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The Handbook of Board Governance

An Introduction and Overview

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Introduction and Overview

Welcome to the first edition of *The Handbook of Board Governance: A Comprehensive Guide for Public, Private, and Not-for-Profit Board Members.*

I hope you enjoy the *Handbook.* To the best of my knowledge, information, and belief, it is the only board governance handbook of its kind in the world. This is because of its scope (all aspects of governance are covered) and its depth (by subject matter experts).

What follows in this chapter is a description of each of the chapters within the *Handbook*. Authors are thanked for working with the editor. There are eight parts to this *Handbook*, corresponding to all the areas of board governance, for any type of board or organization. Each part has relevant chapters within its part, exploring the topics in depth.

Diversity of Authorship

The authors within this *Handbook* are carefully chosen by the editor as subject matter experts within their respective domains, and possessing deep expertise. Their expertise originates from experience, skills, education, knowledge, and training. There are current or past academics, auditors, authors, CEOs, chairs, compensation consultants, directors, executives, investors, lawyers, and recruiters, all with a passion and demonstrated track record for effective board governance. Each author is a leader within his or her governance domain, and many—if not most—authors have considerable governance expertise across all types of companies, including public, private, state owned, and not for profit.

There is also considerable diversity of experience and background among the fifty authors of the 39 chapters in this *Handbook*. The authors, collectively, live and work in eight countries: Australia, Belgium, Canada, France, New Zealand, Turkey, the United States, and the United Kingdom. Age ranges include authors in their twenties and thirties, to authors in their seventies and eighties. There is gender and ethnic diversity among the authors. Most authors are active on social media, and as speakers in liaising with their practitioner communities.

This *Handbook* is not only about the present, but also about where the field of board governance is going, and what changes directors and those who study and advise boards can expect over the next five to ten years. Authors have been asked to be forward-looking and critical as much as possible. Individual authors may agree or disagree, within their respective chapters, and that is characteristic of a field that is in a period of dramatic change.

Drivers and Impediments to Improved Corporate Governance

The field of corporate governance is in a state of continuous change. Enron and WorldCom, among others in the early 2000s, were largely implosions that caused great harm to shareholders, employees, pensioners, and other stakeholders, and resulted in reformulating the independence of audit committees and the reporting relationship of external auditors. The global financial crisis of the late 2000s was more widespread and invoked greater outrage and regulation. There has been considerably more regulation, and it is reflected within this *Handbook*.

The drivers of strengthened corporate governance and the oversight role that boards should serve are the public, the media, legislators and regulators, institutional investors, shareholder activists, academics, and other stakeholders.

Impediments to good governance, transparency, and accountability may include resistant company management, captured or complacent regulators, corrupt government officials, controlling investors or families, advisors retained by defensive management, and sometimes intransigent or underperforming directors themselves.

Some of the challenges to increased strengthening of governance, voiced to the editor, include these views: "This [stronger governance regulation] is regulatory overreach and the regulator lacks jurisdiction"; "We have never done it this way"; "It is too costly"; "It is too difficult to implement"; "We did not cause the financial crisis"; "The reforms do not apply to our company [or sector]"; "Directors will resign and we will not be able to find good directors"; "It is the law of unintended consequences and a 'one size fits all' approach"; and "Directors will end up running the company."

It is not productive to debate each of the foregoing defenses, and there may be truth, vested interest, myths, or untruth within each. The *Handbook* assumes that governance change is occurring, and not only will continue, but is likely to become more pronounced. There has likely been more governance change since the global financial crisis than within a generation or since the Great Depression. Readers of this *Handbook* are encouraged to view the practices within it as a menu of options to consider for their own board. There should be nothing recommended within this *Handbook* that is not already practiced, or is not currently a best practice somewhere. It is not a question of whether the practices herein should be practiced by your board, but when and how.

Précis of This Handbook's Chapters

I will now proceed to outline each of the sections and chapters within this *Handbook*.

Part I: The Board's Responsibilities

In Chapter 2, "Boards That Lead," Michael Useem, Dennis Carey, and Ram Charan focus attention on building more engaged leadership in the boardroom. They identify a distinctive social architecture that is now required of companies if directors are to lead the enterprise along with executives, not just stand guard over it. This calls for a deeper kind of relationship between directors and executives, and a new kind of leadership from both. Dennis Carey is Vice Chairman of Korn/Ferry International. He specializes in the recruitment of chief executives and corporate directors. Ram Charan is a business advisor who has worked with executives and directors of many major companies. He has served on the *Harvard Business School* faculty, and he teaches in Wharton Executive Education. Michael Useem is the William and Jaclyn Egan Professor of Management, and Director of the Center for Leadership and Change Management at the Wharton School of the University of Pennsylvania. This elite panel of governance experts explains: how boards will want to identify where they will lead, partner, or stay out of the way; create protocols for selecting and assessing the chief executive and the board leader; establish a board leadership and governance committee; recruit new directors who substantively contribute to the central idea and ease out those who do not; institute a coaching system to ensure that a faltering CEO is either mentored or removed; and open a channel for directors to connect with investors.

Chris Pierce, CEO of Global Governance Services Ltd., in Chapter 3, "Trends in Corporate Governance," takes an optimistic perspective of governance. He identifies many significant improvements that have been made to corporate governance practices around the world and suggests that these trends are likely to continue. He notes that many countries are continuing to successfully employ voluntary corporate governance codes that contain recommendations for good and responsible governance where companies are typically required to report to their shareholders on a comply-or-explain basis. These changes have focused upon improving director professionalism that lead to improvements in board effectiveness. He argues that it is unlikely that the rate of change experienced over the last decade is likely to diminish in the near future. He foresees that changes in governance practices will most likely emanate in countries outside of the United States and the UK. He argues that regulators around the world are rightly being given ever-increasing powers by governments to oversee, monitor, and enforce governance activities to inhibit and curb any excessive greed of directors and managers or abuse of the public interest.

Drew Stein, professional chairman and director, in Chapter 4, "Governance as a Corporate Discipline," draws on his considerable international experience to map out and explain where governance fits within the chain of corporate obligations and performance expectations, which shape a board's professional and commercial behavior. He describes why governance, as a discipline, is sometimes referred to as the *fourth dimension* alongside a company's three founding documents—the articles of association, articles of memorandum, and the shareholders' agreement. In addition, he addresses the linkage between sound corporate governance and the board's obligations to its shareholder investors. Within the chapter he explains the processes involved in developing a modern professional corporate governance document. Drew is quick to point out that there is no cookie-cutter model that can be used—each business and market circumstance is influenced by strategic imperatives, including factoring in shareholder expectations, that shape the structure and authorities embedded in the governance document. In his final summary, Drew highlights that the corporate governance document needs to be regularly audited and updated by independent professionals to ensure that it continues to remain fit for purpose in this fast changing world of innovation and technical advancements.

Henry D. Wolfe, private investor and Chairman of De La Vega Occidental & Oriental Holdings, in Chapter 5, provides a comprehensive blueprint for a more robust model of the nonexecutive chairman role. Henry Wolfe notes that the current model of governance in public companies is broken. Although there is some positive movement in the right direction, far too many boards have failed to understand that their primary responsibility is to ensure that there is optimization of capital allocation, and maximization of company performance and shareholder value. This failure has led to a grossly imbalanced focus toward compliance, sub-optimal director selection, and a continuing lack of holding management accountable for results. As such, a new, more robust model is needed that approximates the more engaged and high-performance model found at the best private equity firms' portfolio companies. Henry Wolfe recommends that the foundation of this new governance model is an expanded view of the role of the nonexecutive chairman, which will be detailed in this chapter. The concept of this role must extend beyond simply separation from the CEO position and independence. New responsibilities must be defined, including: leadership, setting the standards for the value creation process, focusing the board toward engagement in monitoring progress toward the targets of the value maximization plan, and holding management accountable. In addition, to ensure that this role is executed at the highest level, this chapter delineates the high-level qualities and skills needed from directors, such as a performance-oriented mind-set, understanding of and track record with the value-creation process, and the ability to have a holistic view of the enterprise that is essential to an optimization of this key role.

Mark B. Nadler, is the Principal of Nadler Advisory Services, a consultancy specializing in board effectiveness and CEO succession. He has written or contributed to nearly 65 publications related to leadership, governance, and organizational effectiveness, including the book *Building Better Boards: A Blueprint for Excellence in Governance*. In Chapter 6, "CEO Succession: An Owner's Guide for Directors," Mark focuses on the reality of CEO succession, rather than the theory. He examines ways in which the succession process derails in real life, and explains those breakdowns in a larger context. The three powerful dynamics (emotional, political, and rational) that often derail succession are explored in detail. Mark identifies ten ways where he has seen the succession process stumble and fail, and explains how they are all avoidable, by constantly monitoring and managing the delicate interplay of the emotional, political, and rational dynamics.

In Chapter 7, "CEO Succession Planning," Professor David F. Larcker and Brian Tayan review the processes by which board members carry out their accountabilities to hire, evaluate, and—when circumstances merit—remove or replace the chief executive officer. They provide an overview of the market for CEO talent and examine the individuals that usually serve in this role, their backgrounds, and attributes. They then explore how frequently companies change CEOs—specifically, how responsive boards are in terminating under-performing chief executives. They also review the profile of incoming CEOs, including whether sourced from within or outside the company, and how this decision impacts future performance. They conclude by reviewing the various models that companies adopt to plan for succession events, and evaluate the tradeoffs implicit in their selection. Professor Larcker holds the James Irvin Miller Professorship at the Stanford Graduate School of Business. He is the Director of the Corporate Governance Research Initiative at the Stanford Graduate School of Business and senior faculty of the Arthur and Toni Rembe Rock Center for Corporate Governance at Stanford University. Brian Tayan is a Researcher at the Corporate Governance Research Initiative at the Stanford University Graduate School of Business, where his work focuses primarily on corporate governance. He has coauthored two books, *Corporate Governance Matters* and *A Real Look at Real World Corporate Governance*.

Part II: What Makes for a Good Board? Independence, Competency, Dynamics, and Behaviors

Dr. Richard Leblanc, Associate Professor in Law, Governance and Ethics, and Director of the Masters in Financial Accountability Program at York University, in Toronto, Canada, begins Part II with Chapter 8, "Director Independence, Competency, and Behavior." Based on his work with regulators, public boards, and shareholder activists, Dr. Leblanc homes in on individual director effectiveness. This chapter first explores the differences between regulatory defined independence and independence of mind, and how directors, management, and internal, independent oversight functions can be captured or beholden to senior and operating management, thus rendering them ineffective, and how this can be and is prevented within good boardrooms. Second, Dr. Leblanc describes how to design and implement a proper Director Competency Matrix, to maximize any board's likelihood of having well-qualified directors at the board table. Third, Dr. Leblanc describes fifteen behaviors and other attributes that directors should possess in order to maximize their contribution to boardroom dynamics and oversight of management. If one or more behaviors are inadequate or problematic, overall board dynamics will be impaired. Lastly, Dr. Leblanc summarizes the rationale for recent regulatory or investor actions that attempt to compel board renewal, including: the enhancement of boardroom diversity (e.g., gender, ethnicity, age, geography); term limits for directors (e.g., nine or ten years); limits on the number of boards on which a director may serve (e.g., no more than four boards for independent directors); and proxy access (whereby investors compel management to include investor choices of prospective directors as well as management nominees on the proxy circular, subject to shareholdings). Professor Leblanc concludes this chapter by outlining what could be the most effective way to associate director tenure with performance, namely by peer director assessment.

Dr. Charas, a Board Director, Senior-Level Human Resources Executive, and Adjunct Professor, writes Chapter 9, "The Criticality of Board Director Team Intelligence (TQ) in Economic Value Creation." Research has proven that teams perform better than the best individuals at solving complex problems, and the problems facing boards are perhaps the most complex in the organization. To be effective, the board must be a high-performing team. Despite 90 percent of board directors evaluating themselves as highly effective, these same directors evaluate only 30 percent of their boards as highly effective. What accounts for great individual directors generating ineffective collective board performance? What implications does this have for governance quality and shareholder optics? Until recently, a valid, reliable, and objective way for a board to determine the quality of the team and the ultimate financial impact that team has on corporate performance did not exist. A new and timely way to measure board effectiveness is introduced—given heightened shareholder scrutiny and a focus on hard metrics. Boards will need to address the challenge to prove their effectiveness through high team quality. Dr. Charas's chapter not only provides a way to assess the quality of the board team, but quantifies the financial impact boards have on bottom-line performance.

Dr. Mary Halton, Managing Director of Align Consulting, writes in Chapter 10, "Lessons from the Banking Crisis: Leadership and Effective Board Behaviors," about the importance of both the chair and the CEO in creating the conditions that promote effective board behaviors, in particular constructive challenge and contribution. Drawing on the experiences of chairs, directors, regulators, board advisors, and other key players in the Irish and Canadian banking sectors in light of the 2007–2008 global financial crisis, Dr. Halton looks inside the boardroom to examine the factors that shape behaviors around the table. The chapter begins by placing behaviors within the wider literature on boards, before moving on to consider of the roles of the chair and the CEO, and the importance of the relationship between these individuals, as well as between the CEO and the board. This leads to a discussion of board norms and the significant influence these norms have in facilitating or constraining constructive challenge and contribution. The findings highlight the central role of trust in the boardroom. The issue of information flow and quality is examined, and, in particular, the need for openness. Practical issues around structure and process, and how these help to condition behaviors, are then considered. Findings are summarized and final conclusions are drawn. Through the quotation and analysis of the views and experiences of chairs, directors, and others who operate in and around the boardroom, Dr. Halton brings to life many of the challenges facing directors today. Her work provides valuable insights into life inside the boardroom, and offers considerable food for thought to encourage effective board behaviors.

Holly J. Gregory, co-head of Sidley Austin's global Corporate Governance and Executive Compensation Group, in Chapter 11, "The Challenge of Director Misconduct," provides helpful and practical strategies for addressing this very difficult problem that many board members find themselves confronting at some point in their tenure. The chapter is presented in a user-friendly list format that serves as a baseline reference for any board or board member confronting the difficulties posed by such behavior. Ms. Gregory covers behaviors expected of directors that help boards establish norms that foster a desirable board culture; forms of director misconduct, including breaches of confidentiality which she highlights as likely the most damaging; types of harm caused by director misconduct; appropriate behavior for a dissenting director to consider when he or she disagrees with a majority position of the board; strategies that a board can helpfully undertake to prevent director misconduct from arising in the first place; and, finally, options available to a board to address both unintentional and intentional director misconduct when it does happen. This is a must-read chapter for both current and prospective board members, who will find Ms. Gregory's material to be indispensable in dealing with the perpetual challenge of director misconduct.

Part III: Risk Governance, Assurance, and the Duties of Directors

Nell Minow explores in detail the complexities, nuances, and problems with the Fiduciary Standard in Chapter 12, "The Rise and (Precipitous, Vertiginous, Disastrous) Fall of the Fiduciary Standard." Nell Minow notes that boards of directors have two fiduciary duties: care (doing their homework) and loyalty (putting the interests of the shareholders above their own or the interests of the executives). She points out that the business judgment rule provides that if directors follow the usual procedures, the courts will not second-guess their decisions, even when they turn out to be wrong. In theory, this makes sense but in practice it has resulted in an orientation toward the three *C*'s: checklists, consultants, and compliance. It has been a bonanza for investment bankers, lawyers, and auditors. The chapter ends with a call for a return to a robust fiduciary standard to apply to both institutional fund managers and corporate directors. Nell Minow is Vice Chair of ValueEdge Advisors, which provides guidance and support to institutional investors on engagement with portfolio companies. Previously, she was co-owner and a member of the board of GMI Ratings (formerly The Corporate Library, which she cofounded and chaired). GMI is the leading independent research firm for rating boards of directors and evaluating governance risk. She is the coauthor *Corporate Governance*, a leading MBA textbook in the field.

In Chapter 13, "The Duties and Liabilities of Directors—Getting the Balance Right," Dr. Roger Barker provides a thoroughly effective presentation of the fundamental principles of directors' duties and liabilities. Barker positions his chapter in the context of a continuing flow of corporate scandals that frame a central question: "Whether modern corporate law has struck the right balance between the need for meaningful corporate accountability on the part of directors and the possibility of overwhelming directors with personal liability?" A reader of this chapter will gain the knowledge to grapple with this critical question. Readers are presented with a highly readable up-to-date case law and statutory framework underpinning the following subjects: Why directors have duties and liabilities; The general duties of directors under corporate law, including the duty of loyalty and what a director's duty of care means; What objectives directors should pursue, maximized shareholder value or other objectives; The business judgment rule that protects directors from liability; How directors duties are capable of being enforced; Beyond corporate law examines the leading sources of liability for directors including securities and other laws; and Directors' personal exposure to financial or criminal liability, and whether this is an overwhelming burden or empty threat.

Professor Poonam Puri, of Osgoode Hall Law School and Davies Ward Phillips & Vineberg LLP, discusses the governance of subsidiary corporations in Chapter 14, "Best Practices in Parent and Subsidiary Governance." In this chapter, Professor Puri argues that although choosing to conduct business through subsidiaries can be advantageous for many reasons, boards of parent corporations must ensure best-governance practices in overseeing their subsidiaries, as there is the potential for significant parent-company liability for the actions of their subsidiaries. We are entering a new era of corporate governance where the traditional concept of limited liability corporations is being challenged. Plaintiffs in many jurisdictions are attempting to use a wide range of tools that were not previously available in order to hold parent corporations legally and financially responsible for the actions of their subsidiaries, as well as, in some cases, hold subsidiaries responsible for the actions of their parents and sister corporations.

This chapter provides an overview of parent–subsidiary governance and discusses recent case law that has expanded the ways a corporation can be found liable for the actions of a subsidiary, parent, or sister corporations. The chapter also outlines corporate governance concepts and best practices, along with a checklist of governance essentials. The goal of this chapter is to equip corporate directors, officers, legal counsel, and corporate secretaries with the knowledge and tools they need to develop effective governance strategies to oversee their subsidiaries and mitigate parent company liability.

John Fraser, former Chief Risk Officer at Hydro One Networks, one of North America's largest electrical transmission companies, explains the role of the board of directors in risk management oversight in Chapter 15, "The Role of the Board in Risk Management Oversight." He provides the context of why risk-management oversight is important and, in many cases, why risk oversight is now a governance requirement. The challenges faced by boards of directors are explained, as are the various methodologies for approaching the process of risk management that boards may encounter. Risk can be a confusing and complex concept and this is explored, with concise approaches provided to assist boards in their oversight role. There are several ways that boards may organize to address enterprise risk management, often by using the audit committee or the full board, or increasingly by establishing a separate risk committee. These alternatives are compared. Managing risk in a consistent way across an organization, often now labeled as enterprise risk management, is explained and the board's role in the key steps is highlighted. Overall, this chapter provides board members, management, assurance providers, and academics, who oversee, report on, provide independent assurance, and study this topic, with a valuable resource that includes references to numerous supplementary readings for the serious student of this popular and evolving governance topic.

In Chapter 16, "Board Oversight of Internal Audit: How to Maximize Internal Audit Value," John Fraser, recently retired Senior Vice President, Internal Audit, and Chief Risk Officer, draws on his extensive practical experience in reporting to numerous boards of directors and audit committees. He explores best practices in the oversight of internal audit and how to maximize the value of internal audit within an organization. He explains how best to establish and maintain an effective relationship between internal audit, the board, and executive management, and the attendant pitfalls to be avoided. John explores the respective roles, the many areas where the relationships can be improved, and how audit committees can do a better job in discharging their accountabilities. He explains the types of questions that audit committees should be asking and what type of chief audit executive is best suited for the position, depending on the committee's needs. Most importantly, the author explains the role of trust in the relationship between the audit committee and the internal audit function, and how this might best be achieved or destroyed.

In Chapter 17, "Three Lines of Defense versus Five Lines of Assurance: Elevating the Role of the Board and CEO in Risk Governance," Tim J. Leech and Lauren C. Hanlon provide an overview of the Three Lines of Defense risk governance movement, explain some of the contrarian positions, and outline the sub-optimal—even dangerous—elements of the Three Lines approach. They then propose a framework that they believe boards of directors, C-suites, legislators, regulators, professional associations, consultants, and others should carefully consider as a superior alternative, if the goal is better corporate governance, increasing shareholder wealth, and national prosperity, and that is the Five Lines of Assurance risk governance framework. Tim Leech is Managing Director of Risk Oversight Solutions Inc., and Lauren Hanlon is its Director. Tim Leech received worldwide recognition as a pioneer, thought leader, and trainer in areas of risk, governance, and audit. His newest breakthrough methodology, "Board and C-Suite Driven/Objective Centric ERM and Internal Audit," more generally known as Five Lines of Assurance, has been licensed by the Institute of Internal Auditors for global deployment. Lauren C. Hanlon is an internal audit expert, software innovator, and training specialist. Lauren provides innovative solutions and a fresh approach to ERM methodology and technology training for numerous organizations and risk specialists, around the world.

In Chapter 18, "Commercial and D&O Insurance for Large Corporations: Best Practices in Protecting the Assets and Liabilities of Directors and Officers and Their Organizations," Stephen J. Mallory, insurance industry executive and company director, diffuses the mystique surrounding the placement of the commercial and D&O insurances, necessary for the survival of large organizations. Previously considered the domain of the four or five insurance brokerages, which place virtually all the insurance on large organizations worldwide, this chapter equips executive teams and boards with a methodology for overseeing the provision of excellence in corporate and D&O coverages. To assist directors, this chapter provides 20 questions that should be asked to ensure the provision of adequate insurances. To assist management, this chapter provides checklists which can be used to compare current state versus best practice in areas such as: management responsibilities; broker responsibilities; breadth of D&O insurance; and in the process of shopping (marketing) insurances to the world-wide market of insurers. For any leader responsible for managing or overseeing risk in a large organization, this chapter provides invaluable insights on the insurance responsibility, a critical component to protecting the organization and its directors.

Part IV: The Rise of Shareholder Accountability

Robert A. G. Monks, shareholder activist and governance advisor, in Chapter 19, "The Happy Myth, Sad Reality: Capitalism without Owners Will Fail," addresses the incongruities between the original intent of incorporation and the reality of modern corporations. Building a case for what he calls the illegitimacy of the corporation, Monks catalogs the oft-cited beliefs we have about corporations and proceeds to tell us why they are just not true. Shareholders have no control, managers are not accountable, and corporations (and therefore the managers, as well) have undue control over the resources of national economies. While he remains an ardent capitalist, Monks maintains that corporations have changed—many becoming so large and powerful as to supersede any authority of state or country domicile. What is needed, he writes, is for ownership to reestablish control and for government to aid in this. The authority and responsibility of the fiduciary must be reasserted so that corporations can be made to, once again, benefit society rather than take from it.

Richard Fields, Principal at Tapestry Networks, and Anthony Goodman, a Consultant within Russell Reynolds Associates' Board Effectiveness Practice, address "Board–Shareholder Engagement" in Chapter 20. The authors write that one of the major corporate governance stories in 2014 was the rise in board–shareholder engagement, which was then common in certain markets, particularly in parts of Europe, but much less so in the United States. The authors identify the important milestones for board–shareholder engagement globally, including: updates to the UK Corporate Governance Code, the finalization of the Japanese version, and new guidance for Australian and U.S. companies and their institutional investors (including the launch of the Shareholder–Director Exchange Protocol in which they were both involved). Fields and Goodman identify four key factors associated with higher levels of board-shareholder engagement: concentration of ownership by institutional investors, increasing attention to corporate governance, investor stewardship initiatives, and shareholder activism. The authors also discuss the costs and benefits of engagement, noting that, if executed well, engagement improves transparency, mutual understanding, and the overall quality of governance in the market, while reducing friction and transaction costs for companies and investors. However, the authors note that directors and institutional investors have many demands on their limited time and the barriers to engagement include a lack of trust, the risk of mixed messages or selective disclosure, and poor-quality interaction that can damage relationships. The authors suggest that, while 2014 was a watershed year for engagement, the events beyond reinforce that board–shareholder engagement is a governance process that will only gain in influence.

James McRitchie, Publisher of Corporate Governance (CorpGov.net), in Chapter 21, "The Individual's Role in Driving Corporate Governance," calls on readers to take personal responsibility for transforming corporations into more democratic institutions. Most children learn from an early age how government is supposed to work, but as adults, we see the frequent failure of parties to reach agreement on the most basic issues. McRitchie argues that multinational corporations are increasingly at the real center of power, networking at the speed of light. They finance politicians, write our laws, and play one country off against another with regard to taxes and the regulatory environment. Influencing corporate governance may be a more direct way of creating a future world aligned with our own values, rather than focusing on government alone. But how can we have an impact? Corporations do have elections, but no one usually challenges the board for their seats or other measures. Items left blank are typically counted as votes in favor of the board and its positions. The rules are tipped in favor of incumbents. Over the past 20 years, McRitchie, a prolific filer of shareholder resolutions, has demonstrated that individual retail shareholders can make a difference. He reopened the debate that led to proxy access, prompted the SEC to prohibit issuers from excluding shareholder proposals by substituting watered-down versions of their own, and helped convince the California Public Employees' Retirement System (CalPERS) to announce all their votes in advance of annual meetings. A retired regulator, former board member and activist, McRitchie provides insider knowledge of how individuals can work together, transforming companies to serve society as well as shareholders.

Jon Lukomnik, in Chapter 22, "Thought on the Origins and Development of the Modern Corporate Governance Movement and Shareholder Activism," quickly and expertly traces the history and development of corporate governance from the seventeenth-century Dutch East India Company to today's activist battles. The chapter focuses on both the larger-than–life historical figures who created the modern corporate governance movement and the state of the financial world that made this activism inevitable.

Written by someone who was there at the founding of the Council of Institutional Investors, Lukomnik examines how the lessons learned from fighting greenmail and corporate raids in the 1980s and 1990s have matured into today's corporate governance landscape. Along the way, he introduces us to such larger-than-life sculptors of corporate governance history as Jesse "Big Daddy" Unruh and tells of the game-changing events of an era, such as how investors forced a recalcitrant CEO of General Motors to meet with them in public, just weeks after he said he would not. Today's corporate governance norms and today's activists were shaped by history. This chapter is a must-read for anyone who wants to understand how and why today's corporate governance looks the way it does and what it portends for the future.

Part V: The Unsolved Governance Problem: Performance Measurement And Executive Pay

Charles M. Elson, the Edgar S. Woolard, Jr., Chair in Corporate Governance, and Craig K. Ferrere, the Director and Fellow, both of the John L. Wienberg Center for Corporate Governance at the University of Delaware, in Chapter 23, "Peer Groups: Understanding CEO Compensation and a Proposal for a New Approach," argue that in setting the pay of their CEOs, boards invariably reference the pay of the executives at other enterprises in similar industries and of similar size and complexity. In what is described as competitive benchmarking, compensation levels are generally targeted to either the fiftieth, seventy-fifth, or ninetieth percentile. This process is alleged to provide an effective gauge of market wages that are necessary for executive retention. As the authors describe, this concept was based upon flawed assumptions. It has been observed in both the academic and professional communities that the practice of targeting the pay of executives to median or higher levels of the competitive benchmark will naturally create an upward movement in total compensation amounts. The pay of a Chief Executive Officer, however, has a profound effect on the incentive structure throughout the corporate hierarchy. Rising pay thus has costs far greater than the amount actually transferred to the CEOs themselves. An important step in that direction is to diminish the focus on external benchmarking. Instead, independent and shareholder-conscious compensation committees must develop internally created standards of pay based on the individual nature of the organization concerned, its particular competitive environment, and its internal dynamics.

Steven Hall, Nora McCord, and Steven Hall, Jr., of Steven Hall and Partners, in Chapter 24, "The Effective Compensation Committee," discuss the current landscape of corporate governance best practices related to executive pay and provide practical advice about the keys to an effective compensation committee, grounded in their collective experience as practitioners in the field for over 60 years. They begin with a discussion of the appropriate roles of various participants in the process, including the compensation committee, its chair, its outside advisors, and management. They describe the foundation of the committee's work, the compensation committee charter, the company's compensation philosophy, and the committee calendar, and provide examples of what these items include and how they should be structured to ensure a well-functioning compensation committee. The authors then cover one of the most challenging tasks for today's compensation committees—aligning pay with performance. They provide an overview of issues that compensation committees should consider when selecting forms of incentive compensation, how to select performance metrics and targets that motivate and reward performance consistent with the strategic objectives of the organization, and when it may make sense to use committee discretion to ensure that payouts are appropriate. The chapter concludes with a summary of shareholder engagement best practices in a say-on-pay environment, including ways to mitigate shareholder critiques of the program, the role compensation committees, and particularly committee chairs, should play as ambassadors of the pay program, and how to navigate the influence of shareholder advisory firms.

Jay A. Conger, of Claremont McKenna College, and Edward E. Lawler III, of the University of Southern California, write Chapter 25, titled "Human Resource Management: The Role of Boards." Along with the intellectual and knowledge property they create, human capital has become the most important intangible asset that most corporations possess. Yet surprisingly little corporate boardroom time is spent on human capital issues. Even when boards take important strategic decisions, they rarely consider the overall workforce and talent management issues that are relevant to these decisions. In essence, boards are missing in action when it comes to monitoring human capital. Research shows that boards have a narrow focus on simply two human capital topics: executive compensation and CEO succession. As a result, they overlook most of the human-capital issues that drive the performance success of their organizations. These include the monitoring of the talent in organizations, its condition and how it is managed, its level of engagement, development, and retention. Their research suggests that boards lack both the human resource (HR) information and expertise to assess human-capital requirements and consistently fail to get these from outside experts, their human-resource systems, and HR executives. In order for most boards to be effective in dealing with critical human capital issues, major changes are needed. This chapter examines the areas where boards need to greatly increase their information, knowledge, and focus on human capital issues to monitor the state of talent.

In Chapter 26, "Designing Performance for Long-Term Value: Aligning Business Strategy, Management Structure, and Incentive Design," Mark Van Clieaf, a Partner with Organizational Capital Group, addresses the controversial and unsolved governance problem of the oversight of executive pay for performance, offering tangible reforms. How should performance and success be measured in public companies? Why are total shareholder returns and earnings per share not the optimal performance metrics for management incentives to align with long-term shareholder value? What key performance metrics should management be measured on to align the business strategy and value drivers of both the current and future value of the enterprise? Over 75 percent of public companies are missing essential performance metrics to measure capital efficiency (return on invested capital, return on assets) and innovation (new products, new markets, new business models), which together are required to drive long-term shareholder value. Chapter 26 identifies opportunities and action plans for more effective corporate governance that enhance performance measurement and incentive design to better align with enterprise value drivers and the integration with management structure design and pay for performance.

Stephen F. O'Byrne, President of Shareholder Value Advisors, in Chapter 27, titled "Measuring and Improving Pay for Performance: Board Oversight of Executive Pay," argues that a board cannot effectively discharge its oversight responsibility without meaningful measures of incentive strength and the pay premium at peer group average performance (performance adjusted cost). The measures commonly used for board oversight—percent of pay at risk and competitive position—are terrible proxies for incentive strength and performance adjusted cost. O'Byrne shows that there is a simple, but very informative, analysis that provides measures of incentive strength and performance-adjusted cost that can be used for benchmarking and, more importantly, to understand the pay design needed to achieve perfect pay for performance. Applying the measurement analysis to S&P 1500 CEOs, O'Byrne shows that pay for performance problems are widespread: 28 percent of CEOs show high pay, 33 percent show high risk, 60 percent show low alignment of pay and performance, and 76 percent show at least one of these three problems. O'Byrne also shows that leading governance advisors provide little practical guidance for companies because they don't understand the vital importance of separating industry from management performance.

Part VI: Governance of Information Technology

Bob Zukis, in Chapter 28, "Information Technology and Cybersecurity Governance in a Digital World," writes about one of the most important governance topics of today and the future: the digitally connected world that companies now operate in. Zukis addresses both what is unique to today's information technology landscape, as well as the leading practices and policies that boards are implementing to govern the rapidly evolving information technology (IT) landscape. The headlines that focus on high-profile cybersecurity attacks are only one part of a comprehensive IT governance approach. How companies provide strategic and operational oversight to the implementation and adoption of these emerging tools to design and deliver their value propositions is an equally important part of the conversation that Zukis also addresses. IT governance is a very new governance responsibility that many boards and directors have so far struggled with. Zukis' chapter is a practical primer on the essence of IT's role to the future of the sustainable organization, as well as a pragmatic guide to how boards should approach this challenging and high risk issue.

Chapter 29, "The Board's Role in the Governance of Enterprise Information and Technology," tackles the rapidly emerging topic of the board's changing role in a digital world. Elizabeth Valentine, Researcher at Queensland University of Technology, Australia; Steven De Haes, Associate Professor of Information Systems Management at the University of Antwerp and the Antwerp Management School, Belgium; and, Greg Timbrell, Researcher at Queensland University of Technology, Australia, write that individual directors and the board as a whole can increase risk in at least six areas when information and technology skills and experience are lacking. In particular, they highlight the board's accountability and responsibility to be competent to govern business technology strategy, risk, and opportunity, because organizations of all types and sizes, without exception, are impacted by rapid technology changes. They discuss how two entire boards were sued for breach of duty of care, in part because they did not have IT governance capability. The chapter clarifies the board's role; provides examples of frameworks that can be used; includes an outline of a multi-industry validated enterprise technology governance competency set that boards can use; and suggests practical steps to take to evaluate boards' IT risk readiness and current IT governance capability.

Part VII: Governance of Sustainability: Boards' Changing Roles

Dr. Yılmaz Argüden, Chairman of ARGE Consulting and Founder of Argüden Governance Academy, contributed Chapter 30, titled "Responsible Boards for a Sustainable Future." In this chapter, he addresses a key emerging responsibility for the boards: sustainability. With the adoption of the Sustainable Development

Goals (SDGs) at the United Nations in September 2015 and the commitments of nearly 200 countries at the Paris Climate Change Conference (COP21) in December 2015, there will be a seismic shift in the way corporations address sustainability responsibilities. Boards will need to actively engage in embedding SDGs and COP21 responsibilities to their corporations' business strategies to create sustainable value for all stakeholders. Having served on over 50 boards, and through his position as elected chair of the United Nations Global Compact Local Networks Advisory Group, which brings together companies, civil society, and labor unions from diverse countries and situations around the world, Dr. Argüden applies his tremendous experience to provide a very practical guideline to stimulate and assist any board of a corporation embarking on the journey toward greater sustainability and value creation. This chapter concludes with a detailed and invaluable checklist of questions for any board to ask itself. Dr. Argüden's sustainability checklist helps a board build assurance that it is on the right track. It is as useful to a company just starting on the journey as it will be to those companies already well advanced in creating sustainable, shared value. All boards are strongly encouraged to review this checklist and challenge their executives in all of these areas.

Douglas Y. Park, formerly the Director of Legal Policy and Outreach at the Sustainability Accounting Standards Board, in Chapter 31, "The Board's Role in Sustainability Governance: Connecting Long-Term Value Creation and Executive Compensation," discusses how boards can link sustainability performance to executive compensation. Most boards perceive sustainability as environmental and social issues that have minimal or no effect on financial and operational performance. As a result, sustainability factors are either excluded from, or given minuscule consideration in, executive compensation and long-term value creation. However, sustainability is a much broader concept about the company's ability to prosper over time in the face of evolving nonfinancial risks. A growing body of evidence shows that certain nonfinancial issues present serious risks to any company's business model. Boards can better understand sustainability factors when they are presented as brand, financial, and operational risks that affect long-term value creation. The chapter first considers how sustainability performance can align with long-term corporate performance. The chapter then covers the current state of sustainability governance and compensation for sustainability performance, including real company examples. Action steps are recommended for boards to strengthen sustainability governance:

1. Use standardized metrics to measure and monitor sustainability performance.
2. Connect sustainability performance to business strategy.

3. Set performance targets and embed sustainability performance into long-term compensation.

By effectively connecting long-term value creation and executive compensation, boards can enhance their role in sustainability governance.

Alice Korngold, President and CEO of Korngold Consulting, and author of *A Better World, Inc.: How Companies Profit by Solving Global Problems . . . Where Governments Cannot*, addresses the board's role in sustainability in Chapter 32, "Better Governance for a Better World." Korngold shows how boards of public companies can only maximize shareholder value by embracing business strategies that solve economic, social, and environmental challenges. Furthermore, the chapter describes how the boards and management of several multinational corporations are leading the way by integrating global problem-solving into their corporate mission, planning, and operations. Korngold demonstrates that successful boards distinguish themselves in two ways: First, they are comprised of people who are well qualified, with the diversity of experience, expertise, and perspectives that are most relevant. Second, they focus their attention on mitigating risks, reducing costs, and growing value with a clear understanding of the global marketplace and its challenges and opportunities. The author reveals that it is in the best interests of companies to understand how natural disasters, due to: climate change; violence and terrorism in volatile regions; the increasing scarcity of food and water; wealth inequality and poverty; and the spread of deadly disease, will continue to threaten lives, property, and prosperity in the twenty-first century. Additionally, the chapter shows that investors link board effectiveness in addressing environment, social, and governance (ESG) matters with long-term economic returns. Korngold demonstrates that boards and management that drive innovation best benefit their shareholders, while also building a better world.

John M. Holcomb, Professor at the Daniels College of Business, University of Denver, in Chapter 33, "Corporate Governance: Ethics and Legal Compliance, Risk Management, and Political Activities," examines the growing need for corporate boards to pay close attention to both legal compliance and ethics. Boards must even sometimes wrestle with the conflict between legal and ethical duties and standards, as occurred in cases involving KPMG and General Motors. The clash between short-term and long-term views, whether to benefit just shareholders or other stakeholders as well, comes into stark relief when boards must deal with threats from activist investors, as at DuPont. Going beyond legal duties, boards face complex ethical calculations when overseeing reputational risk factors, whether the issue is, for example: succession planning at Hewlett-Packard and Pfizer; or crisis management challenges at BP, GM, Germanwings, and Volkswagen. Boards have a number of legal incentives, whether derived from corporation law or prosecution and settlement guidelines, to handle responsibly issues of compliance and ethics. To handle their various new challenges, boards are developing innovative board committees, in the category of public responsibility committees, to monitor and advise on external relations, and in the more recent category of ethics and compliance committees, to monitor and advise on even more crucial internal survival concerns. The development of such committees is especially timely as corporate boards face emerging concerns over corporate political activities, a modern aspect of risk management that involves both law and ethics.

Part VIII: Governance of Different Forms

Dr. Eugene Fram, Professor Emeritus at Saunders College of Business, Rochester Institute of Technology, writes Chapter 34, "Transforming Nonprofit Boards to Function in the Twenty-First Century." Nonprofit boards cannot operate as they did in the twentieth century. The roles of volunteer boards of directors must be driven by client-service needs and board responsibilities for due care, transparency, and growth needs. Recruiting qualified volunteer directors has become more difficult and will be a challenge for those organizations that want to provide clients with quality services. CEOs who are just minding the store will no longer be acceptable. Board members will need to improve the efficiency and effectiveness of board structures, and significantly improve board candidate vetting to avoid a decline in director quality. Board operations have been successfully improved with just three to five standing committees: for example:

1. Assessment—evaluating past impacts.
2. Planning and resources—focusing on the future, within resource guidelines.
3. Executive—coordinating the work of the other two standing committees and acting for the board between meetings.

Board members will have to form an ongoing partnership with the CEO to drive fundraising. Fundraising can't be viewed solely as the board's responsibility. The bottom line is that good governance makes fiscal sense. It helps eliminate many hidden costs associated with pursuing activities that have little to do with the organization's mission. For example: A human resources director who must spend an inordinate amount of time to provide routine operating information to board members. Most importantly, board agendas must be cleared of operational issues that paid staff can best resolve. Board discussions should center on policy/strategy issues related to mission, vision, values, and evaluations of program impacts.

Adam Quinton, Founder/CEO of Lucas Point Ventures, in Chapter 35, "Startup Boards—All In for the Company," explains why early stage, high-growth companies have boards that focus 110 percent on growth. Typically composed of founders and venture capital investors, these boards are all about supporting sales along with talent acquisition and development. While they have the exact same fiduciary responsibilities of any other board, much less time is typically given to risk/compliance issues. The need for additional funding can be a constant preoccupation—that and driving to a market position and scale that merits an initial public offering (IPO) or, more likely, a significant merger and acquisition (M&A) exit. But these boards can also have shortcomings, notably by being incestuous and lacking diversity.

Adam J. Epstein, Founder of Third Creek Advisors, LLC in Chapter 36, "Systematically Overlooked Anomalies of Governing Small-Cap Companies," addresses a poignant disconnect: despite the fact that the overwhelming majority of public companies in the United States are small, until quite recently the national corporate governance dialogue in the United States and elsewhere have been exclusively focused on issues faced by directors of large public companies. Implicit in this large-cap myopia, the author argues, is a widely accepted notion that corporate governance is one size fits all; that is, governing a large company is the same as governing a small company, so there is no need to distinguish between the two undertakings. But, as Epstein illustrates with a novel 15-point checklist, directors of small public companies often face resolutely unique governance challenges. These unique small-cap governance issues, the author posits, have been systemically ignored inasmuch as large-cap companies and their stakeholders have long defined what constitutes a governance matter. Epstein further suggests that when large-cap companies and their stakeholders commandeer the corporate governance narrative, small-cap shareholders suffer. This is because risk is relative—an issue requiring no board oversight in a large-cap company could well require demonstrable board oversight in a small-cap company. In order to further elucidate some of the systemically overlooked anomalies of governing small-cap companies and also provide some recommendations for improvement, the chapter focuses on three examples: corporate finance, asymmetric information flow, and the board's role in strategy and corporate service providers.

Drs. Jonas Gabrielsson, Andrea Calabrò, and Morten Huse explore how boards create value in family firms in Chapter 37, titled "Boards and Value Creation in Family Firms: An Extended Team Production Approach." The extended team production approach emphasizes boards as mediating hierarchies assigned with the overall purpose of leading the firm forward. The authors present the core characteristics of family firms, including the long-term perspective, often across generations, and how a broad set of values and priorities are integrated into strategic choices. They also present core assumptions and consequences of the extended team production approach to boards, and position it within a value-chain analysis. This includes responsibility for coordinating and supporting value-creation activities, and channeling the expertise and know-how by which the firm competes. The authors show how boards in family firms contribute to sustainable value creation throughout the entire value chain, via the board's involvement in various sets of board tasks, and supported by different board competences, such as the board culture, board leadership, board structures, and board development activities. This chapter enhances understanding the value and creative potential of boards in family firms versus what is usually presented in corporate governance guidelines.

Ronald Zall, in Chapter 38, "Succession in Family Businesses," deals with changes in leadership in family businesses caused by the occurrence of the departure of the family business leader, due to resignation, retirement, termination, disability, or death. Among other issues, it focuses on: the prodigal child system, qualifications for leadership succession and for the employment of family members in the business, gender and age issues, nonfamily successors, and the role of the family owners in the selection of a successor. The chapter emphasizes the importance of creating a written succession plan so that when the change occurs, the chosen one can seamlessly move into the leadership position with a minimum of disruption, including family quarrels.

Alissa Amico, former Project Manager, Middle East and North Africa at the OECD (Organisation for Economic Co-operation and Development), and currently Managing Director, Govern, Economic and Corporate Governance Centre, in Chapter 39, "From Regulation to Enforcement of Corporate Governance in the Middle East and North Africa," argues that, while corporate governance frameworks have developed rapidly in the region since early 2000, their implementation and enforcement have been of concern, especially by private investors. The absence of shareholder engagement, in particular, places an onerous burden on regulators, not only to improve the existing governance frameworks, but also to ensure their effective adoption by listed companies—a difficult task in the absence of market incentives. While the chapter does not recommend a more litigious approach to governance, it puts forth recommendations for policymakers on a range of regulatory requirements, such as: the definition of director duties and the treatment of related party transactions which, if further refined, could help develop a regulatory environment that would better protect shareholder rights. At the same time, the author suggests that the enforcement capacity of securities regulators needs to be bolstered and their support of shareholder engagement needs to be strengthened. This is crucial for the credibility of corporate governance frameworks in the region and their effective adoption by listed companies.

Conclusion: Future of Board Governance and Unresolved Issues

As described above, the chapters offer an impressive array of new information on current issues and best practices in the area of board governance. This is the first book of its kind to publish such a comprehensive and deep array of topics and coverage.

Corporate governance continues to evolve at a rapid pace. Some of the current topics that I anticipate will evolve and are in need of greater attention of readers include:

- Climate change and sustainability governance, and more broadly, the maturity of nonfinancial risk management and assurance;
- The rapid development of information technology, and addressing issues of safety, security, privacy, and terrorism;
- Addressing the governance of pay for performance, undue risk taking, and wealth inequality;
- The challenges of board composition, diversity, and generational change; and
- The need for shareholder accountability, balanced with long-term investment, innovation, and value creation.

I hope you find this *Handbook* a valuable resource in your own education and development. All chapters are written by leading global subject matter experts. I welcome your comments and suggestions. For teaching materials or resources, please feel free to contact me as well. Thank you.

Richard Leblanc