

THE ROLE OF OWNERS AND THEIR DEVELOPMENT AS DIRECTORS: IS THE CORPORATE LEADERSHIP PREPARED FOR ITS ROLE?

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FORUM IPO+:
INCREASING
COMPANY VALUE

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GÓMEZ-ACEBO & POMBO

ABOGADOS

ICA Instituto de
Consejeros-Administradores

Corporate Governance: Definitions

- Corporate governance for companies
“The system by which companies are directed and controlled”
(Cadbury Committee)
- Conflicts of interest to be dealt with:
 - Shareholders vs. managers
 - Minority vs. controlling shareholders

Benefits of Good Governance: Empirical Studies

- Firms with anti-takeover devices: minus 8,5% return and coupled with poor shareholder protection and poor internal controls: minus 10-15% return.
- The better the quality of shareholder protection the larger the country stock market (and possibilities of financing).
- Weak corporate governance translates into higher costs of capital.
- Countries with higher concentrations of wealth show less progress in institutional reform.

Empirical Studies

- Higher “tunneling” (appropriation of value) chances
 - Increase of acquisition premium
 - US: 2%
 - Latin countries: 18%
 - Russia: 50
 - Good for existing shareholders?

Heated Debates

- LEADERSHIP=OR≠OWNERSHIP
- LEADERSHIP VS GOOD GOVERNANCE
- SYSTEM OF COUNTER BALANCES AND CONTROL
 - AGAINST CROOKS OR HONEST PEOPLE?
- PROFESIONALISM OF DIRECTORS
- OWNERS AS DIRECTORS

Conditions of the System of Good Governance

- Existence of market for corporate control
- Existence of mechanisms for internal control
- Blockholding
 - Owners
 - Institutional investors
 - Shareholder activism
- Financing: Capital market oriented
Bank market oriented

Adequate Reputational Intermediaries

- Accountants
- Lawyers
- Investment bankers
- Rating agencies
- NGO
- Journalists
- Independent directors
- Public regulators

Anti-Take Over Mechanisms

- Greenmail
- Blank check
- Delay of business combinations
- Limitation of bylaws amendment
- Classified on staggered board
- Poison pills
- Control-share cash-out
- Compensation Plans
- Golden Parachutes
- Pension Parachutes
- Silver Parachutes
- Special meeting
- Supermajorities
- Unequal voting
- Voting restrictions
- Written consent
- Fair price

Legal Duties of Directors

- **FIDELITY DUTY: INTEREST OF THE COMPANY**
- **DILIGENCE DUTY**
 - Smell test
 - Business judgement rule
 - Well informed/professional director
- **LOYALTY (FIDUCIARY) DUTY**
 - No competition
 - No benefit from business opportunities
 - Conflict of interest procedure
 - Vinculated transactions procedure

Role of the Board

- **DEFINITION OF STRATEGY AND NECESSARY ORGANISATION AND CONTROL OF THE MANAGEMENT**
 - Strategic plan
 - Investment and financing policy
 - Group structure
 - Corporate Governance policy and CSR
 - Dividend policy
 - Risk control policy
 - Appointment of top executives
- **COMPENSATION OF DIRECTORS (COUNTER BALANCED)**
- **FINANCIAL INFORMATION**
- **STRATEGIC INVESTMENTS**
- **OFF BALANCE SHEET TRANSACTIONS**
- **NO DELEGATION**

Professional Board of Directors

- Board composition: majority of external directors
- Separation Chairman/CEO
- Existence of lead director
- Meetings of non executive/independent directors
- Committees
- Retirement age
- CEO succession plan
- Outside advisors available to the board members
- Board and board members performance review
- Board members education
- Limitation of liability

Commission Recommendation of 15th February 2005 on the Role of Non-Executive or Supervisory Directors and on the Committees of the (Supervisory) board of Listed Companies

- To become legislation or recommendation (comply or explain) by 30th of June 2006.
- Appropriate level of non executive/supervisory directors:
 - a) No dominance of decision making process by individual or small group
 - b) Ensure any material conflict of interest involving directors will be properly dealt with
- Chairman and CEO roles separated or safeguards put in place.
- Appointment for specified term
- Necessary commitment
- Independence
 - Free of business, family or other relationship with the company, its controlling shareholder or the management, which creates a conflict of interest.
 - Criteria for assessment at national level but decision by the board.
 - Resignation to be explained in writing

Commission Recommendation of 15th February 2005 on the Role of Non-Executive or Supervisory Directors and on the Committees of the (Supervisory) board of Listed Companies

- Committees:
 - Nomination/remuneration/audit
 - Number of non executive directors sufficient to effective role
 - Just make recommendations
- Composition of committees:
 - Nomination
 - Majority of independents
 - Remuneration
 - Exclusive non-executive (majority of independents)
 - Audit
 - Exclusive non-executive (specific training) (majority of independents)
- Terms of reference and role of committees

EU Recommendation on Remuneration of Directors

- Remuneration statement:
 - Focus on remuneration policy
 - Importance of variable/non-variable
 - Performance criteria
 - Supplementary pensions
 - Terms of director's contract
- Shareholders to approve remuneration policy and remuneration stake-out
- Shareholders to approve share-based remuneration
- Disclosure total remuneration of individual director

Directive 2004/109 of 15th December 2004 on the Harmonisation of Transparency Requirements about Issuers whose Securities are Admitted to Trading on a Regulated Market

- To be implemented by 20th of January 2007
- Requirements of periodic information
 - Annual financial report
 - Audited financial statements
 - Management reports
 - Statements by person responsible within the issuer
 - Half yearly financial reports
 - Condensed set of financial statements
 - Interim management report
 - Statement by person responsible
- Requirements on ongoing information
 - Information about major holdings (shares or voting rights)
 - Information for holders of security