AMEC has 59 associates – fund managers that work independently or employed by financial institutions, foreign fund managers and open or closed pension funds, which invest in equities and fixed-income securities.

For more information visit <http://www.amecbrasil.org.br/stockmarket/>

¹ Although in fact it deals with coming back to the origins of the Brazilian capitalism. Check out the lecture delivered by the historian Ney Carvalho in www.youtube.com/amecbrasil about the topic.

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Index

Organisations	People	
AMEC	David Archer	6
CVM	Kit Bingham	8
FRC	Dr Vince Cable	3
IIRC	Alex Cameron	6
NYSE Commission on Corporate Governance	Mauro Rodrigues da Cunha	10

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