# Who's minding the store?

By Scott Hammen

**As more scandals rock the financial world, stakeholders are beginning to look closely at who sits in the boardroom, and why.**

Reckless trading of risky financial products. Undisclosed conflicts of interest. Pure greed. All are now-familiar epithets used to describe the causes of the financial crisis which began four years ago. But in the wake of J.P. Morgan's US$2 billion loss in questionable derivatives trading in May, it's clear that, even with increased regulations and scrutiny, the issue of where and how corporate governance failed is still very much with us. In the case of J.P. Morgan, shareholders and other stakeholders are questioning whether - in holding the titles of both Chairman and CEO - Jamie Dimon perhaps had too much power and not enough oversight.

INSEAD Knowledge spoke about corporate governance to several experts: **Mark Sanglé-Ferrière** and **Luke Meynell** - who handle searches for chairmen, chief executives and non-executive directors from Paris and London respectively for the executive search and assessment firm Russell Reynolds Associates - and **Ludo Van der Heyden**, INSEAD Professor of Technology and Operations Management, who directs INSEAD's **Corporate Governance Initiative**, and teaches governance to directors, executives, and MBAs at INSEAD.   On the separation of roles between CEO and non-executive chairman of the Board and how the practice differs from one country to another, Sanglé-Ferrière says, "One of the major differences between the UK and France is that in France you often combine the role of the Chairman and the CEO." In the US, where J.P. Morgan is headquartered, the Chairman-CEO functions are more often combined than not. In the UK however, Meynell points out, "The roles are far more split...the Chief Executive runs the company and the non-executive Chairman runs the board." The split, he argues, provides a system of checks and balances that can protect the firm.   Was the absence of this protection part of the problem at J.P. Morgan?   While warning that it is far too early to tell, Van der Heyden thinks that this is a distinct possibility and that Dimon, as other US Chairman/CEOs, may indeed have consolidated too much power: "I have been arguing for a long time – with little success – that for large US listed companies the separation between CEO and Chairman is a good control, and represents good protection of shareholder value, and should not really be a big issue for executives, unless they are truly power hungry." Van der Heyden asserts further that "It contributes to constrain 'strong leaders' from taking excessive risks. There still is a dominant view in the US that executives should police themselves, and that the rest should be left for shareholders to decide. But good governance is about protecting shareholders from value destruction before it happens by questioning senior execs more and challenging them more forcefully on some assumptions. That is not yet an accepted idea in the US."   "In a corporate structure like J.P. Morgan," Van der Heyden further observes, "The business units (like trading) are governed largely by the corporate management. It does seem that in this instance the corporate management did not govern the trading unit sufficiently. That is a corporate management issue. The governance question is whether the J.P. Morgan corporate board would have seen. This is debatable but what is not debatable is that effective governance at the J.P. Morgan board level could only have increased the chances that poor corporate practice would have been (more quickly) detected." If boards are to function as a bulwark against management errors then how they are chosen becomes a critical question. "Traditionally boards were often like exclusive gentlemen's clubs," says Meynell. "When you got to be a non-executive director, you were almost beyond feedback." So the failure of corporate governance that brought on the fiscal crisis should not have been a surprise. "Some boards were staffed with individuals who might have had great branding understanding or were consumer specialists, but had no concept of how to read a balance sheet of a big financial services organisation."

## Assessment techniques

To reduce the risk of discovering a board member's failings too late, Russell Reynolds has developed specific assessment techniques. Says Sanglé-Ferrière, "We first interview many people who have worked with the individuals so we can understand their style and how they relate. Sometimes we use psychometric tests to better understand how they behave in stressful situations. They are there to manage crises - the ultimate test for a board member." But even before evaluating the personality profile of a candidate, a recruiter needs to make sure the candidate has the requisite technical knowledge and work experience. Says Meynell, "There is a set of learning around governance, around accounting, around CEO succession, around processes that can be very valuably taught." Van der Heyden agrees: "The INSEAD Corporate Governance Initiative (ICGI) was launched in 2010 as INSEAD's response when the financial crisis revealed a systemic failure in governance at corporate, regulatory, and government levels in the financial sector. We aim to develop and educate international directors, undertake research, and bring together chairmen, senior board members, active owners, and academics to discuss the changing realities of governance practices and issues. In the two years that ICGI has been in existence we have put the topic on the map," says Van der Heyden, "and we are starting to impact the governance world with our contributions." Meynell sees the need for combining learning with experience to prepare new board members. "There needs to be a mix," he says. In addition to what can be taught, "there is another set of skills that, like a lot of things in life, you can really only learn with experience on a board with a good chairman and other board members." And there is a responsibility," adds Sanglé-Ferrière, "to properly induct new board members, to expose them to executives, to visit sites, to visit clients. And it is important that a new board member have a mentor - someone to explain the subtleties of the board and of the company."

## Independence as prerequisite

"You have to be a good manager to become a good chairmen but not all managers can become chairman," Sanglé-Ferrière contends. "What makes a really great non-executive director is their independent mindset ... this means that you are ready to resign if you disagree and that your status is not dependent on being part of the board. You must be willing to ask the tough questions." Meynell sees a delicate balance between engagement and detachment: "The really great chairmen are the ones who want to see their chief executive succeed but they do it in a way that retains a framework of both governance and support while providing challenges that allow executive teams to flourish." The demands on non-executive chairmen are increasing but the talent pool is not. And this is particularly true when it comes to identifying qualified female non-executive directors. In France, female board representation is legally mandated - 20 percent in 2012, rising to 40 percent by 2017. The number of women on CAC 40 boards grew by 44 percent in 2011. And Russell Reynolds are increasingly placing female non-executive directors; in the past year, about 22 percent of board appointments they have recruited have been women. But meeting the legal requirements is not easy - it means finding capable women who are willing and able to stay in the business environment in a non-executive role after they leave their executive careers. Meynell speculates that the added difficulty may be due to the fact that women tend to be more efficient about managing multiple demands on their time (the work-and-family balance) and thus more aware of when they might be taking on more than they can handle.

## Deepening the talent pool

In any case, especially for women, the talent pool of candidates for board membership in any given country is often too small and recruiters must look world-wide. This could be a contributing factor behind the fact that 28 percent of board members of French CAC 40 companies today are not

French.   But while recruiting across national borders is a positive development in terms of increasing their international perspective, there are also dangers in the geographical dispersion of board members. The chairman has to make sure, says Sanglé-Ferrière, that "not only does everyone have the same level of information, the same level of understanding but that they have it at the same time." And the chairman must make sure that the board is a closely knit team with shared views so a decision will always reflect the entire board's judgement even if, at any given time, some members cannot attend a face-to-face meeting.   The sudden financial meltdown in 2008 and the necessity to make board decisions very quickly dramatised the problem. Sanglé-Ferrière explains that "when you suddenly have a crisis and need to be talking weekly, the board can split into an 'inner group' of board members who are in the same country and can meet on short notice and a dispersed 'outer' group who can join by conference call but feel less involved."   So being a board member today is a far cry from the roles of times past. Sanglé-Ferrière sees a new insistence on accountability: "Now board members are assessed annually, given feedback on each other by each other. So you understand whether you are in the top quartile or in the bottom quartile. And some of the bottom quartile performers will be asked - very gently - to finish after three years and not do six."   "There is real pressure on our business is to develop, encourage and help nurture more younger, high-achieving executives to step onto boards" says Meynell. Board selection has entered an era of "professionalisation" and the days - not so long ago - when boards were more like clubs are over, says Sanglé-Ferrière, "today it means hard-work and heavy responsibility."      *Ludo Van der Heyden is Professor of Technology and Operations Management at INSEAD. He is also the Mubadala Chaired Professor in Corporate Governance and Strategy and Academic Director of the INSEAD* ***Corporate Governance Initiative****. He co-directs the International Directors Programme, part of INSEAD's portfolio of executive education programmes.*

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