CORPORATE GOVERNANCE: THE PRESENT, THE FUTURE

Michael Mascarenhas
CEO of Desert Group

I recently attended a breakfast meeting with one of my peers, a CEO and Board Member of a listed company. Our conversation wafted towards the steps his company was taking towards corporate governance, the need for it today and how it would evolve over the next 10 years. His view was that corporate governance comes alive, when regulatory bodies step in to promote, impose, and even provide a framework to better govern corporates. That did not send the right signals to me on the role of boards and senior leadership in the modern day.

The conversation then continued to be centered around the regulatory aspects, largely ignoring the inherent and organic need for corporate governance and its impact on performance, inspite of all the corporate failure and fraud in recent years. The question that arises is that, shouldn't the Board and those in leadership positions make corporate governance a cornerstone if they want to ensure sustained performance and value creation? At this point a little self-reflection on the state of affairs within our own organizations would help. A reality check is needed I guess.

So why is corporate governance so important to ensure a sustained performance graph? Let's explore what really happens in businesses, be it SMEs, family owned enterprises, listed or state-owned enterprises, over time.

Any business has a simple structure around its goals when initially started. Systems and processes are closely monitored and managed through simple hands on controls. A strong start up mentality controls operations. Shareholders and members of the Board understand the nuances of its operations and govern easily. Risks are quickly identified and mitigated. There is regular contact with the leadership team and in many cases directly with the employees. However, and this is exactly where the dichotomy sets in, growth is an essential component in the success of any business.

Successful business will continue to grow and put growth as a prime goal year on year, but then business growth creates complexity. There are many plates being spun at one time and people, systems and processes intertwine to create a web which is difficult to govern and manage at times. With the advent of technology the sophistication levels has increased manifold. Even a simple wrong tweet could spell disaster for companies.

This ladies and gentleman is the paradox of growth. Growth creates complexity and a labyrinth within operations. Complexity in the absence of appropriate governance and controls leads to risk both known and unknown which could result in serious financial, reputational and business implications. Business could implode impacting not only shareholders but all stakeholders alike. Employees, suppliers, customers, financial institutions, investors, strategic partners and even countries get severely hit when the lack of governance spells disaster. Poor governance eventually leads to poor returns and value destruction. There have been many an example and no sector has been immune to this destruction. SMEs, family businesses, private or public organizations have not been spared. Look around closely and you will know that the lack of corporate governance destroys value.

So let's get down to what matters most and ask the question - do you think that your company ticks the boxes of an effective corporate governance system? Does your company have the required transparency, accountability, fairness and responsibility – the four pillars of corporate governance – in place? If you are left squirming in your seat then there is a problem that could impact company performance, foster risk through a poor risk management system and be exposed to corporate scandals that includes fraud.

So before we examine how the role of Boards will evolve in the next 10 years it will be important to take stock of the situation as it exists today. Many of my peers who act as Independent Directors have many notes to share. In turn, I would like to share these with you. One of the most common observations spoken about is that the Board structure and mix at times leaves much to be desired.

A summary on the recent scandal at Volkswagen was provided by the Financial Times that highlighted the lack of diversity, expertise and independence at the Board level as the main causes of what happened in what is one of the largest car manufacturing companies in the world. Even the so called best are not immune to the problems at the board level. Companies in the Middle East be it SMEs, family owned enterprises to listed enterprises should take note of the above and reconsider the structure and the mix of skills they have within their Boards.

In the SME environment, so many of us have the skills we require to start and build, but without increased management skills, competence and capability we would struggle to effectively take our businesses to the next level. The ideal solution to grow small businesses then is to ensure that each stage of development was matched with the relevant support, while simultaneously increasing management skills so that businesses are ready for the next step, risks mitigated and value enhanced. This needs a different mind-set and thinking. A degree of openness and realization too is needed to accept that you will need to step aside and let professionals take over. Professionals who are bound by a strong corporate governance framework.

I have to admit though that in recent times we have seen more SMEs seeking independent advice early on. Corporate governance comes in various forms. This advice could come in the form of mentoring or coaching from professionals. This is where bodies like Hawkamah in the Middle East have started to play a major role and provide a pool of professionals certified in Stewardship.

One of the biggest topics doing the rounds is the acceptance of corporate governance in family owned business both regionally and globally. This is what David Feffer, Suzano, Chairman of the Board, speaking to his relatives after his father's death said "…We have two options; there is no right or wrong decision, nor one that is better than the other. But whatever is to be done, will be definitive. There is no turning back. We can continue being a family business, like in my grandfather's and father's days, or become a professional company with a strong and clear capital market strategy." Quite a shocking acceptance but this is where the world and the region is heading – professionalism.

Many of the large business in the world were and are family business. However with chances of fraud, scandals, financial losses and value destruction more companies are ensuring that there is a distance between ownership and management. Toyota, Bechtel, Mars, Cargill etc. are good examples. However family owned business would have to adapt or face a lack of professional stewardship in their business environment. The need for stewardship in the form of a professional board drawing on outside expertise will give them strategic capability to drive management, operations, manage ownership conflict and create succession plans.

This needs a culture change. In a few years' time with competition, the opening up of economies forced by efficient trade and capital flow, technological advancement and the complexity of market place, one will see a transition. Change will happen and family owned enterprises will have to face a tough realization to either adapt or see businesses eventually disappear. No one wants that. Family businesses are an important part of commerce and society. However, it's in their interest to seek advice on furthering corporate governance.

I particularly like what I read in an OECD report. "I don't know cases of families in Latin America that had become more united because of money, but I do know of many cases where families have destroyed companies because of money. The lesson to be learned here is that company value is what unites shareholders, irrespective of whether these are family members, institutional shareholders or investors who are external to the controlling groups." This statement was made by Chairman Roque Benavides of Buenaventura in Peru. The conclusion? Regional barriers and geographical boundaries do not provide immunity and the progress towards better corporate governance is an absolute essential.

In my opinion the biggest challenge lies in listed companies which are most visible to society and business alike. For some strange reason however it's an ostrich "head in the sand approach" that affects many of the listed and public companies. The Board gets powerful and CEO does as well. Both instances are a cause for worry. Further, the composition and the skill mix at Board Level is something that leaves much to be desired. Being on the Board of a company is a trophy and expertise and merit is considered less of an essential.

As businesses become more complex, there is a need to build up a skill base within the boards to match that complexity. Yet you find that the range of both Independent and the rest of the elected members do not reflect the requirements of the current dynamic and ever-changing business environment they operate in. Board members continue for longer tenures than the business needs them and little change is seen at the top even though the business keeps changing. Further the respect and aura around the Chairman's position takes precedence over real issues. This is a global phenomenon.

Another change that will become more visible globally and regionally is the coordination between the board and the employees in an organization. In some countries, such as Germany for example, labor representatives sit on the supervisory boards of companies. But fundamentally, it is important for the boards to look for ways to bridge the ever widening gulf between the Board and the members within organizations. There is much to learn and understand from the workforce which could give an indication of corporate culture and the state of affairs.

If you want a truly responsible board focused on corporate governance then organizations will have to be flattened and the "those at the top" syndrome will have to go. This is where boards are headed 10 years from now. Rather be seen as located at the top in an organogram they will be seen at the center.

It is quite usual for boardrooms and the offices of the senior leadership to occupy the top floors of the company headquarters. This will have to change soon. The view from the top misses the view at the bottom and corporate governance becomes less effective. The focus of the board can only change if there is regular change in structure and mix that suits the new environment it operates in.

In conclusion each of those in senior positions and particularly those that matter most – the shareholders and board members - will have to self-introspect. It is absolutely essential that reform starts with each of one us. In ten years from now there will be more regulation and there will be more flattening of organizations. There will be more advice sought and corporate governance bodies that promote good governance will take center stage. There will be more certification for board members and the demand for skill sets will be extreme. Around the world, the skills gap is fast becoming a skills abyss and the Board is not an exception! It's time we act voluntarily before regulations takes center stage.