



# Al Majlis

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Issue 03, 2009

## From the editor

Soha Ellaithy  
[Contact the editor](#)

Dear Member,

With 2009 coming to a close, I would like to share with you my pleasure as I look back on BDI's achievements: we have doubled our membership base, held three workshops and trained more than 50 directors in the process, organized three Alumni Dinner events, issued our first publication on board effectiveness, as well as released our quarterly newsletter. It's certainly been a productive year for the BDI team and I wish to thank each and every one of you for helping us be so successful.

Through our workshops, we have had the opportunity to meet several truly exceptional directors and witness first hand how much talent and enthusiasm directors in this region possess. We have seen our vastly experienced members plunge into discussions, come up with insights and leave workshops with renewed enthusiasm and fresh resolutions to make their boards truly more effective. These directors, who collectively sit on more than 200 boards, are living proof that despite the bumps in the road, the GCC region has access to the very tools that can help it on the road to becoming a world class economy.

And since we are talking about bumpy roads, we have chosen for you two articles that tackle some of the new challenges that are the product of a crisis whose ramifications are still unfolding.

With bailout deals injecting huge amounts of capital in the private sector, governments now find themselves becoming stakeholders in many large corporations. Between fears of state "protectionism" and hopes for a powerful stakeholder that can bring about real change, the role of this new "stateholder" takes on significant importance. This is the argument presented by Robert Gogel and Professor Ludo Van der Heyden in 'Welcome, "Stateholder" '. In this insightful article, the authors prescribe four simple guidelines that government stakeholders (in their board member role) should follow to become effective agents for reform.

In 'Using the crisis to create better boards', Andrew Campbell and Stuart Sinclair argue that in times of crisis, before boards go on to assess the performance of their executive management, they should first apply some rigorous self scrutiny. The authors then recommend a series of steps to help boards achieve a thorough and honest evaluation of their own performance.

Finally, and as we mentioned in our previous issue, we love hearing from our members. This quarter, in the Members' Corner, Dr. Waleed Al Ajlan, Corporate Secretary of Saudi Telecom Company shares with us his thoughts on the role that a well structured board can play in ensuring sustainable success for family businesses as second and third generations take the helm. If you wish to share with us some of your thoughts, you can submit your letter here.

As 2009 comes to an end, we truly are looking forward to yet another exciting year ahead and as always, we appreciate your feedback, your comments and your continuous support to help us reach the goals we have set out to achieve.

## In the News!

Contribute to  
'In the News!' section

### WELCOME TO OUR NEW MEMBERS

**Mr. Samir Tubayyeb**, Executive Director, Saudi Aramco

**Mr. Kamal Yahya**, CEO, South Rub Al-Khali Co. Ltd.

**Mr. Ibrahim Al Buainain**, Senior Vice President, S-Oil Corporation

**Mr. Abdul Rahman Moraisel**, Vice President, Al Osais Int'l Holding Co

**Mr. Walid Shukri**, Country Senior Partner, PricewaterhouseCoopers

**Mr. Jamal Kishi**, CEO, Deutsche Bank

**Mr. Burhan Al Hashimi**, COO, EPPCO – RBU

**Mr. Ziad Al Labban**, CEO, PetroRabigh

**Mr. Fawwaz Al Nawwab**, President, SAMREF

**Mr. Zaid Al Qufaidi**, CEO, Emirates Petroleum Products Company LLC

**Mr. Abdulaziz Al Rebdi**, President, ASR Consult

**Mr. Abdulaziz Al Sugair**, CEO, Tatweer Holding Co.

**Mr. Abdullah Almajdouie**, President, Almajdouie Group

**Mr. Meshaal Al Rubaya**, Acting Associate General Auditor, Saudi Aramco

**Mr. Mohammad Al-Naghash**, Manager, Tanbu NGL Fractionation Dept., Saudi Aramco

### GCC BOARDS IN ACTION

**BDI Governor appointed as Governor of the DIFC** : Last November, HE Mr. Ahmed Humaid Al-Tayer, Governor on the board of BDI, was appointed as the new Governor of the Dubai International Financial Centre (DIFC), replacing H.E. Mr. Omar bin Sulaiman.

Mr. Al Tayer is considered as one of the most prominent bankers in the region: he is the chairman of both Emirates NBD and Commercial Bank of Dubai, the vice chairman of the Dubai Aluminium Company (Dubal), a board member of the Investment Corporation of Dubai, and deputy chairman of the Emirates National Oil Company (ENOC), among others.

Mr. Al-Tayer has also previously held positions in the government, being UAE's Minister of State for Finance and Industry from 1983 to 1997. He has also served as the Minister of Communications.

**Abdullah Al-Majdouie elected to EPCC Board**: After a week of polling, six new members have been elected to the Board of the Eastern Province Chamber of Commerce in Saudi Arabia. Among the newly elected members is Mr. Abdullah Al-Majdouie, President of Almajdouie Group and BDI member. The other five members who were elected are: Abdulrahman Al-Rashed, Ibrahim Al-Jomaih, Khaled Al-Qahtani, Ghassan Al-Nemer, Faisal Al-Quraishi, Abdullah Al-Ammar, Fahd Al-Shureia, Saleh Al-Syed, Hassan Al-Zahrani, Khaled Al-Ammar and Abdulhadi Al-Zaabi.

We wish to congratulate Mr. Al-Majdouie and wish him a successful tenure on the EPCC Board

HE Ahmed Humaid  
Al-Tayer



Abdullah Al-Majdouie



## Recent BDI Events

### Senior Director Workshop

16-19 November 2009,

Ras Tanura, KSA

BDI's last workshop this year was hosted by Saudi Aramco at their Executive Leadership Center in Ras Taunra. The workshop was attended by a group of 15 senior directors, representing a wide range of industries across the region. Throughout the workshop, participants had the opportunity to join in a number of events and activities, which served to supplement the professional sessions and allow for networking opportunities.

One of the highlights was the marine trip on board the surveyor vessel Karan-8, which Saudi Aramco graciously arranged for all participants and faculty members. The 2-hour tour of this high tech survey vessel took place while sailing to the Sea Island tanker loading facility. Everyone also had the chance to enjoy a traditional Saudi Arabian lunch on board of the ship.

The keynote speeches were also a major highlight of this workshop. On the opening night, Mr. Abdullah Al-Saif, Chairman of Maaden, talked

about his own experience as a BDI workshop participant and the benefits and challenges of creating truly effective boards.

On the second night, Mr. Khalid Al Falih, President & Chief Executive Officer, Saudi Aramco, reflected on the role of corporate social responsibility in today's corporate world, and how progressive leadership should look at CSR as an innovative way to fundamentally strengthen their businesses while contributing to society at the same time.

At last, participants had the opportunity to hear from Professor David Beatty, founding Managing Director of the Canadian Coalition for Good Governance and Conway Director of the Clarkson Center for Business Ethics and Board Effectiveness, Rotman School of Management, University of Toronto. Mr. Beatty spoke during the BDI Alumni Dinner Event, which took place in Saudi Aramco's Al Ghawar

Conference Hall in Dhahran. Professor Beatty took the guests on a historical journey that chronicled the evolution of Boards throughout Europe and North America, and discussed some of the lessons directors can draw from history on learning how boards can remain or become effective in the face of the current crisis.

Professor Beatty also took the opportunity to invite the guests to attend the 2010 International Corporate Governance Network (ICGN) Annual Conference, to be held in Toronto, on 28-30 June. The conference offers an excellent occasion to meet professionals from across the world that have a mutual interest in promoting good corporate governance. For more information, you may visit the website: <http://icgn.org/conferences/2010-icgn-annual-conference/>



1. Workshop in session



2. Group picture during marine tour



3. Professor Beatty giving his speech during the Alumni dinner

EVENTS

- 4th Annual GCC Regulators' Summit : 22-23 February, 2010, Doha, Qatar
- Senior Director Workshop: March, 2010
- BDI alumni dinner event: March, 2010
- Senior Director Workshop: May, 2010
- BDI alumni dinner event: May, 2010
- Chairman's summit: October, 2010
- Senior Director Workshop 1-4 November, 2010 Manama, Bahrain Hosted by Investcorp

**4th Annual GCC Regulators' Summit**  
22-23 February 2010, Doha, Qatar

BDI will be participating in the upcoming 4th Annual GCC Regulators Summit, in Doha on February 22-23, 2010. This two-day conference, organized annually by Complinet, will cover the key facets of compliance and regulation within the GCC region and is expected to attract over 400 professionals.

HE Yousef Hussein Kamal, the Minister of Economy and Finance of the State of Qatar will be inaugurating the summit and delivering the keynote opening speech.

BDI will be hosting a session on the first day of the Summit from 11-12pm. The session will include a panel discussion entitled "Removing the Barriers to Greater Board Effectiveness" and will feature prominent speakers from various BDI partners:

- Ahmed Al Sheikh, Head of Corporate Governance, Capital Market Authority, Saudi Arabia
- Maryam Buti Al Suwaidi, Deputy CEO for Legal Affairs, Issuance and Research, Securities and Commodities Authority
- Alberto Alvarez, Principal, McKinsey & Company

The discussion will be moderated by Mr. Ramzi Abdeljaber, Managing Director, Business Development at Investcorp.

For more information on the conference or on how to register, please visit the Summit website: <http://www.complinet.com/gatherings/gcc/summit/2010/index.html>



Ludo Van der  
Heyden

Robert Gogel



Robert Gogel is a serial turnaround executive and cofounder of the European Executive Council (EEC), a think tank of senior multinational executives.

Ludo Van der Heyden is the Solvay Chaired Professor of Technological Innovation at INSEAD, an international business school with campuses in Fontainebleau, France; Singapore; and Abu Dhabi.

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## Welcome, “Stateholder”

Since 2008, the world’s governments have injected an unprecedented amount of capital into what used to be known as the private economy. The United States and United Kingdom have led the way, but the governments of many other countries have moved into similarly uncharted waters, taking huge equity stakes and purchasing warrants and senior debt positions in financial institutions and corporations. To be sure, bailouts for such companies as AIG, Northern Rock, General Motors, and Fortis were necessary evils. They protected both financial and non-financial industries, as well as the wider public, from the excessive negative aftershocks that would have occurred if the failed organizations had simply gone bankrupt.

But what now? Unlike sovereign wealth funds, which make long-term commitments in many of their investments, governments have made only temporary investments, according to government officials. Nonetheless, although some banks are beginning to repay their investments, government ownership will continue for many companies, if only because it will be difficult to sell the shares at attractive prices. The global economy must first recover, and that won’t happen before mid-2010. The ways in which governments assume their novel

responsibility will remain at center stage; they could have a significant effect on the quality and speed of the recovery itself.

To many capitalists, the prospect of “governments running companies” instantly generates visions of socialism. They regard this phenomenon as a de facto nationalization and fear a turn toward protectionism and government interference in free markets. But it is more accurate to think of this new wave of government intervention as heralding a new kind of stakeholder in corporate governance.

So welcome, “stateholder.” You have means you did not have before to reform corporate governance and bring this function to a new standard. You will be with us for some time, and you may as well learn to do your job effectively.

Questions remain unanswered about whether public monies are and will be wisely invested and spent, whether stateholders will act differently in their board member role than private individuals or institutional shareholders do, how financial performance will be affected, whether these companies will emerge stronger or weaker, and whether such companies will be equipped to operate effectively



or constrained by a heritage of bureaucratic shackles.

Unfortunately, the track records of most state-run, state-owned, and state-supervised institutions — such as Sallie Mae and Amtrak in the U.S., British Leyland in the U.K., Sabena in Belgium, and Alitalia in Italy — have not been very good. These companies have failed in the public eye and have also failed to achieve any non-subjective economic or effectiveness benchmark.

Fortunately, counterexamples exist. They include major French utility Électricité de France, former national airlines Air France and Lufthansa, and Chrysler after its U.S. government rescue in 1979. These examples demonstrate that government stateholders can perform well in their shareholding functions if they have a clear purpose and execute their responsibilities well.

The large sovereign wealth funds of China, Singapore, and the Gulf states may provide another positive example. Sovereign funds do not have the same short time horizon that other stateholders face because they have not been “forced” to become rescuers of last resort. But they face the same duality of public-private interests,

and finding the right balance is still daunting.

Although this new global experiment of stateholding is still in its early stages, four simple guidelines ought to steer the behavior of stateholders. Getting those four elements right will contribute to making the challenge surmountable. Getting them wrong will further erode public trust in both business and political leadership.

#### **1. Commit to systemic governance.**

The root cause of the financial crisis was not a flaw of capitalism. It was a failure of governance — not just by corporate leaders, but by corporate boards and regulators as well. Former Federal Reserve chairman Alan Greenspan admitted as much in October 2008, when he testified to a U.S. congressional committee that his major mistake was “in presuming that the self-interests of organizations, specifically banks and others, were such that they were best capable of protecting their own shareholders and their equity in the firms.”

The failures within the corporate sector (such as Enron and Tyco) are well known, but the extent of the government’s failure to properly supervise the financial sector is still underreported. Regulators allowed

We have just emerged from a long period of market deregulation and government dis-intervention. Rather than letting the pendulum now swing excessively to the side of overregulation, we should find a proper balance by agreeing on a clear vision of the new order

managers to pursue higher returns without properly adjusting for the risk incurred or setting appropriate prices, and in some cases they were simply inattentive: Bernard Madoff's Ponzi scheme should become part of any U.S. Securities and Exchange Commission induction program for new recruits, a case study for business schools, and a semester-long course in law schools. It is simply unfathomable that Madoff was able to perpetrate such a level of fraud for so many years.

Many regulators — and the board directors they oversaw — apparently did not understand the risks that banks were taking in their borrowing and lending practices. Nor did they make managers accountable for results by forcing reductions in commissions and bonuses, or aligning such bonuses more closely with delivered results (as is the case in commodities trading). At no other time in history has so much been paid in short-term commissions in the face of such medium- and long-term value destruction.

An essential tenet of capitalist systems should never be forgotten: Markets and their actors need to continuously earn the public's trust to operate in the public interest. The ultimate accountability for the financial system rests with government. Someone

needs to monitor the system to not only identify bubbles but also pierce them as early as possible. Governments are uniquely well suited to manage this task; no other single actor has the requisite systemic interest.

Let us underline how difficult the task of reforming government practice is, however: We have just emerged from a long period of market deregulation and government dis-intervention. Rather than letting the pendulum now swing excessively to the side of overregulation (as it has in the past), we should find a proper balance by agreeing on a clear vision of the new order, and then taking multiple small steps to achieve it.

This is far from current practice. Consider, for example, the European Union. The economic crisis represents a unique opportunity for European governments to tackle reform together and steer the system with a common approach. After all, it's only logical to assume that the countries of the E.U. should act in concert to prevent bubbles that affect its currency. Yet there has been no single concrete action in this regard. Instead, European governments have largely acted independently from one another, protecting their own national interests.

**2. Hold boards responsible.** The market for corporate control is quite different from the market for goods and services. If a buyer is displeased with the goods or services provided by a supplier, the response is easy and immediate: Buy from someone else. Shareholders can also easily disengage when the prospects of investment returns deteriorate. But when a corporation becomes insolvent, it may very well not recover at all. And that can irreversibly damage communities, employees, business partners, and the regions and nations that governments are elected to serve.

The central justification of stateholder governance is to take control of corporate destinies so that if a company goes south, there is a reasonable promise of its returning north at some point, when it can continue its journey without direct state guidance. When and how much government should intervene by taking equity positions will always be a delicate question, as there will always be tension between intervening and letting the corporation die or restructure on its own. Governance will remain a complex act, distinct from execution and distinct from regulation and policymaking. But just as corporate boards can temporarily intervene in corporate execution (e.g., when nonexecutive

board members become managers), so can governments temporarily intervene in the governance of private corporations by taking stakes in them.

Improving the governance system by delegating this job to regulatory authorities is not sufficient. In 2002, the U.S. witnessed its biggest modern-day corporate governance reform with the passage of the Sarbanes-Oxley Act. These rules, which are onerous and expensive to comply with, and are enforced by the SEC and an agency that oversees the auditors called the Public Company Accounting Oversight Board appear to have done little to prevent the current crisis.

The Sarbanes-Oxley regime forced U.S. corporations to provide more information to shareholders (with the intent of allowing them to make more informed decisions), but some executives continued to collectively mislead shareholders (and employees as well). If they did this knowingly, they ought to be pursued in the courts for fraudulent behavior; the trouble is that such judicial action typically comes too late and does not cure the larger problem. Sarbanes-Oxley has the flavor of providing forensic evidence once a governance crime has taken place. The justification for stateholding is to allow preventive

intervention when larger economic interests are at play — actions that can be put in place sooner and increased gradually as needed.

The first preemptive step is for governments to hold corporate boards responsible not just for financial results and for providing information to shareholders, but more globally for proper governance, which reduces the risk that any corporate crime will occur at all. Too many boards, particularly in the U.S., have been obsessed with short-term execution and results (even at the risk of survival), and have not been attentive enough to longer-term value creation and sustainability. Boards must be required to embrace their fiduciary responsibility to the company as well as to the share price, and to ensure that good governance becomes an integral part of the corporate culture. This should be enforced through legislation, regular prodding, and — crucially — through the threat of stateholder intervention. Governments and regulatory authorities ought to have the means to regularly audit companies to ensure that governance standards are being upheld.

It is no coincidence that certain countries have come out of the recent crisis relatively unscathed, such as

Stateholder representatives on boards will have to be exemplary representatives of the company's long-term interests. They must insist on training of board members (including themselves) in governance capability

Canada, Denmark, and Australia. These countries have reinforced the role of the board chairman by giving that position an explicit responsibility for good governance. The chairman has a primary duty of ensuring that clear responsibilities are established for both managers and their supervisors, so that the firm follows and can benefit from a robust system of checks and balances.

In countries where the chairman and CEO roles can still be held by a single individual, the separation of roles must be encouraged, if not required for companies of a certain size. It is one more safeguard to help us avoid many of the abuses that have led to the current crisis. One person ought to be primarily responsible for execution, and the other for effective governance; when there is a conflict, the chairman should rule — because that is the only way to restore an effective balance between these two corporate functions.

Stateholder representatives on boards will have to be exemplary representatives of the company's long-term interests. They must insist on training of board members (including themselves) in governance capability, as well as improving board processes, including succession. The real lack of

capability on many boards has become a blight in the wake of the recent meltdown; the presence of stateholders provides the corporate world with an unparalleled opportunity for systemic improvement in this domain. To be sure, there will be cries of government interference, and for that reason there should be frameworks and processes that establish restraint. The very fact that the stateholder has intervened should be seen as a signal of corporate malfunction. It should be triggered only by predefined parameters and initiated by a government agency.

As stateholders acquire governance expertise, they will (and should) seek out new ways of sharing knowledge without violating corporate confidentiality. Boards and executives will also find new forums for discussing governance. One excellent model is the Canadian Coalition for Good Governance. It was formed to promote good governance practices in the companies owned by its members, which include a wide range of institutional investors — pension funds, mutual funds, and third-party money managers.

**3. Enforce transparency.** Secrecy is a tradition dear to the financial-services industry and most of the corporate world. It will take vigilance to prevent



stateholders from embracing it as well. Why is transparency necessary? Without broad awareness of the priorities and practices of government-owned corporations, stateholders too will be vulnerable to lobbyists and predators. Indeed, dominant shareholders have often used their power at the expense of minority stakeholders. The public desires information and accountability. As shown by the initial debate in the U.S. on the crisis and on the Troubled Assets Relief Program (TARP), a small group of people at the top of a company or even at the top of government can no longer make critical decisions by themselves. Extensive, honest communication (not “spin”) is required: The stateholder can act much more freely in this regard, with a greater accountability to the public.

For example, if stateholders plan to sell a company, they should make explicit the rationale, conditions, and expectations for the sale, and then leave open the date and the corporate acquirer. If the government’s desire to sell becomes known in advance, the sale could be executed in a way that avoids unhealthy stress on the organization. Sufficient time must be taken for the best match to be found, and the appropriate acquirer may not necessarily be the highest bidder.

There are many examples of what not to do. The takeover by the Belgian government of Fortis Bank in October 2008, and the decrease in shareholder value, led to months of legal disputes and ambiguity. The TNK-BP joint venture, founded in 2003, appears to have been a play by three Russian shareholders to eliminate their BP partner with the (silent) consent of the Russian government. The onerous controls implemented by Swissair on airlines it acquired in the 1990s (Air Liberté, AOM, and Sabena) represented an abuse of minority shareholders that ought to have been identified earlier and stopped.

These examples suggest that interventions by the stateholder should be governed by a neutral body — not governed directly by ministers or officials who are political appointees. In that sense, supervisory authorities must have total independence and should function more like a central bank than a government department.

**4. Choose board members carefully.** Stateholders will need to select competent and experienced board representatives for the companies they own. Because not all shareholder-selected board members add value, one can assume that not all government appointees will necessarily do so — at

## The crisis does offer a surprisingly positive public-service opportunity for financial executives. Working for a stateholder represents a contribution that will help the banking and corporate sector find redemption

least not without better training, selection, and oversight. Opportunities for conflicts of interest abound in a context where ambiguity is pervasive and where feedback takes a long time to arrive and is difficult to evaluate. Yet training may be hard to come by, because compared to management training, governance training is still in its infancy — if not in gestation.

There is now a great opportunity for experienced and professional bankers to volunteer to represent the stateholder stake. Such sufficiently independent government representatives would truly take a long-term view in rebuilding former or still-great institutions. To find them and provide a structure for them, governments should call upon civil society, giving some institutions (like the previously mentioned Canadian Coalition for Good Governance) a clear mandate and a healthy dose of independence to help take on the task.

One area in which stateholders will need to be very careful is the structure for compensation. As institutional health is restored, governments will reap the benefits by selling part or all of their stateholding. Bankers who have a sense of public service and are eager to redeem their industry in

the eyes of the public will embrace this noble and delicate challenge. Remuneration ought to follow, but without the excessive bonuses that boards previously awarded their managers (and even themselves). The foremost reward for public service ought to be public recognition, not financial gain. Again, this points to the difficulty: Without a proper framework and adequate guidance, few people will venture to undertake the task.

The crisis thus does offer a surprisingly positive public-service opportunity for financial executives. Working for a stateholder represents a contribution that will help the banking and corporate sector find redemption. These are new roles in business and in society. They will be training grounds for future leaders in governance and business. And they can also provide a direction for emerging leaders. Our business and law schools might rethink parts of their curricula and begin to develop coursework and cases around the stateholder position and best practices in this domain.

### Making the Stateholder Welcome

Paradoxically, governments' failures as regulators have now led to their massive presence as stateholders. Having reached this point, governments now represent our

greatest hope for corporate reform. They have an opportunity to enter the system as a governor, make effective changes, and then exit. Furthermore, they have a chance to be active players in governance when normal market conditions no longer apply. They ought to develop frameworks and methods for guiding their intervention.

This will not be easy, and governments will need to tread carefully in a domain where knowledge is limited and ambiguity abounds. Yet the biggest mistake would be to engage in wishful thinking: that this is the final economic crisis of capitalism, and that the current crisis simply ought to be managed. Our point is to insist that one lasting impact of the crisis to be hoped for is the introduction of the stateholder, which works for the good of the capitalist system, as a supervisor as well as occasional intervener in cases of massive corporate destruction and governance failure, and also as an advisor and preemptive actor in cases that appear to be on their way to failure.

We believe that all stakeholders ought to actively support the stateholder in the definition and execution of their mission. We may not get another chance like this for a long time.



Andrew Campbell

Andrew Campbell, a director of London's Ashridge Strategic Management Centre, is the author of more than ten books based on his research. The latest, *Think Again: Why Good Leaders Make Bad Decisions and How to Keep it From Happening to You*, was written with Sydney Finkelstein and Jo Whitehead (Harvard Business School Press, 2009).

Stuart Sinclair, chairman and nonexecutive director of several companies in the United Kingdom and Eastern Europe, was previously the CEO of Tesco Personal Finance and GE Capital China.

Stuart Sinclair



## Using the Crisis to Create Better Boards

**During tough times**—and they haven't been this tough for generations—directors are supposed to ask difficult questions about their companies. Yet they rarely ask hard questions about themselves, such as, "Are we the right people, asking the right questions, providing the right sort of leadership, challenging management in the most productive ways?" What's more, except in the banking world, boards haven't had to take the blame for practices they should have corrected early on.

Today, boards are probably under-reacting to the stresses—and opportunities—of economic turmoil. Directors themselves seem to agree: a McKinsey survey conducted in conjunction with an article published earlier this year showed that only half of the 186 directors responding thought their boards had met the demands of the crisis. Just 30 percent reported that a wider range of information was now presented at board meetings or that conversations were more frank than usual. Even among directors who believed that their boards had responded effectively, overall, to the crisis, only 19 percent felt that those boards had really addressed the problems of talent management—meaning not only the composition of the board but also its

role in hiring and remunerating senior executives.

Boards need to assess their performance thoroughly and honestly to figure out what they must change, how urgently they must change it, and where they should start. That view is widely shared: many submissions to the UK Financial Reporting Council's current examination of Britain's Combined Code of Corporate Governance, for example, recommend that boards regularly conduct formal performance assessments. The ideas we propose here make sense in both bad times and in good.

### Assessing the board's effectiveness

During a crisis, when a board's agenda is already overflowing with reports from the front lines, it can be hard to find extra time for self-examination. But if a board is going to ask senior executives to reexamine the way their company is managed, it had better reexamine itself as well. In a recent report, the executive search firm Heidrick & Struggles concluded that 51 percent of European boards fail to meet reasonable standards in their "working style." Three areas were of particular concern: the availability of directors for extra board meetings and discussions; the widespread absence of committees for special topics, such

Boards need to assess their performance thoroughly and honestly to figure out what they must change, how urgently they must change it, and where they should start.

as audits, remuneration, nominations, and strategy; and the excessively long service of some directors.

A simple solution would be to ask each board member to fill out a survey with questions on topics such as the frequency of board meetings, their agendas, the materials presented at them, the time allotted for agenda items, the nature of the dialogue, the contributions of various individuals, access to management and staff, opportunities for less formal discussions, and the way action items are followed up. More elaborate processes can be probed with additional questionnaires reinforced by interviews with directors and conducted by the senior nonexecutive director or an independent adviser. Once the answers have been assembled, the chairman should lead a discussion about them with the whole board.

Care is needed to manage the process. The board's discussion could be awkward because members may feel reluctant to criticize colleagues or make remarks that might undermine the chairman's authority. Answers should therefore be presented anonymously and circulated among all board members before open discussion, which ought to consume an entire

board meeting. Then the chairman and the senior nonexecutive director should formulate recommendations for change and present them at a second meeting. The open discussion during the first one makes for a wider, freer debate on the issues, without the pressure of decision making. Decisions must nevertheless be made, but at another meeting.

For some boards, a full self-assessment during the thick of the crisis may seem like a luxury. One company decided instead to focus on the immediate changes needed. Directors were asked to rate the degree to which the crisis had disrupted the company's normal operating environment and how drastically the board needed to change its agenda and style of interaction with management. The responses showed that a majority of board members desired significant change. A rich discussion led to the introduction of an open-issues agenda item at each board meeting, the elimination of some purely informational reports, greater exposure to executives of divisions, and a resolve to change the mix of skills around the boardroom table.

In another case, the assessment resulted in a small but significant change. Principle accounting



judgments, normally discussed at length only in the audit committee, were now included on the full board's agenda. That move has increased the level of scrutiny for critical accounting decisions, generated a lively debate about the financial performance of the company, and helped educate directors less familiar with its important accounting issues.

Past decisions that went wrong are worth special attention. Boards can identify those that now seem unwise—say, an increase in debt to pay special dividends, hiring executives to lead new growth initiatives, or major acquisitions that stretched balance sheets. The chairman can then ask for a review of the board's decision-making process, including the stated and unstated assumptions and the formal and informal discussions around them.

In many cases, a board will find that a decision was sound when it was made but that the business environment then changed unexpectedly. Some decisions, however, will be exposed as flawed from the start, and the lessons learned from them will help revitalize the board. At a company with two strong divisions, for example, the board concluded that it had supported a disastrous acquisition by one of them

at least in part because the other had made a successful acquisition two years earlier. In retrospect, the board concluded that having supported the first acquisition, it had felt it should also, in fairness, support the second. Directors resolved to change the two divisions' culture of rivalry.

#### Fresh information and conversations

Boards normally spend most of their time reacting to management proposals. Yet today, as managers focus on cost cutting and survival, boards can look further ahead, to identify "the new normal." To that end, they will need new kinds of information, as well as new kinds of conversations among their members.

Chairmen can expose their boards to new sources of information—such as new performance benchmarks, new customer demands, or new financial perspectives—in many ways. One involves tapping into the rich experience of nonexecutive and executive directors who also hold external appointments. Each board member can be asked to share one fresh idea as part of a discussion about the company's future. Given the rich sources of insight a diverse board offers, it's ironic that some banks have been widely criticized for having directors who are not qualified

As Warren Buffett has so crisply explained, “It’s only when the tide goes out that you learn who’s been swimming naked.” He was referring to companies, but the principle is equally applicable to board members and senior executives.

bankers. When the world is changing rapidly, diversity is more valuable than homogeneity.

One company used a more structured approach built around Porter’s five forces—the intensity of competition, the power of customers, the power of suppliers, the threat from new entrants, and the threat from substitute products—a framework that encourages a comprehensive outside-in view of businesses. Each board member was asked to describe a recent experience that suggested how these forces might shape the company’s future. One mentioned that supermarkets had forced suppliers to offer a 60- rather than 30-day receivables period. Another explained that the margins of his company’s customers were collapsing. A third pointed to new competitors that had entered the bottom of the market in his home country.

The chairman of another company used a more traditional form of analysis to spark fresh thinking and discussion. He asked the finance director to lay out the company’s performance, using the DuPont equation—a ratio analysis tool used to measure the return on equity (ROE)—and then to highlight the operating and financial variables that drive it. The analysis compared the

ratios that make up ROE before and after the crisis, showing clearly where it was and wasn’t hitting the business: for example, the cost of debt had increased dramatically and volumes had declined, but the gross margin hadn’t changed. The discussion helped directors decide where they wanted to focus their attention. As a result, they called for additional interest rate forecasts and cash flow information.

A discussion that brings out contrasting points of view is often essential for developing and testing new ideas. Boards can promote such discussions by bringing in facilitators or employing special techniques. For example, in Edward de Bono’s classic colored-hat approach (a thinking exercise designed to encourage group discussion and decision making), each round of debate is explicitly geared, not to the default style of the board member speaking, but to the style defined by the “thinking” hats: such as seeking information, proposing ideas, and skepticism. At a Central European bank, for instance, a normally skeptical executive director who had donned the “proposing ideas” hat turned out to have cogent thoughts about how the company could grow.

Boards should also design more challenging discussions about

important current issues, for even when the economic environment is changing drastically, it’s easy to make decisions shaped by old, outdated paradigms. Chairmen ought to help their boards surmount this tendency—for example, by requesting that all significant proposals come with a “red team” report presenting contrary arguments. This document, which should be prepared by an external consultant, need not undermine the CEO’s authority; the chairman would merely request that the board hear arguments for and against any important proposal. The CEO would therefore have to think deeply before submitting the proposal, undecided board members could insist on a fuller discussion, and a rival paradigm might see the light of day.

#### Reviewing talent-management processes

As Warren Buffett has so crisply explained, “It’s only when the tide goes out that you learn who’s been swimming naked.” He was referring to companies, but the principle is equally applicable to board members and senior executives.

A company should start to appraise its talent-management system by reviewing the composition of the board. The assessment of its processes

may have raised concerns about its effectiveness. Even if not, it's important to make sure that the board's membership is appropriate in view of the new economic environment. Does the board need one extra finance person and one fewer marketing person? Someone with experience in a banking crisis rather than in creating new growth platforms? An additional person familiar with developing economies, environmental challenges, or government relations? Some banks have been forced to change their boards radically, but most companies have yet to reshuffle the team.

Such discussions are hard to have in an open forum, so the chairman and the senior nonexecutive director may need to review the board's balance with an adviser, such as a headhunter. The danger, of course, is overreacting by adding people with now-fashionable backgrounds—in areas such as risk, the environment, or China—rather than experiences that will help the board face the company's probable future challenges. Any review must therefore start with the scenarios that help define those challenges.

The review of the board should also extend to top executives and to the company's talent and succession processes in general. Some people previously identified as high flyers

will now seem to be fair-weather fortune hunters. Others, formerly seen as solid but dull, may be rated more highly because they know how to control operations and costs. If a number of executives are rerated, the next step should be to redesign the processes so that future judgments are more balanced and less influenced by fashion.

At one company, for instance, the board felt that the talent pipeline of managers groomed for senior-executive and top-team positions—including the highest—had too many "growth gurus," reflecting the zeitgeist of the era when they were hired. The new vision was that the company needed more "operators," with stronger experience in controlling costs, restructuring, and emergency intervention. The management group had become a little too homogenous, a little too removed from core operating skills, so the board sent the company's HR processes back to the drawing board for a complete redesign that emphasized operations.

Boards can also view the crisis as an opportunity to reassess the compensation architecture: base pay, expenses, bonuses, and long-term incentives. Many argue that poorly designed remuneration processes contributed to the problems many

companies now face—in particular, that such processes were one reason why so many financial-services firms followed the same risky strategies.

Much criticism has also been directed at the way remuneration committees operate. There are many systems for calculating total returns to shareholders, developing benchmarks, and comparing compensation schemes to those of other companies, for example, so these committees spent too much time on minutiae. They also failed to focus on the big picture because presentations by remuneration experts often dominated their agendas, leaving too little time for broader debate about the overall objectives of the compensation scheme, its appropriateness for the company and the corporate strategy, and the likely reactions of shareholders, employees, the financial press, regulators, and local communities. Public outrage about executive compensation should be a helpful backdrop for a review of the basic pay architecture.

Many boards are underperforming at a time when they desperately need to excel. Any board that expects creative responses and extra performance from its management team must show that it too can raise its game.



Dr. Waleed Al Ajlan

## Family Businesses and Corporate Governance

Family business is a global phenomenon in all countries. In the USA, at least 90 percent of the businesses are family owned and controlled and contribute somewhere between 30 and 60 percent of the nation's gross domestic product (GDP) and half of total wages paid<sup>2</sup>. 25 percent of top 500 US companies are family controlled<sup>1</sup>. Similarly, a third of Standard & Poor's top 500 as well as half of the top French and German public companies are still family owned (FBN International).

In the Arab world and the GCC countries, in particular, the case is similar, in that some figures estimate that family firms consist of 70-95 percent of total business in the region<sup>3</sup>.

However, one advantage that the GCC countries have is that their businesses are only a few decades old and are often still in the hands of the first generation. This gives these organizations the ability to restructure and build up the governance structure in such a way that these firms are able to establish the foundations of a road map for the next generations. Accordingly, it is imperative for the family businesses in the region to take certain steps that will help ensure continuity for these companies and prevent them from disappearing in

the second or the third generations. Namely, the businesses need to develop a proper governance structure by implementing certain initiatives.

First, these firms should give priority to a board structure that allows these boards to be more effective and to be able to seek input from outside independent directors rather than relying on just the family. Second, a succession plan policy acts as a cornerstone in such structures. This requires having a good recruitment policy for family members and non-family members alike to serve on the board and as executives within the company. Third, having an organization structure that covers the roles and responsibilities of every level within the organization can prevent the misuse of power by certain family members according to their ownership and/or positions in the firm.

These are some of the steps that need to be considered when running a family business.....although there is still a way to go.

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