ROLE OF THE CHAIRMAN WHEN THINGS GO RIGHT AND WRONG

ARTICLE BY OLLI V. VIRTANEN

Olli V. Virtanen is an international corporate governance advisor. In his earlier career Virtanen was business journalist at Kauppalehti (Finland), the BBC in London and Helsinki correspondent of the Financial Times.

The rapid rise, and even faster decline of Nokia, once the global leader in mobile phones, counts among the most dramatic corporate transformations in modern history.

It is a story of several wise choices by the Board of Directors, and a few where the top management and the Board failed to cope with oncoming challenges.

It is also a story of corporate governance where the role of the Board and particularly its Chairman had a crucial influence. Ultimately, it shows what can go wrong as well as right when a strong chairman wields unfettered power, especially when the industry in which it operates is confronted by structural change. And it is a reminder of how succession planning can go wrong when a powerful chairman tries to pick somebody to take his place.

Originally a woodworking mill in the rural Finland, Nokia will celebrate its 150th anniversary this May. Yet, its major expansion in the international markets covers only the last three decades.

In the 1980s Nokia was a conglomerate producing anything from television sets and cable machinery to toilet paper and car tires.

At the same time it was a battlefield of Finland's two leading banking groups, Union Bank of Finland (UBF) and Kansallis-Osake-Pankki (KOP). Each had a sizeable minority stake and corresponding seats on the Board. Rivalry between the two groups caused constant hiccups in strategy.

Rapid expansion and recession in the late 80s brought Nokia to the brink of collapse. The banks were prepared to sell their stakes in Nokia to Ericsson, the Swedish electronics group. Ericsson turned the offer down, a decision it came to regret only a few years later when Nokia's fortunes reversed.

Yet, before the turn for the better, the management had to make some major moves.

First, Nokia dismantled overlapping roles and responsibilities. The Supervisory Board was eliminated and the Board of Directors established on Anglo-Saxon governance principles. The roles of CEO and President were no longer separate. And finally the Board decided to change ownership of the company. Both KOP and UBF were urged to sell their respective stakes in Nokia to international institutional investors. The banks were not hard to persuade since both were suffering at the time as a result of the economic recession.

Sale of those stakes paved the way for Nokia's highly dispersed share ownership. Over 50 percent of the stock ended up in the United States, and some 90 percent was held by investors outside of the home country. The largest individual holdings were around 5-6 percent of the common stock.

Thus, from the mid-1990s the Board of Directors dealt with largely faceless owners. Notable exceptions were a few Finnish pension funds, but even they held stakes of only about 4-5 percent.

Nokia's management did engage in a very active investor relations programme meeting international institutions on a regular basis.

Yet, the real power base was the head office in Helsinki, and later in Espoo, a city next to the capital.

Another major move was to dispose loss-making parts of the company. The decision to change corporate strategy completely was made at the Board meeting in Hong Kong on May 12, 1994. The Board decided to focus purely on mobile phones and mobile phone networks.

It was the birth of a new, global and extremely successful Nokia.

The Hong Kong strategy document was prepared and presented by Jorma Ollila who became the face of Nokia. An economist and engineer, Ollila made his early career in international finance at Citibank. He joined Nokia in 1985 as Finance Director.

In 1990 Ollila was appointed as head of Mobira, the mobile phone division, and became CEO of Nokia in 1992. Ollila presided over Nokia's tremendous success story in the 1990s and was appointed Chairman and CEO in 1999.

The last move raised a few eyebrows among observers of governance principles. Nordic corporate governance codes are very strict in separating the roles of the executive level and the Board. In fact vast majority of Nordic listed companies have purely non-executive boards. CEO is always present, and other executives when required, but they have no vote.

Furthermore, for a director to be regarded as independent when appointed to the board, he or she must have not have worked for the company for several years. A recent executive role is considered to compromise independent thought required on the Board level. Nokia was at least open about its approach. Ollila was listed as non-independent when he was the Chairman.

Yet Ollila's successful track record in the 1990s meant criticism of this unorthodox governance was muted. Nokia openly stated that his elevation to these positions was a reward for a job well done. Finland's corporate governance code for listed companies was geared to accommodate the dual role of Chairman and CEO. Dubbed "Lex Nokia" it was amended after Nokia's downfall in the 2010 code to separate the roles:

"The company should clearly divide the areas of responsibility of the managing director and the chairman of the board to ensure that all the decision-making powers of the company are, in practice, not vested in a single individual." (Recommendation 36)

Nokia became the world's leading mobile phone manufacturer in 1998 with a 24 percent market share. This was to rise to almost 40 percent a few years later. Nokia's market capitalization rocketed more than 300-fold between 1991-1999 making it the sixth most valuable company in the world.

Consequently the stature of Nokia, and its Chairman grew to unprecedented proportions. Finland's higher education system was geared to needs of Nokia as well as a cluster of subcontractors and other electronic companies it sprouted. Tax revenues from the company and hundreds of top employees who cashed their generous stock options gave a considerable boost to the national economy. Ollila became the country's go-to individual, and he was also widely tipped to become Finland's next president. He refused to stand for nomination.

If a company is a mirror image of its top management, Nokia can be seen as hardworking, goal-oriented and unassuming.

Ollila learned hard lessons in his early days at Nokia. The first one was the mess created by the uncontrolled acquisition spree initiated by the then CEO, Kari Kairamo. Ollila's Nokia refrained from any major acquisitions. The company grew largely through unrivalled logistics, attractive product portfolio and clever global marketing.

The second lesson was the importance of team work. As Finance Director Ollila witnessed feuds between major shareholders KOP and UBF, as well as turmoil in the top management. Governance issues were resolved in early 1990s when the Supervisory Board was dismantled, CEO Simo Vuorilehto retired and his rival Kalle Isokallio, President and son-in-law of Mika Tiivola, Chairman of the Board, was ousted with a hefty pension at the age of 43. To complete the maneuvers, Mika Tiivola himself retired only after the rest of the Board threatened to step down if he didn't go voluntarily.

The governance issues and reckless expansion influenced the way Nokia was managed in the next decades. Ollila focused on organic growth and building a smoothly working team of collegues. He also became obsessed in avoiding negative publicity and was often uncomfortable with media.

For example, Nokia never owned a business jet. Top executives hired planes when needed and the company even had a fractional ownership arrangement in one plane. But a Nokia Business Jet would have looked too ostentatious.

When Ollila became Chairman and CEO in 1999 he had no de facto boss. This is a familiar structure in the US, and has lately come under increased criticism for the absence of checks and balances, witness the criticism leveled against Jamie Dimon at J P Morgan. Nokia decided to follow the US approach since most of international shareholders were familiar with the structure.

Highly dispersed ownership – much through his own design as Finance Director and CEO – left no single shareholder with enough statute to challenge Ollila. Vast majority of Nokia's biggest shareholders were international institutions, which refuse to take board seats as standard practice.

Some institutions did occasionally question and even sue Nokia for misleading information in investor relations. But any mishaps from the management's side turned out to be accidental or due to incompetence rather than deliberately planned measures.

In corporate governance Ollila paid serious attention to the composition of Nokia's Board of Directors. For some two decades Ollila's Board was designed on the platform of Nokia's requirements and merits of candidates rather than affiliations or other motives.

To pick just a few examples, Nokia's board in the 1990s and the first decade in 2000 included an American banker, a Finnish professor of economics, a Swedish consultant, a French global tire company executive, a British media group CEO, former head of the Finnish broadcasting company, and even an Indian micro banker.

In other words, to formulate the future strategy, Nokia's board required expertise in global finance, global economic trends, patterns in consumer electronics, global brand marketing, trends in media, and consumption patterns in the developing countries.

Ollila himself became hot property in the global headhunters' list for board members. In 2006 he stepped down from the executive position but stayed on as Chairman of Nokia. The same year he was appointed non-executive Chairman of the Royal Dutch Shell, position he held until 2014. He was also non-executive Director of Ford Motor Company in 2000-2008. The Ford tenure came to an end when the company's Board filed a complaint to the SEC that Ollila cannot devote enough time for the position.

Between 2000 and 2009 Ollila was also Chairman of the European Round Table of Industrialists and board member of the UPM, one of the world's largest pulp and paper groups.

So, what went wrong at Nokia?

Did it have something to do with corporate governance?

Nokia's mobile phone sales grew more than 10-fold between 1998 (41 million sets) and 2008 (468 million). In 2007 Nokia made record operating profit of 7,985 million euros, up 45% of the previous year (declining to 4,966 million euros in 2008).

These figures did not impress international investors or analysts. Nokia's share price had already peaked in 2000 (64 euros). By record sales in 2008 share price had plummeted to around 10 euros.

Something serious happened in the first decade of the milennium. Most analysts agree that Nokia was too slow to adapt to challenge of Apple and other smart phone manufacturers. Wrong choice of operating system (Symbian) and slow product development also contributed to downfall.

More fundamental and much more difficult to analyse is the question of right people. When Ollila resigned as CEO in 2006, he hand-picked Olli-Pekka Kallasvuo, a close colleague since the mid-1980s as his successor. Kallasvuo failed to chart a new course for Nokia at the critical times and was replaced by Stephen Elop, a Microsoft executive, in 2010.

Several key executives left probably as the result of Kallasvuo's appointment. The "Nokia spirit", which carried the company in the 1990s, evaporated. Sinking fortunes made other key employees leave the company – while many were sacked. Communication between different units became more difficult.

The Board of Directors was manned by highly competent individuals with different backgrounds. Still the Board apparently had little specific understanding of the issues that were critical for the company, the choice of hand set models, smart phone operating system or global partners.

A Chinese leader once said: it does not matter whether the cat is black or white as long as it catches mice. This seems very apt in the case of Nokia. When market share climbs and profits soar it seems pointless to dwell on corporate governance structures.

But when things start going wrong governance will be among first items that come under scrutiny. Were checks and balances in place? In the case of Nokia, apparently not. Role of the Chairman grew to proportions unhealthy for the company in distress.

Meanwhile, the rest of the board seemed unable or unwilling to challenge prevailing strategy or leadership. Or it did not have sufficient competence to navigate the stormy waters of mobile communications. Either way, the board failed.

If the board fails, spotlight will be on shareholders. Were they vigilant enough to stop the rot? No, they were not. Nokia's largest shareholders, international institutions, had practically no role in vital issues like board selection. And when confidence in its future evaporated institutions simply walked away. Hence the rapid decline in share price.

Nokia is an object lesson in corporate governance. It is difficult to assess how much of the failure was due to the lack of checks and balances. In retrospect it is clear that a more active role of the key players, all board members as well as largest shareholders, could have created a more balanced decision making process.

On September 3, 2013 Nokia signed an agreement to sell the mobile phone business to Microsoft, its arch rival.