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FROM THE PRESIDENT'S DESK

IS EXCESSIVE REGULATION HURTING INVESTORS?

Boards are going through a churn. Record changes are taking place at the top of US corporations. 103 CEOs were shown the door in February alone. This was 11 more than in January which was a record in itself. Sacked CEOs include HP's Carly Fiorina, until recently corporate America's most powerful woman, AIG's Maurice "Hank" Greenberg and Boeing's Harry Stonecipher. A great mutiny is raging at Morgan Stanley. The record increase in the sacking of CEOs is despite the fact that CEOs are reported to be spending nearly 40% more time in the office than a year ago is the result of the fall of CEO's from grace. A recent survey stated as many as 73% of CEOs have thought of quitting.

This is both good news and bad news. The good news is that the boards are ultimately breaking the umbilical cord that has so far tied them to the company managements. They are beginning to cast off their sleepy image and holding the management rightly accountable for their performance.

The churn is due to the public outcry for transparency in business practices and is the direct result of turbulence caused by a series of regulatory measures mandated by Sarbanes-Oxley Act, new rules of NYSE and Nasdaq Stock Market. Directors are becoming increasingly afraid of being hauled up in legal actions for letting fraudulent conduct go unchecked. Settlements such as of \$31 million by directors of Enron and Worldcom to recoup shareholder losses has made them sit up and change behaviour.

The proposition that the corporate world and specially the capital markets need to be regulated to improve transparency, accountability and integrity is irrefutable. As Eliot Spitzer, the New York Attorney General recently said in the recent issue of Wall Street Journal: "The honour code among CEOs didn't work. Board oversight didn't work. Self-regulation was complete failure." AIG's board did nothing about Mr Greenberg's use of murky accounting practices, his offshore vehicles and alleged bid rigging until he was confronted by Eliot Spitzer and threatened with criminal prosecution. This has a familiar ring about a similar threat by Eliot Spitzer to three white knights of banking – Citi Group, CSFB and Merrill Lynch which made them cough up \$1.1 billion in fines and restitution back in 2002.

The opacity with which the markets are run has excluded most of the world population from the stock market. Corporate governance is not only an issue of compliance and disclosures but a powerful instrument for national economic and social transformation. Only by encouraging the participation of disfranchised masses in the stock markets can any nation hope to achieve a measure of sustainable prosperity and remove inequalities.

The bad news is that at least in some cases these sackings are not because of fraud but an irrational exercise by the board of their new found authority. Carly Fiorina whose stellar performance brought Hewlett Packard to such heights was one of those to face the brunt simply because her merger of HP with the Compaq failed to deliver results. Similarly Stonecipher's exit from Boeing had nothing to do with his performance or integrity.

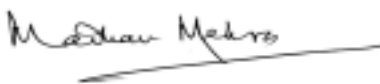
The fact is that a fear psychosis has set in motion because of over zealous regulation and has begun to hurt investors by diverting focus from competitiveness to compliance. By taking on powerful czars of corporate America successfully Mr Spitzer has shown that the system can be reformed applying the existing laws instead of bringing new ones. The issue, therefore, is not of having more laws but enforcing the ones we have more effectively.

In his article in this issue Rene Banez talks about restoring trust at the workplace. A recent study of the World Economic Forum shows a dramatic lack of trust in key institutions. In fact the public trust in institutions is increasingly going downhill. The worst in this are corporates. 67% of those surveyed distrusted executives of multinational companies.

The real issue in corporate governance is the handling of individual greed as opposed to self-interest. Self interest can be enlightened and long term. Greed is self centred and short term. The current business culture is not driven by "do what is right" but "do whatever you want to do but don't get caught". The issue is not that there are a few rotten apples, as some tend to think. Both pre-Enron and post-Enron eras have shown us that greed is widely spread. Post Enron years have seen mighty falls of corporate icons from their pedestals. Almost all the business icons have fallen from grace. It was not only Tyco's chairman who gave huge gifts to his wife and had lavish parties on her birthdays. Maurice "Hank" Greenberg, a celebrated star in the American corporate firmament until last month gave his wife more than 2 billion dollars of AIG shares 3 days before he stepped down. Even Warren Buffet the great sage of Omaha is being grilled by Spitzer's office about his role in a questionable deal between Berkshire Hathaway and AIG.

Like in the sustainability debate where the defenders of the old regime have tried to pooh pooh the idea of the sustainable development and the reduction of the green house gases, there is a strong lobby spawned by Chief Executives, Board Directors and Chairmen, threatened by the new regulations requiring induction of independent directors. This lobby is working overtime and sponsoring reports showing companies would be better off without outside directors. Independence is an attitude of mind. You can be independent as an Executive Director and not independent even as a Non-Executive Independent Director. Leadership skills and communication skills have to be cultivated. So the endemic problem of the conflict of interest cannot be solved simply by having more independent directors. Furthermore, if these independent directors, most of whom are usually retired people, are paid remunerations in the region of £100,000 a year by the company, would you really expect them to be independent? The key issue in the debate about independent directors is the selection and training of directors. We have to train directors to develop leadership skills, an independent mind and questioning skills because independent minded directors are the only hope of good governance. Excessive regulation on the other hand simply means throwing good money of the investors down the drain.

These are some of the issues being addressed in the 6th International Conference on Corporate Governance in London on 12-13 May 2005 where the theme is "making corporate governance decisions that work".



SARBANES OXLEY - USHERING AN EXTRAORDINARY AGE OF TRANSPARENCY

*Dr Madhav Mehra

“Laws such as Sarbanes Oxley, reforms in NYSE and NASDAQ and a raft of regulations such as IFRS, OFR, BASL II that are bedeviling the markets are reminders that we are entering an extra ordinary world of transparency. We have no alternative but to disclose all. Transparency is the key to survival. As Don Tapscott & David Ticoll say in the book “The Naked Corporation”, “Strobe like glare of public scrutiny through the nasty web has melted the veil of secrecy and made the corporation Naked”. Investors will forgive errors but punish omissions specially when they turn out to be deliberate. Only the firms who can harness the power of transparency will survive,” says Dr Madhav Mehra

This is the year when the curse of Enron really strikes and companies all over America and abroad are feeling the pinch of regulations that were put together in the post-Enron crisis. Its high point is the Sarbanes-Oxley Act. Neither Paul Sarbanes nor Mike Oxley the two legislators who coproduced the Act, could have imagined the huge industry spawned in their name that has created a gold rush for lawyers and auditors. Companies are spending an average \$5 million each to comply with the requirements. The relatively brief legislation has been expanded to hundreds of thousands of words and there is a whole class of auditors and lawyers who are earning millions in interpreting it. Neither would have imagined that the accounting companies whose powers they both wished to clip because of their involvement in corporate history's biggest scandals would profit so hugely from this legislation and double their income from its implementation.

Latest survey by the Corporate Executive Board shows that US audit fees have, on average, doubled. The lowest increase in 2004 was 78 % achieved by Deloitte. The highest was PwC with 134% increase. Sarbanes-

Oxley has provided the biggest boost to the Big Four accounting firms, much more than they could ever imagined.

Though Arthur Anderson was the star performer in Enron scandal, Lynn Turner, Chief Accountant of the SEC for 1998-2001, who earlier was a partner of Coopers & Lybrand admitted in a TV interview: “All the Big Five accounting firms helped Wall Street investment banking firms to engineer hypothetical transactions to make companies look better than they actually were”. We should in fact be grateful to Enron for throwing open the murky world of corporate finance and providing us the opportunity of getting real with the huge problem of cleansing it. Arthur Levitt, former Chairman of SEC tried for four years to curtail the power of accounting profession. He could not even get the Big Five to meet in his office. Finally, he had to hold it in the office of one of them.

It has been said that the Sarbanes-Oxley Act is the single most important piece of legislation affecting corporate governance, financial disclosure and the practice of public accounting since the US securities laws of the early 1930s. The Act was enacted in the US

in July 2002 as a response to high-profile accounting and document-tampering scandals which cast an unwelcome shadow over the credibility of US company financial information and so became a risk to US company investment. It is named after its two authors Paul Sarbanes (Democratic Senator) and Michael Oxley (Republican Congressman).

The Act, also referred to as “SOX” and “Sarbox”, requires all public companies doing business in the US to follow a comprehensive accounting framework. SOX means that companies will be required to disclose huge amount of information publicly in a standard and transparent manner.

Sarbanes-Oxley is not merely a US problem, it has relevance for many overseas organisations, particularly for subsidiaries of US corporations. And it is far from being the end of the story; similar legislation is appearing within Europe and the principles of Sarbanes-Oxley are being taken up by regulatory authorities outside of the US as guidelines for good corporate governance.

Nor is SOX just an issue for a company's internal accounting

professionals and external auditors. Compliance with the new regime which it imposes can have significant implications for its competitiveness and access to global capital markets.

The key element of the new SOX regulations is the requirement that companies must establish, and then maintain, accounting procedures that eliminate any possibility of so-called “creative” accounting. Any hint of creative accounting should be eliminated from the financial reports, removing any possibility of interpretation. Additionally, financial reports must be capable of withstanding close scrutiny; they should be auditable and supported by all relevant data. Further, such reports should be tamper-proof. Systems will need to be in place which will identify who has accessed data, and when, such that a full audit stream can be identified.

The Act is intended to address the problems that generated it by instituting various new levels of control and sign-off such that financial reporting provides full and accurate disclosure and corporate governance is completely transparent.

Its major provisions include:

- certification of financial reports by CEOs and CFOs
- ban on personal loans to Executive Officers and Directors
- accelerated reporting of trades by insiders
- prohibition on insider trades during pension fund blackout periods
- civil penalties added to disgorgement funds for the relief of victims
- additional disclosure
- auditor independence, including outright bans on certain types of work and pre-certification by the company’s Audit Committee of all other non-audit work
- criminal and civil penalties for securities violations

The most feared is the Section 302 which requires the CEO and CFO to personally sign off on the appropriateness

of the firm’s financial statements (see also section 1102 regarding tampering with records). Section 404 covers attestation of the adequacy of financial reporting controls. This means that organizations must not only introduce adequate systems in the first place but must also assess the adequacy of those systems on an annual basis. This is a short section that lays down the responsibility of chairman and CEO for disclosure. But the auditor/consultant/lawyer industry spawned by the Act for its implementation has expanded it into thousands of words. This is the most hated section. Section 409 is another highly relevant section that calls for real-time reporting.

“The implementation of SOX leaves much to be desired. Despite its avowed purpose of protecting the investors, it is the investors who are being skinned. They are the ones who are bearing the huge costs of \$5 million. Sarbanes-Oxley Act was legislated to force CEOs to take personal responsibility for financial reporting and building up control systems to ensure its accuracy. The result has created a bureaucratic nightmare and shown that the US approach continues to tick every box and preferably several times over.”

The implementation of SOX leaves much to be desired. Despite its avowed purpose of protecting the investors, it is the investors who are being skinned. They are the ones who are bearing the huge costs of \$5 million. Sarbanes-Oxley Act was legislated to force CEOs to take personal responsibility for financial reporting and building up

control systems to ensure its accuracy. The result has created a bureaucratic nightmare and shown that the US approach continues to tick every box and preferably several times over. The legislation is making the US accounting profession a joke. Excessive regard for following the rules to the letter has altered the accounting landscape and the driving purpose of the audit. Essentially audit is supposed to be conducted on behalf of the investor to protect their investment and report on the integrity of financial reporting. Contrarily, the profession is becoming an agent of the regulator. Every clause of the Act is being subjected to hair splitting by auditors to protect themselves from falling foul of their new boss – Public Company Accounting Oversight Board (PCAOB), the new regulator appointed under the Sarbanes-Oxley Act.

There is a great danger that the burgeoning, bureaucratic and box driven process is negating the very purpose of the Act and its fundamentals are being lost in egregious detail. The traditional exercise of judgement has given place to following the letter of the law as per regulator’s rules.

Auditors are supposed to protect investors. Instead they are being squeezed. The Big Four simply cannot cope with the astronomical demand for their audit services created by Sarbox. Investor has been a loser because just four big firms would not provide the degree of competition, security and choice that is needed. Secondly, in order to keep themselves on the right side of the regulation, the big four are dropping clients that they see as risky. These clients go to the third tier accounting firms. But they too have little resources and are working to overcapacity.

Despite all the hoopla and enormous resources and money spent on its implementation there is little change in the attitudes. Auditors have become even more important than they were during Arthur Levitt’s days. William Donaldson, the SEC Chairman, has been acutely concerned with the

shenanigans of both lawyers and auditors. Speaking to a Washington audience of more than 1000 securities lawyers he said lawyers and auditors are crucial gate keepers for the integrity of the markets.

Lapses over the past few years by outside advisers directly contributed to financial frauds that devastated thousands of investors, he said. "I hope you will not expend significant time, money and energy devising structures aimed at evading requirements and trying to achieve an accounting or disclosure result that . . . artfully dodges the rule's purpose," Donaldson said.

The SEC has lodged 76 cases against lawyers in the past 3 1/2 years, chief litigation counsel David L. Kornblau said in a separate Practising Law Institute session. Kornblau said 18 cases have been filed already this fiscal year. "These lawyers did not seem to have in their vocabulary the word 'no,'" Kornblau said.

The conduct of auditors at accounting firms of all sizes also remains on the SEC's radar screen. Agency officials said they will continue to scrutinize auditors' relationships with their clients for possible violations of independence rules. They said they expect more enforcement actions to come in cases where auditors have grown too cozy with their clients to render impartial reviews of financial reports.

Separately, SEC chief accountant Donald T. Nicolaisen laid out several of his priorities for 2005. Donaldson said his office soon would release a report about corporate use of off-balance-sheet entities such as those that hid billions of dollars of Enron Corp. debt.

Nicolaisen also said the agency staff would provide guidance later this year for companies on how to value stock options on their financial statements.

Accounting standard-setters are mandating that companies for the first time treat stock options, or chances for employees to buy stock at a set price and time frame, as an expense on their books.

The move has proved controversial for technology firms, which used stock options heavily as an employee recruitment and retention tool.

SEC Enforcement Division chief Stephen M. Cutler endorsed the fear psychosis when he said the agency was considering its own reality-based TV show, "Corporate Fear Factor," where "big-time executives have to eat worms, jump out of a moving car, and for a final test, they have to sign a Sarbanes-Oxley 404 certification."

The answer of course is not withdrawal of the act or even delisting from US bourses which many European firms are threatening. All said and done the Act provides an excellent self-improvement, risk management opportunity and therefore, is of considerable competitive advantage. This advantage, however, is diminished if the implementation is focused on box ticking. Nonetheless in a survey conducted by PwC of 1300 two thirds of the CEOs interviewed felt that the money spent on its implementation was an investment.

Most CEOs understand that improving corporate governance by strengthening board expertise, board oversight and exercise of better internal controls to manage risks, would improve managerial effectiveness and add significant benefits and savings. The compliance can result in enhanced reputation, increased operational effectiveness, higher employee morale, improved customer loyalty and more transparent engagement with civil society. Transparency is the heart of corporate governance. With the increasing demands on disclosures,

companies cannot survive without putting in place internal control architecture that will enable timely disclosures without risking reputation.

The globalisation today offers huge opportunities for proactive businesses. Today's business is dealing with only a fraction of the infinite field of available options. There are enormous opportunities for innovation and creativity. But innovation does require investment. Transparency can work wonders in improving company's credibility and access to global capital.

The real management challenge for global companies lies in creating systems for global governance that comply with stakeholder expectations right across their global operations and help them to build new markets and increase profitability. One of the nagging worries of the businesses after Enron and WorldCom directors accepted to compensate company losses from personal funds is to attract quality independent directors. Companies that have developed robust compliance programme and transparent structures would make them ideal choices for qualified directors.

Laws such as Sarbanes Oxley, reforms in NYSE and NASDAQ and a raft of regulations such as IFRS, OFR, BASL II that are crowding the corporate firmament are reminders that we are entering an extra ordinary world of transparency. We have no alternative but to disclose all. Transparency is the key to survival. As Don Tapscott & David Ticoll say in the book "The Naked Corporation", "Strobe like glare of public scrutiny through the nasty web has melted the veil of secrecy and made the corporation Naked". Investors will forgive errors but punish omissions specially when they turn out to be deliberate. Only the firms who can harness the power of transparency will survive. ■

THE COMING REVOLUTION IN CORPORATE GOVERNANCE

*Richard Leblanc and James Gillies

“It’s not only about where you have been but where you’re going.” Director

One of the great paradoxes of the twentieth century is that while enormous progress was made in understanding how economies in general operate¹ and in improving the management of corporations, relatively little was learned about the way in which the people who are by law responsible for the oversight of the corporations, upon which so much of prosperity is based, actually made their decisions. The fifty years between 1940 and 1990 was a period of drought in the study of the governance of corporations. Indeed, the term “corporate governance” itself was not widely used until the mid-1980s.² In spite of the importance of good governance for assuring the attraction of capital to the corporate sector through fair and well-functioning markets, there was little in-depth analysis of precisely how boards of directors undertook “the governing of enterprises.”

Again, paradoxically, although boards were seldom studied and generally dismissed as relatively ineffective, whenever problems arose within the corporate sector, much of the blame for the difficulties was directed towards the manner in which corporations were governed – at boards of directors. Every recession, let alone depression, saw the formation of commissions and study groups charged with the responsibility of making recommendations for improvement in corporate governance.³ “Where were the directors?” became the rallying call for reform, even though for half a century there was a general view that governance did not matter, that directors were no more than expensive accoutrements required by law who were more impediments than assistants in assuring the efficient operation of enterprises.

In spite of this irony, when crises did develop and attention was paid to boards, as was the case in the late 1990s, most of the rules and regulations that were enacted with the intention of making boards operate more effectively had to do with board structure. As a result, the number of outside directors on boards was increased; greater transparency about the operations of corporations was achieved;⁴ more corporations separated the positions of CEO and chair; and in general, a great deal more attention was paid by directors, regulators, academics, managers and the media to matters of corporate governance.

Because of the interest generated about boards and the plethora of new regulations put in place since the 1990s, a general view evolved that “boards of directors” were fulfilling their duties more effectively. There was really no evidence to support such a conclusion, but it was widely believed that the pressure from institutional investors, the increase in threats of litigation, the need on the part of management for good advice in more competitive and global markets, the large role played by directors in the unfriendly takeover movement of the early part of the decade, and particularly new regulations were all bringing about more effective operations of boards of directors.⁵

It was, however, confidence misplaced. As the experience of the early years of the twenty-first century so clearly showed, the effectiveness of boards and individual directors has not improved substantially. Despite all the optimistic expectations, there was no

general revolution in corporate governance. All the new rules and regulations had, at best, only marginal impact on board performance. The reason that the results (from what appeared to be almost heroic action on the part of regulators, trading exchanges and commissions) were so modest is that board structure in and by itself does not appear to have much impact on the performance of boards. An independent board structure, as it is currently conceptualized, may be a necessary but it is certainly not a sufficient condition for board effectiveness, or for that matter even individual director effectiveness.

In short, the belief that regulations and recommendations about board structure, transparency, *et al.*, in and by themselves will ensure board effectiveness, and by extension, better financial performance of corporations could well be wrong; indeed, the slight evidence that is available suggests that it is.⁶ Directors, while perhaps being something more than “parsley on fish – decorative but useless” are in many instances still far from being selected in such a manner that they collectively, as a board, are having a major impact on the way in which corporations are being governed.⁷ While the significance of certain specific changes in corporate governance that occurred in the 1990s and the early years of the twenty-first century may be debated, what is not debatable is that no revolution in corporate governance took place during those years. Some minor changes, but no revolution.

What Boards Really Do

The principal work of a board of directors is to make decisions. Some

are trivial – deciding when the next board meeting will be held, the date of the annual meeting, and so on. But, most issues that the board spends (or should spend) a good deal of time on are very important —decisions about strategy, about financing, about removing or hiring a CEO, about acquisitions and divestitures, about writing down the value of a subsidiary. Indeed, they are so important that how the board decides many of them is critical to the success or failure of the enterprise.

Given the fact that boards are made up of small groups of individuals, a critical factor in their decision-making is the interrelationship among and between directors, which in turn is largely based on the behavioural characteristics of individual directors. As many directors pointed out in the course of this study, it is individuals, not corporations, who make decisions. Indeed, board dynamics may be the single most important factor in determining the effectiveness of the board in carrying out its duties of overseeing management in the best interests of the corporation. And the success of these dynamics, that is, the effectiveness of the boards in making decisions, is clearly influenced by the behavioural characteristics of the directors that make up the board.

From observation of boards in action and interviews with directors, it has been possible to develop a new classification scheme for directors that go well beyond the traditional method of classification. Ten director types have been identified. Five functional director types – Conductor-Chairs, Change Agents, Consensus-Builders, Counselors and Challengers – are associated with effective boards, and five – Caretaker-Chairs, Controllers, Conformists, Cheerleaders and Critics – are associated with dysfunctional ones. It is hypothesized that for a board to have efficient board processes and effective decision-making, it needs to have a full complement of all five functional director behavioural types.

However, the appropriate mix of functional director types is not in itself a guarantee that a corporation will be governed effectively, when “effective” is defined as making decisions that contribute directly to the success of the enterprise. The board must also include directors with the specific and necessary competencies to deal with the issues that the company faces, in the industry and environment in which the company is lodged, and with the strategies that the firm is pursuing, now and into the future. Consequently, if the goal of the board is to be effective, the selection of directors must be based on how the competencies and individual behavioural patterns of directors are aligned with the company, its environment and its strategy. This is, of course, a far cry from selection of directors on the basis of who current directors might know or the choice of someone because they have a high public profile.

Obviously, if an effective board is to be created, the recruitment process of new directors must be sufficiently rigorous to give directors, nominating committees and director search firms confidence that they have selected the proper candidate, despite the fact that directors might not know personally the candidate selected.

Finally, in order to create the best of all possible boards, non-performing directors who refuse to perform, who are incapable of performing, who refuse to augment their competencies or behave in inappropriate ways, given the strategy of the corporation, must, in the interest of good corporate governance and fairness to their colleagues, be asked to step down. The inability or unwillingness of boards, including chairs of the boards and chairs of governance and nominating committees, to rid themselves of dysfunctional members is as serious an issue in corporate governance as is the importance of selecting functional new directors. Counseling non- or under-performing directors off the board is a major task that many directors believe is not being adequately completed.

Leading the Effective Board

An effective board must have, in addition to effective directors, solid leadership. There is no doubt that the leadership skills of the chair of the board are the most important factor in assuring effective board processes, wise decision-making and determining the overall effectiveness of the board of directors. Obviously, the selection of the chair is critical. It should not be based on seniority of a director or tenure on the board or ties to management or a high percentage of share ownership, but rather on the independence of mind, competencies and knowledge of the business and leadership effectiveness. The chair should be responsible for fulfilling the duties outlined in the position description and be assessed by fellow directors on the manner in which he or she does so.

Needless to say, the skills necessary for fulfilling the position calls for a Conductor—a person who can lead the setting of the agenda, run the meetings effectively, moderate discussion, manage dissent, work towards consensus, communicate persuasively with colleagues and management, and most importantly, set the tone and culture for effective corporate governance. Normally these paragons of virtue are individuals who possess the traits of Consensus-Builders, Counselors, Change Agents and/or Challengers. Whether the chair is also CEO is less relevant to the effectiveness of the board than is often thought. An executive chair is not necessarily ineffective and a non-executive chair is not necessarily effective. What matters are not the separation of the positions but the demonstrated independence, competencies and the behavioural characteristics of the person or persons who hold them?

C-B-S-R : The Acronym for the Effective Board

The acronym for building effective boards might well be “C-B-S-R” – the identification of directors with the mix of competencies and behavioural

patterns that match the strategy of the firm and then the lively pursuit and recruitment of board members who meet these requirements.

A change from structure-based to competency- and behaviour-based boards of directors will bring about a revolution in corporate governance. The dimensions of the revolution are awesome. It will mean that the era of “directors are like parsley on fish – decorative but useless” will be over. It will lead to no less than a total rethinking of the concept of appropriate corporate governance from emphasis on form and structure to emphasis on performance and results. It will mean that effective governance will be as much about putting in place strategies and policies that earn satisfactory returns to shareholders as it is about monitoring the activities of the management of the enterprise to conserve or maintain shareholders’ wealth. It will mean that the role of the effective board of directors is neither more nor less significant during a crisis than it is at any other time, and it also will mean that the historic role of the board of directors as an active, dynamic representative of the shareholders will be resurrected.

Moreover

1. It will mark the beginning of the era of penetrating and effective board and director assessments. Effective boards cannot be created without the full knowledge of the behavioural characteristics and competencies of existing board members. Consequently, corporations that wish to have effective boards will develop programs of board and director performance assessments.

2. It will mark the end of the era when casual acquaintance and cronyism is the chief criterion for selection to a board. Directors will be chosen very carefully and specifically for their behavioural characteristics and competencies. No longer will being a member of “the old boy network” be sufficient criteria for board membership.

3. It will end the practice of retaining ineffective and dysfunctional directors on boards until retirement age simply because it is inconvenient to remove them.

4. It will mean that the power that boards have in law will become power in fact. Directors will be chosen for their competencies to contribute to the major functions of the board—monitoring the activities of the corporation in the interests of the stakeholders and contributing to the creation of shareholders’ wealth.

5. It will lead to more effective board practices. Directors elected for their specific competency and behavioural characteristics will not tolerate inefficient board operations. Because of their competencies, such directors will—as they may be cited individually for lack of performance in their areas of competency—demand effective continuing education and induction programs to the company. They will demand proper board information and effective board mechanics and communications. Directors will make greater use of consultants, educators and advisers. They will know what they need to know in order to fulfill properly their obligations and will insist that they have access to the best advice available and all the information they deem necessary to make informed decisions. Because of their competencies, they will know what that information is.

6. It will increase the accountability of individual directors to fellow directors and shareholders. Members of various committees of the board will be held more responsible for the activities of the committee, since they are deemed to have the competency to serve on that committee. For example, members of the Audit Committee will have to take more direct responsibility for any mistakes in the financial statements. They cannot hide behind the excuse that their auditors and financial officers were incompetent: *they* were elected to their position presumably because of *their* competence to judge the competence of

the auditors and financial officers. Members of the Compensation Committee will have to be competent enough to judge and oversee pay and performance, and ensure the link between the two is made. Members of the Risk Management Committee will have to have a sound knowledge and understanding of the principal risks to which the company is exposed, and ensure that management has appropriate standards, practices and policies to militate against these risks.

7. It will increase the general level of accountability of boards of directors to shareholders. A board specifically elected because of its members’ competencies and behavioural characteristics that do not deliver acceptable rates of return to its shareholders will have to explain the reasons for its failure. With greater public disclosure and scrutiny on the process by which boards identify new candidates for board nomination—including the assessment of competencies and behavioural skills of current and prospective directors—shareholders will have greater information upon which to assess the effectiveness of boards and individual directors.

8. It will lead to many more elections of individual directors, rather than slates of directors. Shareholders will know the competency for which and why a particular director is being nominated. If it is clear that he or she does not have the competency or some other characteristic that is essential for the success of the corporation, shareholders will be inclined to vote against election or re-election.

9. It will lead, because of increasing demands on individual directors, to the growth of a core of professional directors, *i.e.*, people whose major source of employment is serving on boards. Conversely, it will lead to a decline in the number of boards that fully employed executives will join.

10. It will lead regulators to focus attention on competency and

behavioural characteristics of directors when developing policies for corporate governance.⁸

11. It will end the view that certain shareholders, such as institutional investors, should, because of their holdings, automatically have a position on the board. Most of all it moves the evaluation of effective corporate governance from the static and negative concept of form to the dynamic and positive belief that governance must be evaluated in terms of results.

Will the Revolution Take Place?

Will there be a major shift from structure-based boards to performance-based ones? Or is the situation very much as it was in 1990s, when there was great optimism for reform because of the growth in importance of the institutional investor, the increase in litigation, *etc.*, and yet nothing much really happened? In spite of the spurt of activity with respect to corporate governance as demonstrated by the Sarbanes-Oxley legislation in the United States and the implementation of rules and regulations for listing on exchanges and reporting to governing agencies, will the results be the same as they were in the 1990s? Will anything happen?

There is no question that there are many directors on many boards who believe that they need to change—not because regulators or shareholders or anyone else is telling them that they must, but rather because with the increasing complexity of business they know that under current circumstances they cannot adequately fulfill their duties. The one theme that was constant from interviews and observing boards in action was that directors are deeply concerned with the ineffectiveness of many of the boards with which they are associated. Even directors on boards of companies with acceptable rates of return for their shareholders and no signs of serious legal or other problems indicate a concern that their board is not doing as good a job as they intuitively believe it should.

The scandals of the corporate world in the first few years of the twenty-first century have created, within corporations themselves, a climate for change. The problem for many directors and board members is that while they believe there is a need for change if they are to fulfill all their obligations, both legal and practical, they have little general knowledge about what the change should be.

The reason that intuitive feelings on the part of board members have created so much of the climate for change is that currently, boards are just at the forefront of undertaking a critical self-examination of themselves as boards and as individual directors, so they do not yet know for certain how effective they are. However, the good news for those interested in building better boards is that the number of boards willing to undertake such assessments is growing. So, the first reason to be optimistic that change will come is that thoughtful directors want it.

Second, since the 1990s, there has been a great increase in interest in the concept of corporate governance. From being a forgotten part of the operations of a business, it has now become relatively central. As a result, in response to growing concerns of shareholders and regulators about board activities, there has been considerable change in board practices. More and more boards are writing job descriptions for the board—for directors, the chair, committees and committee chairs. Some also are not only developing board and committee charters, criteria for director effectiveness, descriptions of the board's role in strategic planning and in setting compensation levels, but publishing them and holding directors accountable for achieving them.

Third, directors are more and more realizing that as well as the fiduciary duty obligation to their shareholders, they also have a moral obligation to all their stakeholders to operate the company in a legal and ethically responsible manner, and have concluded that the best way of fulfilling that

obligation is through full and complete disclosure of their activities.

Fourth, increased disclosure has had the result of increasing shareholder activism, and vice-versa. Both provide ammunition to those who believe that change is necessary, and is, therefore, a positive step in exerting pressure on boards and regulators to change.⁹

Fifth, and very importantly, the great interest in corporate governance generated by the failures in the early 2000s has generated considerable interest in director education. Many directors, when they join a board, have very little knowledge about the industry and the business in which the corporation is involved and even less about the legal, financial and regulatory environment in which it operates. There is no question that this lack of knowledge about such things as risk management, corporate law, responsibilities of directors, how to undertake CEO assessments, how to ask effective questions, *etc.* makes it almost impossible for a director initially to make a significant contribution to discussion of many important issues.

However, the situation is changing. Director educational programs are growing in number and some types of director certification, based on examination and experience, have developed in a number of jurisdictions. And there is no question that the increase in formal education, and the possible requirement of some type of educational qualification for membership on a board, will hasten the movement for change in the manner in which directors are selected.

Sixth, directors are being paid more. Consequently, they are expected to spend more time and be more effective. Higher pay brings pressure for better performance.

For all these reasons, there is a climate for change. Consequently, it is possible to be optimistic that there is beginning to be and will continue to be a steady movement from structure-based

to competency- and behaviour-based boards.

Regulations Will Not Be Sufficient

Searching for and promoting a greater understanding of how boards make decisions and the factors that lead to board and director effectiveness does not imply the imposition of more rules and regulations. Rather, it should lead to fewer. As chairs of nominating committees seek directors not on the basis of their external profiles and relationship to existing board members, but instead on the basis of competence, behavioural characteristics and their fit with the strategic direction of the firm, the need for specific rules should decline. The role of the regulator should move much more towards research on the relationship of corporate governance to corporate performance—on finding the issues that really matter in governance—and providing information to organizations on how to deal with them. Indeed, moving away from structure-based boards would be a major step in reducing the need for specific, stultifying rule-making. Moving towards competency- and behavioural-based boards would encourage the risk-taking and entrepreneurship that are part of the essence of capitalism. As the change takes place, regulators will be in a position once again to do what they were intended to do in the first place: make certain that there is a level playing field for all.

However, old habits die-hard. Despite the evidence to the contrary,

as legislation and regulations such as the Sarbanes-Oxley Act and the New York Stock Exchange governance guidelines in the United States so clearly show, regulations appear to be still focused on structure and form, although there is some reason to believe that Canadian regulators are seeing the need to change. Indeed, so many more requirements for reporting various actions of officers and directors have been and are being put in place that a strong reaction will undoubtedly develop against more regulation. It can be argued that many of the new rules not only substantially increase the costs of operations, but also more significantly restrain organizations from taking action to promote growth and development, and therefore have the cumulative effect of retarding economic growth. Inasmuch as there is no evidence that the rules will improve corporate performance, or assure more effective operation of the institutions of capitalism, the concern is well felt.

Will it Happen?

It is the hypothesis of this book that boards would be much more effective if directors were selected on the basis of competency and behavioural characteristics, as well as on the basis of meeting certain structural requirements. Such a change should lead to more effective decision-making, which in turn should lead to more effective corporate performance. But before one can be completely confident in the latter, that is, of the importance of board process to corporate

governance and of governance to corporate performance, there must be much more, albeit difficult, research on a broad range of board and individual directors' issues. This study, based on the observation of boards and board committees in real time and almost two hundred interviews with directors, regulators and students of corporate governance over a five-year period, suggests that such work can be undertaken. There are indications that such work may well confirm that there is a causal relationship between governance and performance—that boards constructed on the competencies and behavioural characteristics of individual directors, as suggested in this book, will lead to superior corporate financial performance.

Is it important to find out if the hypothesis is true? The answer is, of course, yes, because everyone—all stakeholders, the community and the economy—benefits from well-run corporations operating profitably within fair, efficient capital markets, and everyone suffers when corporations fail. Most practitioners and scholars agree that there is a relationship between corporate financial returns and a certain pattern of corporate governance, but no one is quite sure what that pattern is. This study is a step towards finding the relationship that, unlike the unicorn, may exist. Continuing research to flesh out the competency, behavioural, strategy and recruitment model developed in this book is the major challenge for the students of corporate governance in the twenty-first century. ■

***Dr. Leblanc's PhD was defended unconditionally and was adjudicated as the winner of the Best Dissertation Award by the Administrative Sciences Association of Canada, as assessed by independent peer-review. His book, co-authored with Prof. James Gillies is entitled "Inside the Boardroom: How Boards Really Work and the Coming Revolution in Corporate Governance," is published by John Wiley & Sons. Recently chosen as one of Canada's "Top 40 Under 40,"™ Dr. Richard Leblanc is an award-winning teacher, certified management consultant, professional speaker, assistant professor, lawyer and specialist on boards of directors and effective governance.**

- 1 See, for example, J. M. Keynes, *The General Theory of Employment, Interest and Money* (London: Macmillan, 1936). It is difficult to believe that in the 1930s, there were not even reliable figures on the gross national product of countries, and there was no understanding of the forces leading to full employment and price stability.
- 2 Robert Tricker, *The Pocket Director*.
- 3 For an account of the superficiality of one such report, see D. H. Thain, "The TSE Corporate Governance Report: Disappointing."
- 4 This was done primarily by requiring more extensive reporting to regulatory agencies about the financial activities of corporations and to shareholders about executive compensation.
- 5 James Gillies, *Boardroom Renaissance*, 19–24.
- 6 See Chapter 5.
- 7 See Chapter 3.
- 8 This has been done by the Ontario Securities Commission in its proposed Policy. See e.g., Step One and Step Two in section 12 of the "Proposed Multilateral Policy 58-201: Effective Corporate Governance," January 16 and October 29, 2004, on which one of the authors has advised.
- 9 See, for example, the activities of the Canadian Coalition for Good Governance in Canada and CalPERS in the United States.

RESTORING TRUST IN THE WORKPLACE

*Atty. Rene G. Banez & Jilla S. Decena

Perhaps, the basic problem besetting the corporate world today is simply the absence of trust or the lack of it. Perhaps, the challenge now is to go back to basics and to stick to the fundamentals if I may borrow the advertisement lines of the television program “Lifestyle Network”. But what are those basics or fundamentals? I propose that we rediscover, relearn and relive our old fashioned values of INTEGRITY, HONESTY, FAIRNESS, TRANSPARENCY AND ACCOUNTABILITY. This is the key to restoring and enhancing TRUST in the workplace. The foundation of good corporate governance is TRUST.

I. Corporate Governance and the Different Paradigms

Countries are different from each other and so is the practice of corporate governance. Morck and Steiner (2004)¹ showed the history of corporate governance in different countries by exploring what capitalism meant to different parts of the world. It explained that different economies are organized in different ways, and so is corporate governance. Capital is entrusted to different sort of people and different institutions.

Adams (2003) presented three paradigms or models that are followed in corporate governance: the Anglo-American, Japan/Germany model, and family capitalism paradigm.

The Anglo-American capital market based model emphasizes the maximization of shareholder value. On the other hand, the Japan/German Model is focused on a relationship-based model that emphasizes the maximization of the interest of a broader group of shareholders.

The corporate governance of large corporations following these paradigms in a way is entrusted to the CEOs and other professional managers. The monitoring of corporate governance is focused on the management running the business.

For family business/ family capitalism, family values appear to have significant influence on the outcomes of family capitalism and therefore corporate governance. This paradigm is predominant in Asia. See Table 1.

According to Morck and Steier (2004), family capitalism, one of the most common system of corporate governance, is where the governance of a country’s large corporations is entrusted to its wealthiest few families. This situation arises if investors are deeply mistrustful of most companies, and prefer to invest by entrusting their savings to persons of good reputation. Family firms constitute larger fractions of the stock markets of countries that provide investors with fewer legal rights. Respected business families can leverage their reputations by controlling many listed companies, and by having listed companies they control block of other listed companies in successive tiers of inter-corporate ownership. Such pyramidal business groups are also common where investor’s legal rights are weaker.²

Family capitalism is present worldwide. See Figure 1. However, the dominance of family corporations or businesses separates Asia from the rest of the world.

Table 1: Family Corporations

Country	Family Groupings	% listed Assets	% of GDP
Indonesia	15	61.7	21.5
Philippines	15	55.4	46.7
Hong Kong	15	34.4	84.2

Source: *The Morality of Corporate Governance: Issues of Quality and Quantity*, Ismail Adams, September 2003

Claessens (1999) reported that two thirds of listed companies, and substantially all private companies, are family run. Even principal investors in largest enterprises are often family members or close friends.³ “With such a situation, there is a tendency for such individuals to establish large interlocking networks of subsidiaries and sister companies that include partially-owned, publicly listed companies. This then allows investors to direct this money to the markets and industries in which particular subsidiaries specialize and which investors believe hold the greatest potential for profits[...]such pyramidal structure can lead to inequitable treatment of shareholders. The extent of this disproportionate control is frequently opaque to outsiders and undisclosed by insiders.”⁴

Business in Asia is somehow attached to the identity of the family. Family is seen as the most important basic structure. Business transactions are an extension of the honor of the family and its name. Failure of the corporation is seen as a failure of the family.

Adam (2003), however, questioned the extent to which family values as opposed to values of culture in general influence or impact corporate governance—for better or worse? For example, the nature of representations

that stakeholders can expect from boards of corporations depends crucially on the social background or representatives or family values.⁵

II. Implementation of Corporate Governance in Asia.

Asia and Its Culture

According to Hitchcock, “the word “Asia” itself has much meaning beyond the geographical one. The diversity of the region- racial, cultural, religious, historical – makes it the richest, most fascinating areas of the world, but also seriously complicates the task of defining a discrete “Asian” form of democracy or “Asian” set of values.”

Culture shapes identities. Culture explains the differences in societies, people’s attitudes and motivations. The Asian culture generally focuses on community over individualism or consensus building, attachment to family as the basis of society, frugality, respect for learning, public duty, respect for authority, teamwork, and tolerance. Also, religion is seen as an integral component of cultural values. An example, is the Filipino Value Framework on “Asal” or character (see Figure 2).

With Globalization, Asian companies are under greater pressure to embrace global standards. It is seen as an

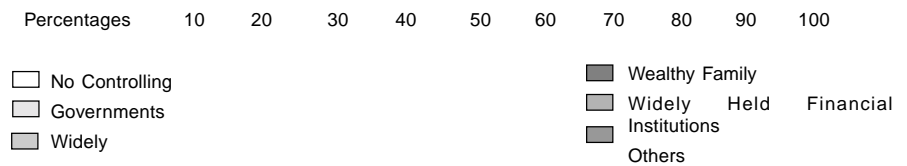


Figure 1: Family Corporations of the World

Source: The Global History of Corporate Governance – An Introduction by Randall Morck and Lloyd Steier, November 9, 2004

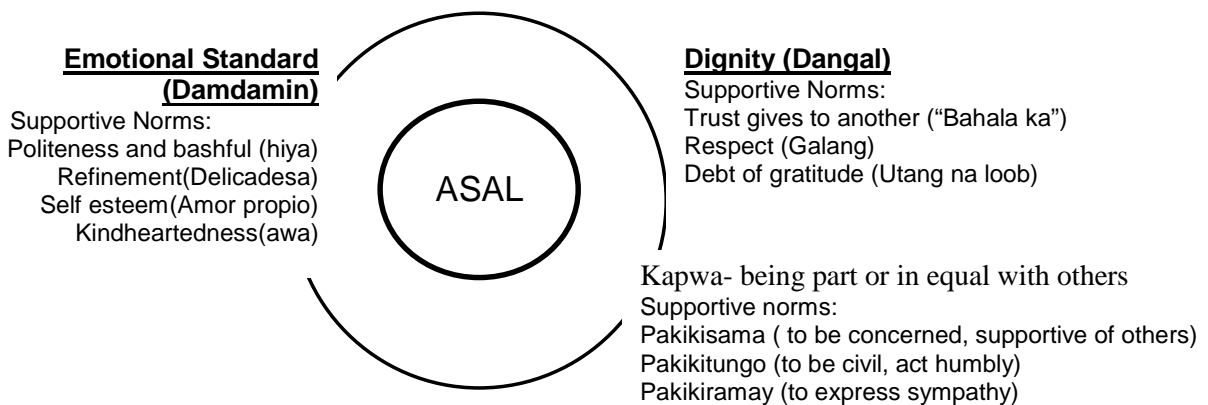


FIGURE 2: FILIPINO VALUE FRAMEWORK OF CHARACTER

Source: *Management by Culture*
F. Landa Jocano (1999)

TABLE 2: SOCIETAL VALUES

East Asia	United States
Having an orderly society	Freedom of expression
Societal harmony	Rights of individual
Ensuring accountability of public officials	Personal freedom
Open to new ideas	Open debate
Freedom of expressions	Thinking of oneself
Respect for authority	Accountability of public officials

Source: Hitchcock, David . *The United States and East Asia: New Commonalities And Then, All Those Differences*

imposition of the west, many Asian corporations will argue, that western corporate standards are inappropriate in their working environment or coming too early in the development process of those countries.⁶

On the other hand, David Hitchcock’s⁷ survey in 1994 presented six societal values and five personal values prominent among East Asian countries versus the United States. See Table 2 and 3. He presented the differences and said “that Asian values are imbedded deep inside the social structure of the Asian society, whatever the merits of disadvantages it has compared to the western believe, the changes will have to be slow and painful.” Remember, Asia make up more than 60 percent of the world’s population.

The Soul of the Business

Adams(2003)emphasized that corporate governance has a major indirect effect on the socio-economic-growth-development nexus of a country, because finance and investment decisions impact either positively or negatively on the development process and thus the quality of life of people. He then recommends that corporate governance should go beyond the functional framework of focusing on rule-based environment or the quantitative aspects of governance and towards important social goals

such as poverty alleviation, improved quality of life, enhanced opportunities for better education, health, and more.

According to Keidanren’s “Charter of Corporate Behaviour,” the key driver is trust through customer relationships and a concern for the “users of products and services.” There is a growing emphasis on the “corporate band.” The council for better corporate citizenship, set up and supported by the Keidanren, defines this as “a brand” and is more than just a name. A brand has a value that indicates whether the company’s products and services can be expected to create assurance, satisfaction, and a sense of confidence.” Confidence is the key word and perhaps a more useful one than trust, although the focus on a trust deficit at the World Economic Forum’s 2003 meeting is the one that has to be acknowledged. The Conference Board

survey of business agreed that the current atmosphere of distrust that pervades international political relations will certainly impact on the global commerce. ⁸

Business could be likened to a human person. It has a soul and a body. In business, the soul comprises the values and ethics of its people and the organization while the body comprises the structure, the systems and the processes that make up the organization. When an organization has a healthy body and a fine soul, productivity becomes a daily obsession and excellence becomes a way of life, not by an extra effort that an organization needs to make. Values and ethics are not tools to an organization. Balanced scorecard, TQM, Six Sigma and other reengineering models are the tools. Rather, values and ethics are the guides and the foundation of an organization.

As Johnson (2003) illustrated, living in a multilateral network requires rules but a system based on principles and values makes it strong.⁹ No doubt we need rules, especially in this complex environment. We need rules to endeavor to elicit the desired behavior of corporate executives. We need rules to provide the means to decide and make choices. We need rules to know what to comply. We need rules to have a list of what is encouraged and prohibited since it provide a certain order in the corporate arena. It defines the relationships of the

TABLE 3: PERSONAL VALUES

East Asia	United States
Respect for learning	Self reliance
Achieving success in life	Personal achievement
Self discipline	Hard work
Fulfilling obligations to others	Achieving success in life
Personal achievement	Helping others

Source: Hitchcock, David . *The United States and East Asia: New Commonalities And Then, All Those Differences*

various corporate actors and stakeholders. Rules, theoretically, put everyone on the same plane. But whether everyone follows the rules is another thing.

As Adams (2003) pointed out, having more rules and regulation do not ensure more honesty for one cannot legislate against dishonesty. There is a need to develop a culture of qualitative governance where state and corporation is underpinned by institutional or cultural norms and value systems.¹⁰

Standards and rules are present in these developed countries but scandals such as ENRON and Worldcom still happen. This leads me to ask if there are real independent auditors? I believe there is no such thing as real independence. Business relationships exist. One way or another, the auditors can give in to the client or they will loose the contract. But if auditors are guided by ethics, by the proper values, then losing the account would not matter. Following corporate governance principles should extend more than just following rules but giving emphasize that by following one is doing its part in improving the quality of life of human kind. Corporate decisions should have a conscience...should have ethics, the people who makes decisions should have the right values.

As a lawyer, rules are important but not everything can be covered by rules, by the law. Standards are important but what that law does not cover is covered by ethics. **Legal may not be ethical.** Rules are important in developing a work environment. However, if organizations behave ethically and follow a undistorted set of values, at the end of the day one do not need rules. As the foundation of good corporate governance is TRUST.

III. How to Restore Trust?

Another challenge facing business today is how to be profitable and ethical at the same time. It is a common belief that being ethical in the conduct of one's

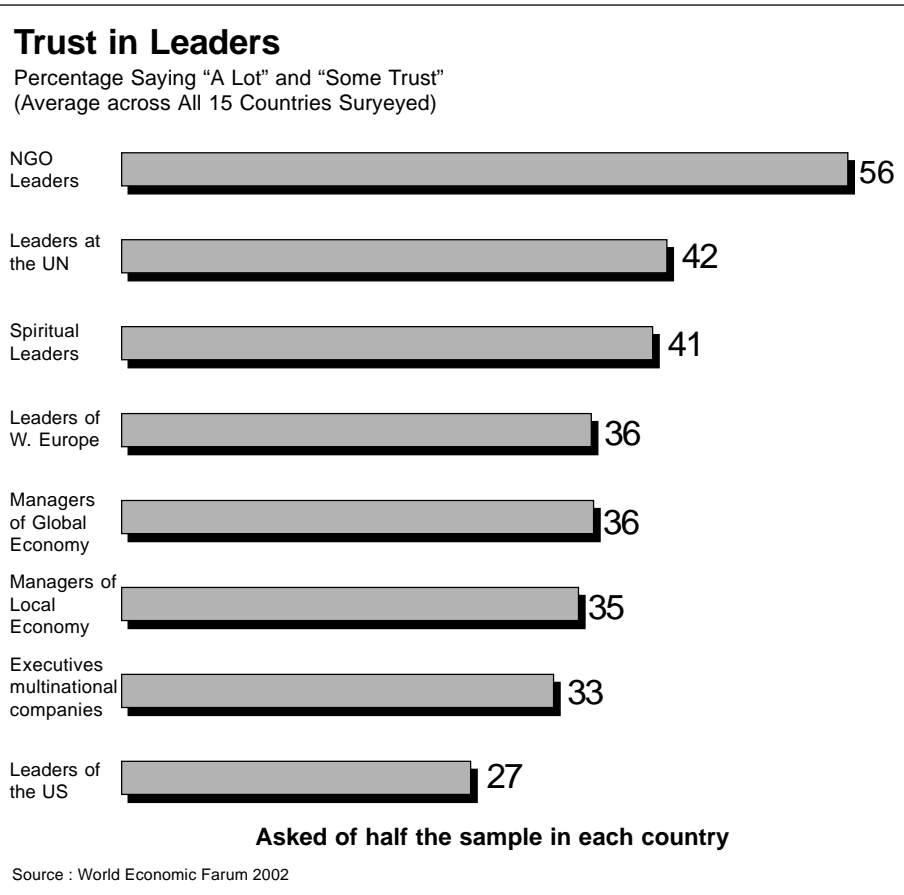


FIGURE 3: TRUST IN LEADERS

business is absurd. It limits your flexibility and restricts your opportunity. This belief needs a serious revisit.

Trust, as defined by Mayer, Davis, and Schoorman (1995), is the willingness of a party to be vulnerable to the actions of another party based on the expectation that the other will perform a particular action important to the trustor, irrespective of the ability to monitor or control that other party. This is an important dimension of the governance of business transaction that goes beyond formal agreements and contracts. Morck and Steier warn that the absence of trust or even distrust makes coordination and control problematic.

The Level of Trust

The World Economic Forum (2002) opinion research survey showed that

there is a dramatic lack of trust in key institutions (see Figure 3.) The study concluded that the global companies and large domestic companies are equally distrusted to operate in the best interest of society. "Over the past year, trust in executives of domestic companies has fallen more than trust in executives of multinational companies in most countries. Over four in ten citizens report decreased trust in executives of domestic companies, six percentage points more than the number reporting decreased trust in multinational executives. A slim majority report their trust in both sets of executives has stayed the same or improved in the past year."¹¹

In another survey by the US public relations firm Golin/Harris International confirmed that Asian businesses are experiencing a crisis of confidence and trust. Japan featured strongly with 85%

of those surveyed saying that recent events have caused a crisis in the way they do business. A wave of corporate scandals in Japan since the late 1990's led the Japan business Federation (the Keidanren) in October 2002 to "strengthen measures for the prevention of corporate misconduct" as scandals have provoked the widespread criticism not only of the corporation directly involved, but also of Japanese business as a whole. The Keidanren's Charter of Corporate Behavior now states that member corporations are expected to conduct themselves in a socially

responsible manner, to observe both the spirit as well as the letter of all laws and regulations applying to their activities both domestically and overseas."¹²

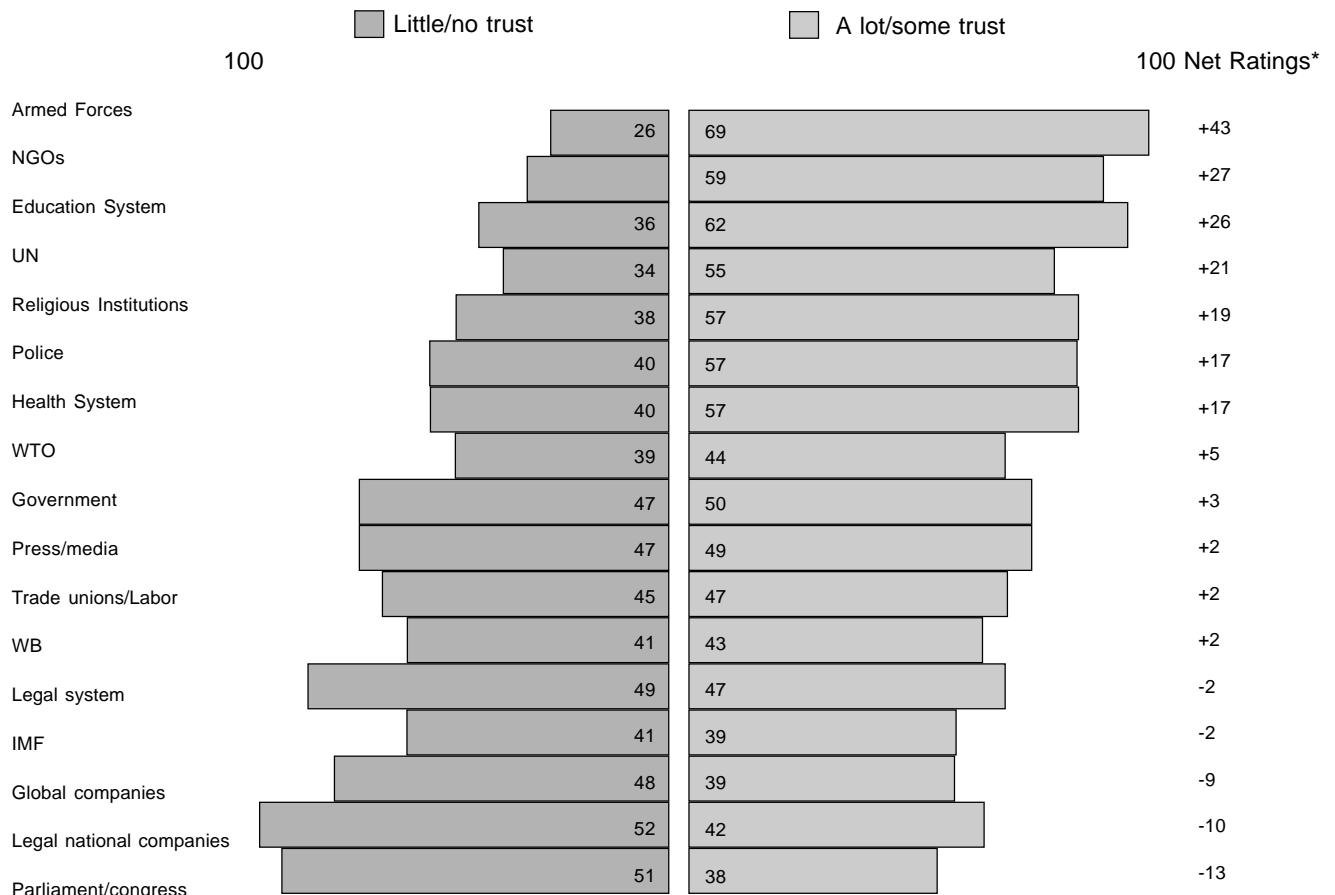
The global public opinion survey reveals that trust is not only declining in institutions across the world, but leaders themselves have suffered declining public trust over the past year and today enjoy less than the institutions they lead (see Figure 4). It also interesting to compare who Asia trusts (see Figure 5 and 6).

The public is pessimistic on the future. The poll also reveals a decline in public trust that the world is going in the right direction, compared to a year ago.

The issue of trust is part of the broader societal reaction; as one fund manager with a major investment group said: "we are losing trust in Japanese society – with politicians, high class bureaucrats, big companies, even where there is no evidence of company scandals. This is the trust, which has been the basis of the economy for the last 50 years. People are losing confidence in every

Trust in Institution to Operate in Society's Best Interests

Global Ratings (n= 34,000 across 46 countries)



*% trust minus % distrust net rating

Source: World Economic Forum 2002

FIGURE 4 : 2003 TRUST IN INSTITUTIONS

aspect. “As one commentator recently claimed, ‘statements that “ the customers are always right” are an empty catchphrase and consumer protection is secondary.’¹³

According to Doug Miller, President of Environics International, “There are three key take-away from the survey: 1) declining public trust appears to be a leadership problem more than an institutional reform issue, 2) regaining trust will largely require changing policies and directions to better reflect citizen aspirations, and 3) leaders of NGO, the UN, and religious groups (as well as others enjoying high public trust) will need to be included as part of any solution.”

The world today is complex. The need to have trust is much important. Although, there is a call from world leaders to restore trust, safeguarding the remaining level of trust is equally important.

Restoring trust and enhancing reputation has been a focus of corporations across the world and especially in the US.¹⁴ PricewaterhouseCoopers, in its Annual Global CEO Survey 2003, says: CEOs are engaged in the issues of restoring public trust, improving corporate governance and increasing transparency. Less clear is any consensus on how to achieve those goals-aside from increasing the role of the CFO and devoting more resources to improving risk management procedures.

However, disclosure is not a panacea. “Disclosure can help the savvy, the institutional investor or bond trader who deals daily with others who have a stake in their advice. It can be the right remedy. But disclosure is often sold as a way to protect the unsophisticated, and they may be least equipped to use the information to make wise choices.”¹⁵

The call is beyond disclosure. “Transparency includes an affirmative obligation for corporations to openly and honestly talk about their corporate social responsibilities initiatives in a proactive and responsible way...it

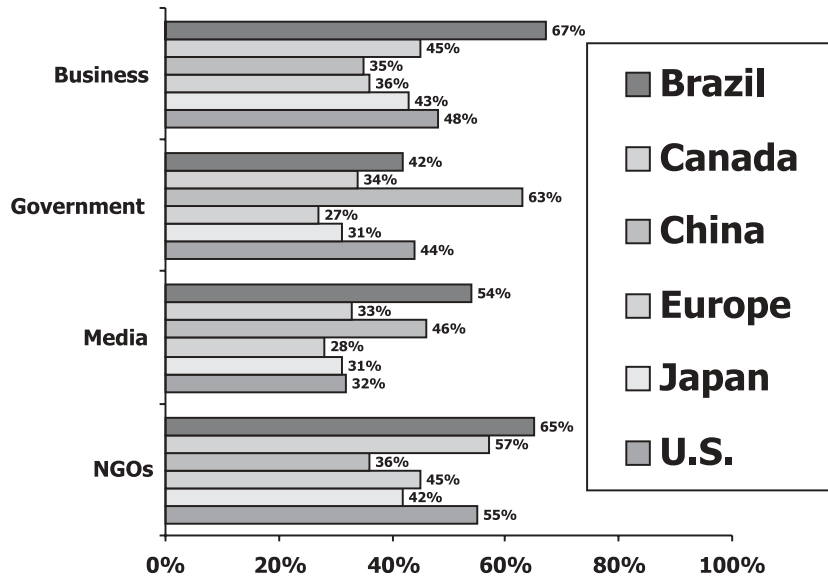


FIGURE 5: 2005 TRUST IN INSTITUTIONS

Source: Edelman Annual Trust Barometer, Jan 05

means that it is not enough to provide complete and honest information. There is also an obligation to “find me and tell me.” The need for consistent, open and frequent communication is essential to building or rebuilding trust[...] Building trust is also like putting a deposit in the bank...having a strong reputation give you some ability to draw down your deposit without draining the account.”¹⁶

Miller advises that “unless existing leaders pull together some significant trust-building initiatives relatively quickly, there is likely to be even greater system instability, and many leaders will not doubt soon replace them. But more importantly, without action there will be mounting calls for fundamental system changes.”

Compliance and Enforceability

How is trust demonstrated, exhibited, and thought? I believe that a person is trustworthy when one does something good and avoid something bad.

Trust is corporate governance. One will gain trust if corporations follow the principle of corporate governance. Trust cannot be regulated. It is either one has it or do not.

Adams (2003) mentioned that an important but neglected element in the corporate governance literature is the influence of institutions on economic outcomes. “Importance of institutions, cultural traditions, value systems, mores and history are crucial ingredients in the development process over the issues of compliance[...] Policy makers should realize that the quality of corporate governance is relevant to capital formation, for weak corporate governance systems combined with corruption and cronyism distort the efficient allocation of resources hindering investment opportunities and ultimately economic development.”¹⁷

Adams (2003) warns that the existing socio-economic structure is not a sufficient condition in addressing the moral dimension of corporate governance. Corporations and organization should shift from “conformance mode to performance mode.”¹⁸ Indicators therefore that exhibit the effectiveness of corporate governance should establish.

The success or failure of the policy implementation is heavily dependent on the cultural and political institutions in place. Williamson (1994) and Puttman (1993) argue for the importance of social

institutions based on trust over the outcome of economic relations performance. Once social institutions are disrupted, the possibility of successful public policy implementation to restore “social capital” is a tedious and time-consuming task.

Morck and Steier noted that wealthy families, to lock their corporate governance, might block the emergence of trustworthy markets and institutions, and so greatly harm their countries. Or, they might persist as a sort of corporate governance appendix while institutions and market development around them...they might serve shareholder by providing constitutional guarantees of good governance, and contribute to the higher levels of trust.

Adams further explains that the issue of trust is paramount because a decline in business ethics has important economic consequences. “ETHICS is a low cost substitute for internal and external regulation. Ethical behavior reinforces and is the root cause for successful performance standards.”¹⁹ Morck and Steiner added that wider networks of high trust behavior appear to be important to the creation of an effective system of governance for large organizations and of reliable institutions in general.

Zak and Knack (2001) concluded that high trust societies produce more output than low trust societies. A sufficient amount of trust is crucial to successful development.²⁰

After the 1997 Asian crisis, some parts of Asia quickly recovered and continued its development growth rate. This may indicate that there is still sufficient amount of trust in Asia. How is this safeguarded?

Jordan (1999) stressed that Asia doesn’t need better laws; Asia needs better enforcement and better court systems. On the face of it, it would appear hard to argue with effective legal enforcement and a good judiciary. But here it is useful to consider the “role of law” as well as the “rule of law.”

NGOs are super branfs in the U.S., Europe

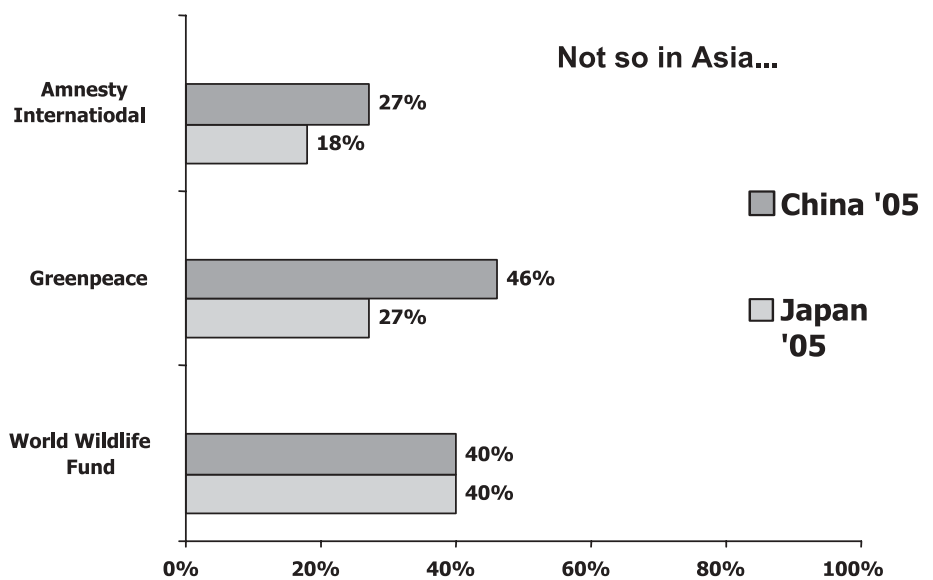
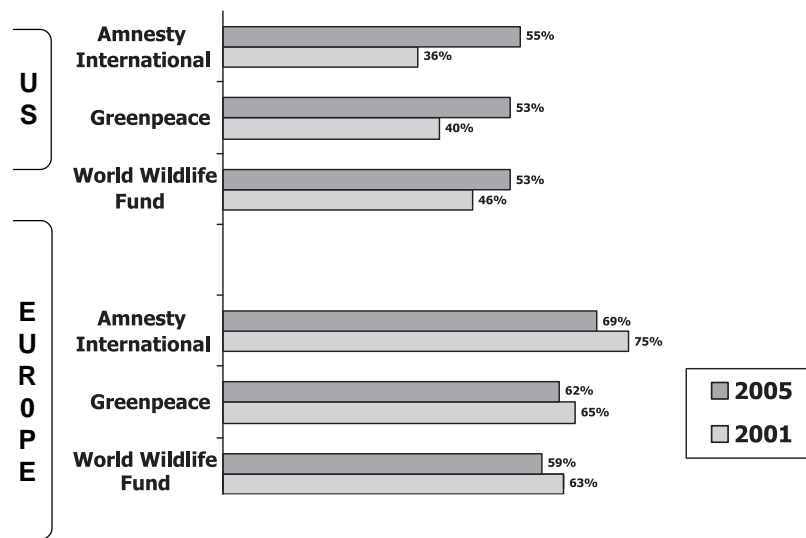


FIGURE 6: 2005 TRUST IN NGOs

Source: Edelman Annual Trust Barometer, Jan 05

In commercial matters, recourse to enforcement mechanisms and the courts implies a failure in commercial dealings and the operation of commercial laws, the purpose of which is generally to facilitate and promote good faith

commercial activity free of formal government or judicial intervention.²¹

Johnson²² (2000) asked “is legal origin a fundamental exogenous variable or determinant of the governance

process?” He added that there is evidence that countries with weaker investor protection suffer greater adverse effects when hit by a shock. Corporate governance provides at least as convincing an explanation for the extent of exchange rate depreciation and stock market decline as any or all of the usual macroeconomic arguments. Johnson and others (2000)²³ present evidence that the weakness of legal institutions for corporate governance intensified the depreciations and stock market declines in the Asian crisis.

Furthermore, Johnson believed on the importance of the law. “Countries with more investor protection have better-developed financial markets and more growth. The determinants of law are complex, but the origin of the legal system is an important factor[...] Legal reform works. The change may come slowly, and there may be setbacks, but a sustained effort to improve investor protection definitely pay off.”

On the other hand, Thompson study, for example, compared the reaction of Malaysia and Indonesia on the 1990’ financial crisis. He noted that researchers found either a cultural explanation and/or on the legal systems in placed. “Malaysia was a British colony and its legal system is based on the common law: the set of rules, norms, and procedures that has guided the legal system of England and the British Empire for about nine centuries... countries that come from a French civil law tradition struggle to create effective financial markets, while countries with a British common law tradition succeed far more frequently[...] The evidence supporting their theory is hardly absolute[...]The logic underlying the theory isn’t universally accepted either. Legal and economic scholars alike have attacked nearly every premise and conclusion, though the frequency and fury of the attacks seem to be evidence as much of its importance as of its flaws. If true, the theory provides more than just a new way of looking at legal history...”²⁴ This argument shows that

the origin of the law is not a conclusive factor; the maturity of the legal system and the capacity to enforce are other factors to be considered.

The credibility and utility of corporate governance are compliance and enforceability. The two are very much interrelated. Compliance will be enhanced if regulators are competent and capable to enforce the laws and rules. Compliance is expected and even exceeded if values are rooted in the organization and ethics is observed.

Maybe, instead of thinking complying and enforcing, it is better to simply knowing who are we accountable for?. Stakeholders, from government regulators to customers, expect companies to move from a compliance mode to that of affirmative and proactive interaction with their various audiences, which goes beyond what they are required to do under the new rules.²⁵

The 1998 APEC symposium on rebuilding Asian Growth concluded that a corporations effectiveness is dependent on its ability to define and enforce roles, rights and responsibilities of its principal players, namely owners, shareholders, managers and directors.²⁶ Zaman (2003) further synthesized that inputs to corporate responsibility should not judged the results by the input and the community involvement but by the difference to poverty reduction on the ground in the developing world.²⁷

Who are human beings accountable for?
What, how, and for whom to produce?

Zaman recognises the need to focus on human beings themselves rather than on the market or the state as the latter are but parameters within which economic agents interact with one another. Human beings constitute the living and indispensable element of an economic system[...]. Passing more legislation, does not ensure corporate scandals from happening, governance rules and their compliance does not guarantee intellectual trust and honesty.

IV. Conclusion

Trust is abstract but it suggests a way of enhancing and maintaining. How is trust measured? Maybe if I have trust, there is no need to measure.

With the changing roles of to who to entrust managers should think much harder about business ethics than they appear to at present. It is lack of clarity about business ethics that give rise to confusion over what manager’s responsibilities are and over where the limits of those responsibilities lie.²⁸

Trust like honesty is universal. What could have prevented the corporate scandals in the world? Not the presence of securities rules in different jurisdictions. Most of the response is the requirement for better disclosure, but the issue is, is it ethical? When disclosing, is trust affected?

The excesses and greediness of the corporate world could only have been prevented if the executives involved have the RIGHT and CORRECT values. Even without the securities rules, the scandals would not have happened had these executives possessed and practiced the values of INTEGRITY AND HONESTY, FAIRNESS AND ACCOUNTABILITY.

Morally there is a world of difference between greed and self-interest...
“²⁹Greed, in the ordinary meaning of the word, is not rational or calculating...where as the kind of self interest that advances the public good is rational and enlightened... It looks beyond the short term and plans ahead. It considers sacrifices today for the sake of gains tomorrow...If self interest, guided a though an invisible hand, inadvertently serves the public good, then it is easy to see why society can prosper even if people are not always driven by benevolence.

Unless trust is restored in the workplace, corporate governance will simply remain a rhetoric, an aspiration, a vision and not a reality. ■

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INDEPENDENT DIRECTORS, KNOWLEDGE SYMMETRY AND ALL POWERS

*Dr. Darlene M. Andert

INTRODUCTION

This discussion argues that the corporate world cannot improve Boardroom decision-making and member independence, with the same thinking creating today's realities. The discussion is fourfold. First, there's an absolute need for knowledge symmetry to reap decision-making synergy in the Boardroom. The *all powers* provision within the US Model Business Corporation Act offers an underutilized framework for directors' inter-relationship, individual member independence or autonomy, and decision-making fluidity. Secondly, traditional structural barriers, plus new post-Sarbanes-Oxley structural barriers, impel Two-Tiered Board Syndrome which dilutes the distribution of knowledge and deteriorates decision-making fluidity. Thirdly, there are socio-political realities from the duality of independent and non-independent membership status that further undermines the equilibrium of Board decision-making. Finally, the discussion centers on a prescriptive corporate governance model (Andert 2003, 103) that challenges the role of independent and non-independent Board members by separating *leadership in action* as an internal operational function and *leadership in thought* as an oversight function. This separation of function supports the concept of *all powers* and adds symmetry and synergy to decision making without redundancy.

STRUCTURAL PROBLEMS AND DECISION-MAKING

The symmetry of information and the creation of new knowledge among Directors is a necessity to achieve Board

decision-making synergies and to maintain individual member independence and autonomy. Lessons from Enron and other recent cases indicate that the same information may not be available to both non-independent and independent Directors and remixing the proportions of independent and non-independent Board members has yet to appear a full solution.

In 2002, the New York Stock Exchange released the Selected Final Recommendations of NYSE Corporate Accountability and Listing Standards Committee report that offered new listing standards with the hope it would restore investor confidence by "empowering and ensuring the independence of directors and strengthening corporate governance practices." (NYSE Press Release 2002, 1). The final recommendation defines independent directors and reads:

Independent directors must comprise a majority of a board. Companies must have a nominating committee, compensation committee (or committees of the company's own denomination with the same responsibilities) and an audit committee, each comprised solely of independent directors. Controlled companies are exempt but must have a minimum three-person audit committee composed entirely of independent directors (Fig. 1)

Though increasing the membership of independent board members may assure investors that there exists a potential for a different balance of power and a lessening of potential conflict of interest issues on the Board, it does not offer decision-making synergies when the knowledge base of the Boardroom is divided.

This discussion will explore corporate governance restructuring. Section 8.01(b) of the United States Model Business Corporation Act serves as the unifying construct for the various US state-authored statutes that govern private or public, profit or not-for-profit corporations and associations. The Act offers a structural foundation for unity of Board action that "all corporate powers shall be exercised by and under the authority of, and the business and affairs of the corporation managed under the direction of, the board of directors" (p. 8-5). If the full ramification of this Act were embraced, then corporate governance powers would structurally be given to this whole body and not to the individual members. As simple as this statement sounds, it would support full Board decision-making and eradicate decision-making by autonomous committees or powerful members. The Act further describes "actions without meetings" (8-24) forcing ALL members to sign-off on actions needed between meetings. The "voting and quorum" (8-27) rights which, when applied equally to ALL Board members, result in the creation of a non-hierarchical, one-vote-for-one-member collective structure.

Despite this mandated framework (Model Business Corporation Act), many Boards still approach the Boardroom as a managerial-based hierarchical structure with the Chair at the head. Many Boards still hold the CEO and Chair as one position despite years of urgings by Blue Ribbon Committees to avoid this duality (Dedman 2002). The result of this traditional managerial paradigm is the loss of member autonomy to hierarchical thinking, and the need to

label Directors by title such as *independent* and *non-independent* members effectuating the possible loss of equilibrium and the corruption of the concept of *all powers*.

The standard argument for maintaining a Board populated with both independent and non-independent directors is the argument that internal or operational, non-independent directors are more knowledgeable concerning corporate business. This is a circular argument. A study by Nowak & McCabe (2003) interviewed 45 directors from Australian public companies found independent Directors perceived information asymmetry. Directors with less access to information are likely to experience information asymmetry. The identifiable problem is the uneven flow of information needed to perform excellent *oversight*.

Different, but equally damaging to Board member autonomy and decision-making are actions by the Board's Executive Committee on behalf of the full Board, which occur between meetings. Such wholesale delegation of Board authority may also be granted to the Compensation Committees or assumed by such committees, as may be unfolding with the Disney corporation case. Recent changes mandated by the US Sarbanes Oxley Act (2002) support more autonomy for the Audit Committee. Though this action may elevate the independent Director's knowledge base in that area, it also dilutes full-Board decision-making synergies.

If there is a gift resulting from the Sarbanes-Oxley Act it may be the emerging firewall being erected between management's operational side of the business, and the Board's oversight of those operational realities. This change moves governance in the direction of a single class of Directors. A study published in the European Business Review by Weir & Laing (2001) indicates that there is no clear relationship between governance structure and corporate performance.

But, substantive changes in governance structuring are still forthcoming, and the needed changes must focus on symmetry of information and collective decision-making while discouraging wholesale delegation of Board powers and accountabilities.

Exercising *all powers* in the Boardroom should enhance fluidity of information flow and collective decision-making synergies. But this is only a theory yet untested in most corporate board structures.

PROCESS PROBLEMS AND DECISION-MAKING

Leveling member autonomy may also positively impact the *process* of decision-making. Research indicates that individuals are influenced when working in a group setting. The classic work by Janis in 1972, on *group think* concludes that the personal desire to maintain group loyalty can cause the most intelligent person to rationalize bad group decisions. Group think is defined by some as "an agreement-at-any-cost mentality that results in ineffective group decision making" (Lewis, Goodman & Fandt, 2004, 197). Gersick and Hackman (1990) further offer that over time, groups "often

develop habitual routines for dealing with frequently encountered stimuli" (¶1). The resultant decisions may lead to preset or even, involuntary answers. To avoid the potential for group decision-making process errors, Boards need structures that support access to outside professionals as an alternate set of eyes and source of new information to improve potential decisions. Information redundancy between the Board and management may create the environment where *group-think* and other process pressures materialize in poor outcomes as the Enron case may attest. Changes in governance structures have yet to address information inertia occurring from the still low number of independent members. A further cause of information inertia or poor decision outcomes may be the reality that managerial reporting lines are challenged (or honored) during decision-making in the Board room.

A MODEL FOR CORPORATE GOVERNANCE

The discussion now leads to the offer of a prescriptive corporate governance model (See Figure 1) that supports information symmetry and member autonomy. The structure suggests the formation of a non-operational board

with a direct (and singular) reporting line between the internal auditors and the Board. This structure also mandates a solid reporting line between all the various external professionals and the Board. These professionals serve the full Board as a contingent source of research and consultative knowledge and in theory report to the full Board session, offering information symmetry and reframing. This structure offers Board members a solution to information inertia, and provides a dual-source of information to all members of the Board that augments and expands the information offered by management. This schema exploits the relationship established by the Sarbanes-Oxley Act between the Board and the external auditor and uses it as the schema for Board's relationships with all other outside professionals. The new model is anchored in the utilization of outside and independent sources to lessen possible redundancy or preset outcomes. The model offers the Board full autonomy and information symmetry.

Boards are encouraged to seek information from such professionals as: the internal and external auditor, specialty consultants, legal counsel to the Board, and researchers. Boards may also desire the services of an exclusive staff member for administrative support. Boards may consider private meetings with more than just the external auditors.

This prescriptive model further suggests the use of a CEO Advisory Board, which may be populated to serve as an interlocking Board, or an external

peer-review Board, and/or a senior management development board. The Advisory Board serves the CEO's and senior management, but on an advisory level only as ALL POWERS exists in the oversight Board. The Advisory Board, however, provides a purposeful and proactive approach to CEO succession development, senior-report development, and organizational development. It also offers placement to Board members who have a business relationship with the organization.

Current corporate governance structural changes are dwarfed when compared to the giant corporate failures experienced in the both the US and Europe. It is acknowledged that evolution is more comfortable than revolution when choosing a response to these realities. Yet, if Boards are to obtain information symmetry and decision-making synergies, then it becomes obvious that there is much more change that is needed. The prescriptive model may appear to be too revolutionary, but shareholders are now demanding accountability by members of the Boards of Directors., and believe that both *all powers* and all *accountability* rest with the Board as a whole. As Directors share *all liabilities*, why not share *All powers*? Full member symmetry in all aspects, is a natural new paradigm waiting to unfold.

CONCLUSION

Democracy splits the powers between the Judicial branch, Legislative branch, and Executive branch, with each

holding separate and distinct autonomy. The emerging paradigm of corporate governance structuring offers new balanced between the three distinct powers, the Board providing oversight, Administration (or management) providing operations and Regulatory agencies providing legislative enactment. A balanced between these three branches challenges the wisdom of dual roles for members of the Board of Directors — which has long been a topic of much debate. As dual roles continue to diminish, directors may see the strengthening of member autonomy and decision-making synergies. The compelling question is “How swiftly can the separation of powers between operational roles and oversight roles occur so knowledge symmetry and director independence can emerge?” This may be a radical change to those involved, but it is a change most see arriving on the horizon. When this shift finalizes, the next question will be “How do we create a profession known as Professional Corporate Director?”

Lord Acton is quoted “that power tends to corrupt, and absolute power corrupts absolutely”. If one believes this true, then corporate governance must continue to seek a balanced structure of director autonomy, and avoid redundancy. As *knowledge is power*, restructuring and process improvements must support the symmetry of information and autonomy of members to maximize decision-making synergies in the Boardroom. Shareholders are demanding this improvement. ■

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MAKING CORPORATE GOVERNANCE DECISIONS THAT WORK FOR WHOM?

*James McRitchie

Ten years ago, when I started an internet site on corporate governance,¹ most in the United States would have answered that corporate governance decisions should work to maximize shareholder value, regardless of consequences to the larger society.² Although effort in corporate governance is still largely focused on that goal, several trends promise that corporate governance decisions might also contribute to a more sustainable society and environment.

While we have achieved significant reforms after the Enron debacle, we are now facing something of a stall and possibly retrenchment, at least from the standpoint of reforms I have been advocating and with regard to the central role played by the California Public Employees Retirement System (CalPERS).³

Calpers Background

In the United States when most people think of corporate governance, especially with regard to active shareholders, they think of CalPERS, with \$185 billion in assets. Their activism began in 1984 when California's Treasurer, Jesse Unruh, learned that Texaco had repurchased almost 10% of its own stock from the Bass brothers at a \$137 million premium. Texaco's managers paid "greenmail" to avoid losing their jobs in a takeover. CalPERS, although also a substantial shareholder, wasn't given the same option so Unruh organized a powerful shareholder rights movement by helping to found the now \$3 trillion

dollar Council of Institutional Investors (CII),⁴ composed mostly of public pension funds. Corporate governance activities at CalPERS and CII were not aimed at creating a better society; they were aimed at strengthening shareholder rights and earning more money.

By the early 1990s, the movement started by CalPERS had led to a period of sweeping changes in boardrooms across America. CalPERS and CII won new regulations that allowed shareholders to communicate with each other about specific firms without filing Securities and Exchange Commission (SEC) documents. CalPERS targets, generally 10 to 12 poorly performing companies each year, became the subject of negative publicity and directors took action. Chief executive officers (CEOs) were ousted at American Express, Chrysler, General Motors, IBM, Kodak and Westinghouse.

In 1995, Steven Nesbitt published a study, which examined the performance of 42 companies targeted by CalPERS. It found that while the stock price of "focus list companies" trailed the S&P 500 Index by 66% in the five-year period before CalPERS acted to achieve governance reforms, the same firms outperformed the Index by 52.5% in the following five years. Nesbitt dubbed it the "CalPERS effect."⁵ A similar independent study by Michael P. Smith, with the Economic Analysis Corporation, concluded that corporate governance activism had increased the value of CalPERS holdings in 34 firms over the 1987-93 period by \$19 million at a monitoring cost of \$3.5 million.⁶

Early Concerns Of CorpGov.net

Looking back at my earliest commentaries, one of the first was on fiduciary duty.⁷ I knew there was a growing shift in who controlled money. In the 1970s almost 80% of US equities were held directly by individuals. By 1995, when I started GorpGov.net, that proportion was considerably smaller and by 2002 it fell to just over 37%.⁸ Institutions, bound by fiduciary obligations, control the rest. I felt the key to future corporate behavior depended on the voting behavior of pension funds and mutual funds in corporate elections.

I was familiar with a 1988 Department of Labor (DOL) opinion (the *Avon Letter*)⁹ that, since proxy voting can add value, voting rights are subject to the same fiduciary standards as other plan assets. But I also suspected that most funds were shirking their duty. I read the findings of three DOL proxy-monitoring projects conducted between 1989 and 1996. In 1989, DOL said they would continue to conduct inquiries and, "where appropriate," would "take enforcement action." No enforcement action has been taken to date.

By 1996, still only 35% of the plans surveyed could provide evidence that they performed substantive monitoring of voting authority delegated to money managers. Of those that delegated proxy-voting authority, only 38% provided written guidelines to investment managers and some were general to the point of irrelevance, since the law already required "vote proxies in the best interest of the client."

6th International Conference on Corporate Governance

Nuffield Hall, 27 Sussex Place, Regents Park, London, 12th-13th May 2005

“Making Corporate Governance Decisions That Work”

PROGRAMME*

THURSDAY, 12 MAY 2005

0900 -1000

Registration

1000 -1115

**Plenary 1
Opening Session**

Dr Ola Ullsten, Former Prime Minister of Sweden
Hon'ble Prem Chand Gupta, Minister Company Affairs, Govt. Of India
Justice A.M. Ahmadi, Former Chief Justice of India & Chancellor Aligarh Muslim University
Ms Lynn McGregor, Chairperson Conference Organising Committee
Dr Madhav Mehra, President World Council for Corporate Governance

1115 - 1130

Tea

1130 - 1300

Plenary 2

Keynote Session: “Making Corporate Governance Decisions That Work”

Prof Roman Tomasic PhD, Acting Pro Vice-Chancellor Victoria University of Technology, Melbourne, Australia
George Dallas, Managing Director & Global Leader Governance Services, Standard & Poors
James McRitchie, Publisher Corporate Governance, USA
Peter Whitehead, Research Director Corporate Executive Board, UK

1300 -1400

Lunch and networking

1400 -1545

Plenary 3

Corporate Governance - Global Issues, International Developments & Country Experiences

Matthew Cadbury, Former Managing Director, Cadbury Schweppes
Prof Takashi Aihara, Kwansai Gakuin University, Japan
Ken Peattie, Director ESRC Centre for BRASS, UK
Ms Bridget Rosewell, Chief Economist, Office of the Mayor of London, UK
Dr Caspar Rose, Associate Professor Copenhagen Business School, Denmark
Dr RK Jadhav, Director Jamna Lal Bajaj Institute of Management, India
John Reynolds, Managing Director, Houlihan, Lokey, Howard & Zukin, UK

1545 -1600

Tea

1600 -1745

Plenary 4

Panel Discussion: Making Corporate Governance Decisions That Work for All Stakeholders

Prof Victor Ayeni, Director GIDD, Commonwealth Secretariat, UK
Mr Grant Kirkpatrick, Senior Economist, OECD, France
Paul Moxey, Head of Risk Management & Corporate Governance, ACCA, UK
William Claxton-Smith, Director, Investor Responsibility
Mina Gouran, Managing Vice President, Korn/Ferry's Global Board Services

1745 onward

Networking break

1900-2100

Presentation of Golden Peacock Awards & Dinner

FRIDAY, 13 MAY 2005

0830 -1000

Working Session One - Decision-Making Perspectives

1A

Towards an effective framework for decision making -inclusiveness, transparency & equity

Anwar Hassan, Managing Director Tata, UK (Chair)
Rene Banez, Corporate Governance Advisor, Long Distance Telephone Company, Philippines
Ms. Jilla S Decena, Research Manager, Hills Governance Centre, Asia Institute of Management, Manila
Dr Giovanni D'Orio, University of Calabria, Italy
Dr. Julien Le Maux, Assistant Professor of Finance, University Paris I Sorbonne
Dr RK Jadhav, Director Jamna Lal Bajaj Institute of Management, India

1B

How can the quality of the decision-making process be improved?

Dr Ola Ullsten, Former Prime Minister of Sweden (Chair)
William Claxton-Smith, Director, Investor Responsibility
Mina Gouran, Managing Vice President, Korn/Ferry's Global Board Services
Rosetta Lombardo, University of Calabria, Italy
Peter Blackie, Advisor on EU Affairs, Bruxelles, Belgium
Dr Oumar Barou Makalou, President and Director CERDES, West Africa

1C	<p>Examples of best decision-making practice</p> <p>Prof Roman Tomasic PhD, Pro Vice-Chancellor Victoria University of Technology, Australia (Chair)</p> <p>Dr Tatyana Boikova, Professor RIGA International of Eco. & Business Administration, Latvia</p> <p>Fernando Lefort, Pontificia Universidad Catolica de Chile</p> <p>Dr Sunita Sharma, Faculty of Management, M S University of Baroda, Vadodara, India</p> <p>Rev Dr Graham Wilson, Oxford, UK</p>
1000 -1015	Tea
1015 -1145	Working Session Two - Addressing Opportunities & Constraints
2A	<p>Addressing national/global opportunities & constraints</p> <p>Prof Laura D Tyson, Dean London Easiness School (Chair)</p> <p>Mr Grant Kirkpatrick, Senior Economist, OECD, France</p> <p>Dr Bryane Michael, Linacre College, Oxford University, UK</p> <p>Dr RK Jadhav, Director Jamna Lal Bajaj Institute of Management, India</p> <p>Dr Mehmet Ugur Dean Political & Economy, University of Greenwich, UK</p> <p>Ibrahim Bulent Tokgoz, Capital Markets Turkey</p>
2B	<p>Addressing market opportunities & constraints</p> <p>James McRitchie, Publisher Corporate Governance, USA (Chair)</p> <p>Ms Bridget Rosewell, Chief Economist Office of the Mayor of London, UK</p> <p>Dr Caspar Rose, Associate Professor Copenhagen Business School, Denmark</p> <p>Dr Melsa Ararat, Executive Director of Corporate Governance Forum, Sabanchi University, Turkey</p> <p>Prof Poonam Kumar, Chairperson Mega Ace Consultancy, India</p> <p>Prof PK Banerjea, ICFAI Business School, India</p>
2C	<p>Addressing legal & statutory opportunities & constraints</p> <p>Justice A.M. Ahmadi, Former Chief Justice of India (Chair)</p> <p>Prof Takashi Aihara, Kwansei Gakuin University, Japan</p> <p>Ms Komal Anand I AS, Secretary, Company Affairs, Government of India</p> <p>Dr. Clemens Völk, Institut für Zivilrecht, Universität Wien, Austria</p> <p>John Reynolds, Managing Director, Houlihan, Lokey, Howard & Zukin, UK</p>
1145 -1315	Working Session Three - Decision-Making in Practice
3A	<p>Improving the effectiveness of corporate boards</p> <p>George Dallas, Managing Director & Global Leader Governance Services, Standard & Poors (Chair)</p> <p>Dr Richard W Leblanc, Professor Corporate Governance, York University</p> <p>Ms Lynn McGregor, Managing Director Convivium & Author "Human Face of Corporate Governance"</p> <p>Vindel Kerr, President GovStrat & Author "Effective Corporate Governance", Jamaica</p> <p>Dr Darlene Andert, President Andert Governance Corporation, Florida USA</p> <p>Dr. Eleanor O'Higgins, London School of Economics & Political Science</p>
3B	<p>Corporate social responsibility - the heart of corporate governance</p> <p>Matthew Cadbury, Former Managing Director, Cadbury Schweppes</p> <p>Dr Uddesh Kohli, Chairman, Consultancy Development Centre and Representative UN Global Compact, India</p> <p>VC Agarwal, Executive Director, Indian Oil Corporation, India</p> <p>Biswajit Roy, Indian Oil Corporation, India</p> <p>Professor Lucian Gill, Chairman and Managing Director Ocean-ESU</p> <p>Peter Walker, Pielle Consulting Group, UK</p> <p>Roylston Flude, Switzerland</p>
3C	<p>Achieving the right balance - triple bottom line, ethics and risk management</p> <p>M B Lal, Chairman, Hindustan Petroleum Corporation Ltd. (Chair)</p> <p>Simon Abrams, Jupiter Asset Management UK</p> <p>Craig Bennett, Head of Corporate Accountability, Friends of the Earth, UK</p> <p>Paul Moxey, Head of Risk Management & Corporate Governance, ACCA, UK</p> <p>Jeremy Roche, Chief Executive CODA Group & Author "Beyond Governance", UK</p> <p>Dr Marilyn Dyason, Justices' Chief Executive, Bedfordshire Magistrates' Courts, UK</p> <p>Prof Michael Kaye, Emeritus Professor Portsmouth Business School, UK</p> <p>Onder Yucer, UNDP Representative, Pakistan</p>
1315 -1415	Networking Lunch
1415 -1505	Presentations from 5 working groups (10 minutes each)
1505 -1530	Tea
1530 -1610	Presentations by Group Leaders from balance 4 groups (10 minutes each)
1610 -1700	Panel discussion to crystallize a summary of solutions, conclusions and recommendations
	Presentations from working groups
1700-1730	Closing Remarks

Although DOL interpretive bulletins indicated that prudent shareholder activism was consistent with a fiduciary's legal obligations, only one investment manager reviewed by DOL was so engaged.

The best answer I could find as to why pension plans shirked their duty was in a 1992 book *Fortune & Folly*¹⁰ by William M. O'Barr, John M. Conley, and Carolyn Kay Brancato. The authors used the tools of anthropology to locate a common thread in the culture of pension funds. What they found was "an overriding concern with managing personal relationships" and an all-pervasive "need to manage responsibility and blame."

Involvement by fund trustees in corporate governance issues was not yet the norm. The duty of care requires them to act after due consideration with the care that a "prudent person" would take in a similar situation. The legal system made it difficult to do anything but "follow the herd." I later learned the same person, Robert A.G. Monks,¹¹ who was instrumental in the Department of Labor's *Avon Letter*, was also instrumental in prompting a letter that set similar duties for mutual funds many years later.

I used my internet site to publicize the CalPERS effect¹² and studies that showed funds could earn more money by targeting poorly performing companies for reforms, investing more heavily in firms with fewer management entrenchment devices, such as poison pills, and by taking an active role in corporate governance.¹³ However, I also argued that funds could increase earnings by investing in companies that shared power with their employees.

This was a "double bottom line" argument. Funds wouldn't have to sacrifice returns by investments that would also have benefits to society. If workers were empowered at work, they would take that sense of empowerment into the political realm as well. Employees who are not involved in significant decision-making at work are

less likely to be involved in politics and a democratic government, such as ours, depends on the intelligent participation of its citizens.¹⁴ Additionally, employees would be more concerned than absentee shareholders about issues like worker safety and environmental protection. Most employees live near work and they want a clean environment for themselves and their children.¹⁵

I thought the U.S. should be ripe for such arguments because of the growing importance of "intellectual capital." Tangibles contributed by financial capital, such as property, plant and equipment, had accounted for 62% of the total value of mining and

The best answer I could find as to why pension plans shirked their duty was in a 1992 book Fortune & Folly¹⁰ by William M. O'Barr, John M. Conley, and Carolyn Kay Brancato. The authors used the tools of anthropology to locate a common thread in the culture of pension funds. What they found was "an overriding concern with managing personal relationships" and an all-pervasive "need to manage responsibility and blame.

manufacturing firms in 1982, but only for 25% more recently.

Margaret Blair made a significant contribution to my understanding of "knowledge work" and its application to corporate governance. She contends that employees, like shareholders, have firm-specific investments at risk, in the form of human capital. The key to wealth maximization is to be found in providing ownership-like incentives to "those who control critical specialized inputs."¹⁶

In its April 1998 report, *Corporate Governance: Improving Competitiveness and Access to Capital in Global Markets*,¹⁷ an advisory group to the Organization for Economic Co-operation and Development (OECD), led by Ira Millstein, gives a nod to aligning the interests of employees with corporate performance through stock-based incentive. Millstein notes that, increasingly, the board becomes a "mediator of rents." "The more important human capital is to a business, the more those investors should stand to gain - or lose - and the greater voice they should have in governing it." More democratic workplaces make better use of employee capacities and generate more wealth.¹⁸

It is paradoxical that autocratic practices are justified by alleged efficiency, since the research does not support that conclusion. In fact, increased rank-and-file responsibility, increased participation in decision-making, and increased individual autonomy are associated with greater personal involvement and productive results. Even department store clerks are crucial to profits. Sears, for example, found that if employee attitudes improve by 5%, customer satisfaction jumps 1.3%, resulting in a 1/2% rise in revenue.¹⁹

Why do organizations allow workers so little control over their jobs? Most decision-making structures are designed around status needs related to dominance and control; they are not designed to maximize wealth creation. In order to gain higher status, individuals seek to dominate more and more people by shifting important decisions upward, far away from the problems being addressed and most of the information sources. Even if complete information can be instantaneously transmitted to the top, those managers are unlikely to have all the required expertise to address the depth and breadth of issues that inevitably arise in a large corporate structure. Governance structures that provide greater opportunities for participation, both at the board level and at the shop floor, make better use of all

the information and expertise available, generating more overall wealth.

I pushed employee ownership and participation as a means of obtaining “double bottom line” returns knowing that CalPERS already had some experience with this concept. In the early 1990s CalPERS established a home loan guarantee program. That program has earned CalPERS 20% a year, allowed employees to buy homes at lower interest rates, and has generally stimulated California’s economy and the tax base that employs public sector workers.

Transition In Consciousness

In the mid to late 1990s one of the issues that socially responsible investors (SRIs) focused on was tobacco. It was also a concern to many members of CalPERS, who spent their days working to convince children not to start smoking, to help adults quit, and to deal with tobacco related illnesses. I remember attending a seminar where one of the board members of CalPERS defended tobacco investments, saying he had a fiduciary duty to make as much money as possible for CalPERS, regardless of the social consequences. In fact, he said he had a fiduciary duty to invest in prostitution, addictive drugs, or anything else that would bring more money to the fund, as long as such investments were legal.

Even though many of the same directors still sit on the CalPERS board, their attitudes changed. They sought to have targeted firms emphasize innovative practices in the workplace and they divested tobacco holdings in 2000. CalPERS went on to issue corporate governance standards for emerging markets countries based, in part, on political stability and labor standards. They got involved in campaigns on global warming at ExxonMobil. They pushed oil and auto companies not to fight new regulations in California that would reduce global warming by requiring increased fuel efficiency. As I write this in March 2005, CalPERS and the California State Teachers’ Retirement System (CalSTRS)²⁰ are sponsoring a “Green

Wave” investment conference, pledging to invest \$1 billion in “clean” technologies ranging from rechargeable battery makers to manufacturers of fuel-cell membranes. They will also audit their \$16 billion real-estate portfolio “to use clean energy, energy efficiency and green building standards.” Experts say these ventures could grow into an \$11 billion to \$25 billion industry in California over the next decade and could also help slow global warming.²¹

What happened? Of course, I would like to take credit for the change. After all, I ran for the CalPERS board, raised issues on my internet site, and encouraged SRI funds to focus more on corporate governance and corporate governance advocates to unite with SRI funds on various issues. However, if any one person has shaped this direction recently it has been California State Treasurer Phil Angelides²² who has played a critical role in emphasizing double bottom line returns. He sits on the boards of both CalPERS and

Universal owners have a particular interest in issues that affect the economy as a whole.

CalSTRS, the first and third largest public pension funds in the U.S.

Universal Owners

Of course no one person is responsible for the shift, which has systemic causes first discussed by Robert Monks²³ and more fully elaborated by James P. Hawley and Andrew T. Williams in their book, *The Rise of Fiduciary Capitalism* and in a more recent paper, *Shifting Ground: Emerging Global Corporate Governance Standards and the Rise of Fiduciary Capitalism*.²⁴ Their basic thesis is that as institutional investors have grown, especially those with indexed funds, they have become “universal owners.” Just as owning shares in both companies during a merger provides a different perspective, so does owning a bit of just about everything in the market.

Universal owners have a particular interest in issues that affect the economy as a whole. While owners of a specific firm may seek to increase gains by externalizing costs, by polluting the environment, or paying workers so little they are dependent on public welfare, universal owners are largely dependent on a rising market. Issues such as fiscal policy, infrastructure, education, and worker health, and safety standards that generate a positive environment work in their favor. Their returns – and their ability to meet their fiduciary duties – more often depend on how well state, national, and increasingly international economies perform. CalPERS, for example, is disproportionately invested in California but also has 31% of its equity investments abroad.

Fiduciary duty, based on the duty of loyalty and the duty of care, begins to change. Universal owners begin to consider not just current beneficiaries but those who will be retiring forty years from now. They begin to see the need for national and international corporate governance standards, fiscal policies, infrastructures, and other elements that drive the economy as a whole. When reinsurance giant Swiss Re issued a report warning that natural disasters worsened by global warming could cost insurers \$49 billion in claims annually by 2014, universal owners such as CalPERS and CalSTRS paid attention.²⁵

Hawley and Williams point out that since active ownership “carries with it the need for certain shareholder rights (timely access to proxies, an ability to vote and to have those votes count, for example), it follows they must then seek global standards that will enable them to fulfill their fiduciary duty at any company in which they own shares.” They point to the growing role of organizations such as the International Corporate Governance Network with \$10 trillion in member assets, the OECD, the World Bank’s Global Corporate Governance Forum in setting international standards for disclosure, insider trading, protection of minority shareholder rights, etc.²⁶

Financial service firms such as Moody’s, Standard & Poor’s and Fitch,

as well as proxy advisory firms such as Investor Responsibility Research Center, Institutional Shareholder Services (ISS), and Glass Lewis bring the weight of the market to bear on such standards, impacting the terms on which capital is made available.²⁷ Non-governmental organizations (NGOs) such as the Coalition for Environmentally Responsible Economics and the Global Reporting Initiative have also begun framing environmental concerns in terms of risk, expanding the boundaries of fiduciary duty into areas previously the sole domain of SRI funds.²⁸

Of course governments have also played a significant role. Of three most significant SEC proposals, two were enacted; one was not. On September 20, 2002 the SEC proposed two sets of rules, one for mutual funds, the other for investment advisors.²⁹ Both embodied the notion that since proxy voting can add value, voting rights are subject to the same fiduciary standards as other plan assets.³⁰ Both required disclosure of policies and votes. After thousands of comments,³¹ overwhelmingly in support, and resistance from the Investment Company Institute to the requirement to disclose all votes, both rules were adopted in early 2003.³²

Many mutual funds and investment advisors have a blanket policy of voting with management on all “social responsibility” resolutions. The new rules make it harder to justify such rubber-stamp policies and will make funds and advisors more accountable to investors. Additionally, with votes now accessible, the impact of potential conflicts of interest, such as voting in a company’s election while managing their 401(k) plan, can be more easily determined. For example, according to Michael Garland with the AFL-CIO, “Fidelity earns more than half its revenue selling fee-based services to corporations—the same companies whose proxies they’re voting on.”³³

The SEC proposed an even more important rule, Security Holder Director Nominations, on October 14, 2003. What prompted the proposal? Post-

Enron, more shareholders began to recognize the danger of CEOs playing a dominant role in selecting directors and that corporate “elections” were elections in name only. Les Greenberg, Committee of Concerned Shareholders,³⁴ and James McRitchie, of CorpGov.net petitioned³⁵ the SEC on August 1, 2002 to allow shareholders to use proxy proposals to nominate and elect directors. The Council of Institutional Investors said our petition “re-energized” the “debate over shareholder access to management proxy cards to nominate directors.”³⁶ Soon, internet group eRaider³⁷ and AFL-CIO³⁸ followed suit with additional petitions.

The idea was to provide a low-cost way for shareholders to run alternate candidates for board seats. As we wrote in our petition, “entrenched managers and directors will only improve corporate governance when they can be held personally accountable, e.g. voted out of office and replaced.” Access to the proxy would allow investors to run their own candidates for the board at an affordable cost. “Equal access to board nominations is the holy grail of corporate governance reform,” said Patrick McGurn of ISS.³⁹

Finally, in October 2003 the SEC proposed a weak rule that would make it easier for shareholders to nominate a token number of directors, which they predicted might happen at 45, or 0.3%, of companies each year.⁴⁰ CalPERS, CalSTRS, and thousands of others supported this as a “foot in the door.” In fact, the rulemaking received more favorable comments than any SEC proposal in history.⁴¹ However, it so disturbed corporate managers that the U.S. Chamber of Commerce threatened to sue the SEC if the rule was enacted.⁴² The Business Roundtable, made up exclusively of top CEOs, placed ads in major newspapers signed by CEOs of 40 large corporations, warning the proposal would erode the independence of directors.⁴³ However, while it is important for directors to be independent of managers, it does not follow that directors should also be independent of *shareholders*. That is like advocating that politicians should be

independent of voters. In fact, the solution to the problems surrounding entrenched management is to make directors *dependent* on shareholders and managers *dependent* on board members.

Throughout the summer of 2004, SEC Chairman William Donaldson kept announcing he would push forward. “The need for action,” he said, “can’t stop for partisan politics.”⁴⁴ Yet, during President Bush’s innately appealing campaign discussions of an “ownership society,” he failed to endorse the idea of giving shareholders a greater stake in selecting corporate directors...of taking an ownership role. Many took Bush’s reelection as a sign that CEOs could push back. The “equal access” proposal was dead.

Calpers Under Attack

Even before Bush’s reelection, the call went out against CalPERS. In an editorial during the spring of 2004, the Wall Street Journal accused the fund of taking the governance issue “to absurd new lengths” and advancing its own pro-union political agenda.⁴⁵ The U.S. Chamber of Commerce said CalPERS was in need of reform.⁴⁶ The San Francisco Examiner indicted the fund’s proxy campaign as “strident.” Disappointed with CalPERS votes against corporate directors, the California Republican Party issued a statement in the spring of 2004, “How unfortunate that the 1.4 million people served by Calpers — not to mention taxpayers — can’t sit across the table from the recalcitrant Calpers board and shout, ‘You’re fired!’”⁴⁷

In January 2005, Governor Arnold Schwarzenegger released his official plan to curb California spending. A key feature is a proposal to amend the state constitution prohibiting public employees hired after 2007 from being covered by a defined contribution plan.⁴⁸ At least initially, the public appears ready to accept the word of an action-hero governor who pitches the plan as a money saver, even though it is likely to cost taxpayers billions and may force future public sector retirees into poverty. According to a poll by the Public Policy Institute of California, 61% favored his plan, while 25% opposed it.⁴⁹

There are few rational arguments in favor of such a change. Requiring two systems during a forty-year phase-out won't save taxpayers money. It will result in lower retirement benefits for the vast majority of new public employees.⁵⁰ According to the San Francisco Chronicle, the median DC plan return from 1990 through 2002 was 6.86 percent. For the same time period, CalPERS' rate of return was 8.9 percent.⁵¹ Public employment will be far less attractive, so levels of service will continue to deteriorate. And, it will wipe out inflation-fighting pension protections for existing employees. So why the proposal?

One obvious reason is that some want to feed at taxpayer expense. It costs 0.37% to administer the CalPERS defined benefit (DB) plan, but will probably cost more than 1.5% per year as a defined contribution (DC) plan, with no death/disability benefits or inflation protection.⁵² If California funds have assets of approximately \$500 billion (CalPERS and CalSTRS alone have \$300 billion), the yield to money managers will be an extra \$5.65 billion every year while earning \$10.2 billion less for public employee retirements every year.

Second, Schwarzenegger raised more than \$23 million in political donations in 2004, using the money for initiative campaigns, travel, and fundraising. The DB to DC initiative will help him raise a fortune — at least \$50 million to fund his 2005 initiatives and another \$50 million for his reelection campaign. And the amount to be raised for initiatives may be understated, since these are not subject to the reelection campaign limits of \$22,300 per donor. Schwarzenegger will raise more money than all candidates but the President.

However, another huge reason is the role CalPERS, CalSTRS and other public funds have taken in corporate governance. The Howard Jarvis

Taxpayers Association is now collecting signatures to put an initiative on the ballot. Their president, Jon Coupal, said the proposal seeks to end “the social engineering and corporate governance agenda” of CalPERS.⁵³ Why do powerful forces want to end traditional pension funds, especially public pension funds? Because pension funds are the primary check on the power and greed of corporate CEOs. CalPERS has been a leader in the effort to bring accountability to corporate boardrooms. In November 2004 they announced their next major target — CEO pay.⁵⁴ Could that have something to do with the current attack?

All of the CEOs in the S&P ExecuComp database have defined benefit plans. Of course, qualified pension plans (exempt from taxation) are limited to about \$200,000 a year and the average S&P 500 CEO earns much more. Supplemental executive retirement plans, known as SERPs, are an inefficient way to compensate CEOs but they come with one great benefit — camouflage. “Neither the increase in value of the SERP plan before retirement nor the amount of payments after retirement appears in the compensation tables, the existence of SERPs, and the formulas under which payouts are made must be disclosed in the firm's SEC filings.”⁵⁵ While CEOs want to keep their owned defined benefit plans, they want to outlaw them for public employees.

Conclusion

Killing public pension funds would allow CEOs to wield power nearly without accountability, since public pension funds have been the primary corporate governance watchdogs. As has been shown in many studies, firms with stronger shareholder rights that protect against entrenched managers have higher values. The most frequently quoted study is *Corporate Governance*

and *Equity Prices* by Paul Gompers of Harvard and Andrew Metrick of the University of Pennsylvania's Wharton School.⁵⁶ As more such studies are published, institutional investors that vote in favor of weakening shareholder rights could face legal action for violating their fiduciary duty.

Would such studies stop being written if public pension funds in the U.S. were terminated? Not entirely, but making corporate decisions that work for society-at-large depends on instilling corporate values that guard against negative impacts on society and the planet. Most corporations need prodding from government, activist shareholders, rating companies, and NGOs to realize those values. Take away large players in any of those sectors and we suffer setbacks. Without CalPERS, who will set the new fiduciary standards that allow us to save the people and the planet? Who will make the herd run? Let us hope Californians are not misled when they vote this November.

Addendum: On the morning of April 7, 2005 California's Governor withdrew his support of the initiative that would have outlawed defined benefit pension plans for all public employees in California. When voters began learning the initiative would eliminate death and disability benefits, images of disabled police and firefighters, as well as their widows, drew hundreds of protestors to Schwarzenegger's fund-raisers. His approval rating dropped below 50%. “I have decided to work together with leaders in local government and public safety to craft new initiative language that makes it absolutely clear that the families of every cop, firefighter and public safety professional lost in the line of duty are protected in our pension reform plan,” said Schwarzenegger. “I think it is better to improve the language and put our plan on the June 2006 ballot,” he said. ■

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- 55 <http://www.hup.harvard.edu/catalog/BEBPAY.html>
- 56 "Firms with stronger shareholder rights had higher firm value, higher profits, higher sales growth, lower capital expenditures, and fewer corporate acquisitions." Investors who bought firms with the strongest democratic rights and sold those with the weakest rights "would have earned abnormal returns of 8.5 percent per year during the sample period." <http://icf.som.yale.edu/Conference-Papers/Fall2001/gov.pdf>
See also Bebchuk et al. (2004) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=593423, GovernanceMetrics International (2003 and 2004) [http://www.gmiratings.com/\(113im3i3xjepxv55aauigabn\)/Performance.aspx](http://www.gmiratings.com/(113im3i3xjepxv55aauigabn)/Performance.aspx), Drobetz et al. (2003) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=379102, Bauer et al. (2003) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=444543, Gugler et al. (2003) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=299520, and McNabb and Martin (1998) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=102688.

NEWS & VIEWS

Wall Street icons fall from pedestal

Accused Of Using Illicit Accounting Tricks To Smooth Profits, Hike Exec Pays Investors are in for further shocks. In a recent article The Economist comments on the manner the Wall Street icons are again being disgraced. Warren Buffett, the investment icon whose name is typically preceded by accolades, is being dragged off his pedestal by a dodgy insurance deal between General Re, a unit of his firm Berkshire Hathaway, and AIG, the world's largest insurer.

With regulators poring over his accounts, Maurice Greenberg, who led AIG for four decades, has been forced to quit the firm he built into a financial giant. Insurance is not the only financial business under siege. CEO Philip Purcell against a group of former executives, who blame him for its lacklustre showing over the past five years. Power has also shifted at JP Morgan.

In December, Fannie Mae, the housing-finance giant, pushed out its long-serving CEO, following the earlier forced departure of his counterpart at Fannie's sister company Freddie Mac.

At Citigroup, three senior executives were shown the door in October 2004. And last June, CSFB, an investment bank, disposed of its boss.

Though each case has its own drama, there seem to be two broad causes for these upheavals: incompetence and regulatory failure, with one often contributing to the other. Freddie, Fannie and AIG are all accused of using illicit accounting tricks to smooth profits and perhaps to boost executive pay inappropriately.

Citigroup has put its foot into it with regulators on three continents. JP Morgan, Morgan Stanley, and CSFB have all had regulatory problems as well, but their main defect has been the inability to make sufficient profits with sufficient frequency. Those who rail against Wall Street's pitiless insistence on success in other firms should be pleased to know it is now taking an equally harsh view of its own performance. What links all these companies is that their credibility has been damaged. There is doubt about their earnings, their products, the way they sell and whether they are correctly structured. All are large and complex organisations serving different sorts of clients. ■

Wolfowitz gets top World Bank job

To take Charge on June 1, Promises Europeans to Consult Bank Members The World Bank has unanimously confirmed Paul Wolfowitz as its president despite quiet misgivings by some members over the deputy defense secretary's role as the Bush administration's architect of the Iraq war. The outcome had already largely been decided in the capitals of the bank's major shareholder governments when the 24-member board met in a vote that was conducted by consensus.

Wolfowitz will have a few months of transition before he takes the reins of the bank on June 1, when James Wolfensohn steps down after 10 years at the helm of an organisation that spends billions of dollars a year in projects aimed at reducing poverty in the world's least developed countries.

"It is humbling to be entrusted with the leadership of this critically important international institution," Wolfowitz said in a statement.

He said the next six months would be important for international development policy decisions, before a UN summit in September to measure progress on meeting global targets to reduce poverty. He also said he understood the urgent need for easing the debts of the bank's poorest borrowers, infrastructure improvements and regional integration if poverty was to be tackled.

The Pentagon's No. 2 civilian official was the only nominee for the World Bank job, which by informal agreement is headed by an American, while the top post of the International Monetary Fund usually goes to a European.

A group of US-based anti-poverty activists from 50 Years is Enough, Action-Aid International USA and Mobilization for Global Justice held a small demonstration outside the bank's headquarters in Washington to oppose "the one-horse race".

But Wolfowitz's nomination was assured despite private disquiet among Europeans who opposed the US invasion of Iraq but who are hoping Washington will support their candidates for top jobs in other international agencies like the World Trade Organization. Wolfowitz won their backing during a visit on Wednesday to Brussels, where he acknowledged he was a controversial figure but vowed to consult broadly with bank members. ■

Canada to invest in green projects abroad to meet Kyoto obligations

Canada's government said it would fulfil its obligation to reduce greenhouse gas emissions under the Kyoto protocol on climate change by investing in projects abroad that would reduce emissions, phasing out coal-fired power plants, and quadrupling its target for wind energy.

The landmark agreement with the automotive industry to cut vehicle emissions through fuel efficiency measures, announced last week, will also form a key part of the country's strategy.

Setting out its full plan for honouring the Kyoto protocol yesterday, the Canadian government admitted that it would have to purchase emissions "credits" from developing nations, by investing in such projects as renewable energy that poorer countries would otherwise be unable to afford. The protocol allows such offsetting as a way of reducing emissions worldwide.

Ottawa will also encourage work on technologies that reduce emissions, such as the capture and storage of carbon dioxide and wind power, and "clean coal" technology. It also said it would institute a green procurement policy for the public sector, and would urge consumers to lower their emissions by using less energy.

Canada could soon be facing a general election if the minority Liberal government is brought down by a no-confidence motion in parliament. This could bring to power the Conservatives, who oppose the Kyoto treaty. The United Nations-brokered Kyoto protocol came into force on February 16, after Russia finally ratified the treaty late last year.

Kyoto demands that developed countries cut their greenhouse gas emissions by varying amounts relative to 1990 levels by 2012. The US and Australia, alone among developed nations, have rejected the treaty.

Last week, carmakers operating in Canada agreed to reduce their vehicles' greenhouse gas emissions by about 6 per cent by 2010. Though the deal was voluntary, the government warned that it would monitor progress and remained "ready with legislative and regulatory action as needed". ■

Extradition warning in fraud cases

Directors of publicly listed companies with just one shareholder in the US could face the threat of extradition in cases of alleged fraud or false accounting, a prominent barrister has warned. Alan Jones, QC, told a special extradition conference that under recently revised US-UK rules, any director or chief executive could be extradited to the US to be

tried for fraud if his or her company's allegedly inaccurate financial reports were published in a US newspaper to a solitary US shareholder. The risk would apply even if UK authorities declined to prosecute.

"A UK national may now be extradited to the US where he is accused of 'conduct which took place mostly in the UK - even where the UK authorities have declined to prosecute him,'" said Ms Jones, who acted for the three former NatWest investment bankers who are fighting extradition over Enron-related fraud charges. ■

Investment icon buffett to be grilled

Regulators have called Warren Buffett to answer questions next month about any involvement he might have had in an insurance transaction between a unit of his company, Berkshire Hathaway and American International Group, the Wall Street Journal reported. The newspaper, citing people familiar with the matter, said Buffett's interview is set for April 11. The office of New York Attorney General Eliot Spitzer and the Securities and Exchange Commission, are handling the probe. ■

BAT fined \$250,000 for racketeering

A FEDERAL judge has hit British American Tobacco with a \$250,000 fine for failing to follow a court order in the US government's racketeering case against the industry.

US district judge Gladys Kessler said in a written opinion that she had fined BAT because it failed to make available a witness who could discuss some key documents in the case involving document retention at a BAT unit in Australia. "BATCo's conscious choice of this course of action amounted to reckless misconduct and bad-faith dealings with the court," Kessler wrote.

At issue is a 1990 memorandum written by a lawyer named Andrew Foyle, advising a BAT subsidiary in Australia on its document retention policy. Justice Department lawyers contend that the document, whose existence was first revealed in an Australian court case, shows BAT efforts to destroy documents. ■

Ebbers faces 20 years prison sentence in \$11 bn fraud

Bernie Ebbers, the former WorldCom chief executive, was found guilty yesterday of leading an \$11bn (£5.75bn) accounting fraud that pushed the once high-flying telecommunications group into the largest bankruptcy in US history. On their eighth day of deliberation, a New York jury

convicted Mr Ebbers, 63, of securities fraud, conspiracy and seven counts of filing false information with regulators. He faces more than 20 years in prison when he is sentenced in June. The verdict marked a stunning turn for Mr Ebbers, who rose from humble roots as a basketball coach in Mississippi to assemble one of the largest telecoms companies in the world and become a celebrity of the 1990s stock market boom. It also marked a high point for prosecutors in their highly publicised crackdown on white-collar crime following a series of scandals that first erupted just over three years ago, bruising investor confidence and ushering an era of corporate reform.

Some lawyers argued that the trial's outcome could re-establish standards of corporate responsibility for chief executives, because jurors rejected Mr Ebbers' defence that he was unaware of criminal activities at WorldCom in spite of serving as its chief executive. If so, the case could have implications for the forthcoming trial of Ken Lay and Jeffrey Skilling, respectively former chairman and chief executive of Enron. Alberto Gonzales, US attorney general, called the verdict "a triumph" for the legal system and President George W. Bush's corporate fraud taskforce. Mr Ebbers left the courthouse with his family following the verdict, declining to comment. Reid Weingarten, his lawyer, challenged the jury's decision, saying: "We continue to believe there's not one chance in the world that he participated in any fraud or cooking of the books at WorldCom." Mr Weingarten cited the judge's refusal to grant immunity to three former WorldCom employees so that they could testify on his client's behalf as a promising ground for appeal. The five-week trial charted the rise and fall of WorldCom in the era of telecoms deregulation. Under Mr Ebbers, the start-up grew into a global colossus through a series of mergers.

However, former executives testified that the company's fortunes began to sour after the internet bubble burst in 2000, and several of its customers failed. Scott Sullivan, WorldCom's former chief financial officer and the government's star witness, recounted that he began to manipulate the company's accounts in late 2000 to hide mounting network expenses and satisfy Wall Street's earnings expectations. Mr Sullivan, who had already pleaded guilty, told jurors that he had warned Mr Ebbers in private meetings that the company's accounting was improper, but was repeatedly ordered to "hit the numbers".

Securities & Exchange Board of India (SEBI)

Defers enforcement of Clause 49

Clause 49 of the listing agreement has created a storm in India. Companies were supposed to implement it from 1st April 2005. Instead industry has been able to lobby with the Securities and Exchange Board of India (SEBI) to have the implementation postponed until the end of this year.

SEBI issued Clause 49 in February 2000. All Group A companies had to comply with its provisions by 31 March 2001. All other listed companies with a minimum paid-up capital of Rs 100 million and networth of Rs. 250 million had to comply by 31 March 2002, and the remaining listed companies with a minimum paid-up capital of Rs. 30 million or net worth of Rs 250 million had to comply by 31 March 2003.

Subsequently, on 29 October 2004, SEBI amended the original Clause 49 and issued a new Clause 49. "All existing listed companies will have to comply with the provisions of the new clause by 1 April 2005. However, it has already come into force for companies that have been listed on the stock exchanges after 29 October 2004. The new Clause 49 lays down tighter qualification criteria for independent directors. Unlike the original clause, the new clause disqualifies material suppliers and customers from being independent directors. It also disallows a shareholder with more than 2% stake in the company from being an independent director as well as a former executive who left the company less than 3 years ago. Partners of current legal, audit, and consulting firms, as well as partners of such firms that had worked in the company in the preceding 3 years, too, cannot be independent directors.

A relative of promoter, or an executive director or a senior executive one level below an executive director, too, cannot be an independent director. Another important difference is that while the original clause gave the board, the freedom to decide whether a materially significant relationship between director and the company affected his independence, the new clause take this discretionary power away from the board.

According to the original clause, the maximum time gap between 2 board meetings could be four months. The new clause has reduced this time gap to three months.

The original clause had stipulated that the audit committee must meet atleast three times a year and at least once every six months. The new clause makes it mandatory for the audit committee to meet a minimum of four times in a year with a maximum time gap of four months. Moreover, unlike the original clause which was silent on the qualifications of audit committee members, the new clause states that all members should be financially literate and atleast one should have financial or accounting management expertise. The new clause also give a definition of financially literate and accounting or related financial management expertise". The new clause also strengthens and widens the role and responsibility of audit committees". ■

Greenberg asked to exit AIG

MAURICE, ‘ Hank ‘ Greenberg will retire shortly as chairman of American International Group, ending a four-decade career with the insurance company as regulators investigate questionable financial transactions that occurred during his tenure- In a letter sent through his attorney, Greenberg told AIG directors that he would retire when he returns from a trip to Asia and Europe, and won’t stand for election as a director when his term expires in May.

The company released the letter and said lead director Frank G Zarb would assume the duties of chairman until a new one is selected. “To lead meaningful changes in the industry and at AIG, the company and its officers and directors must resolve any outstanding questions or issues and move forward: according to the letter from Greenberg’s attorney, David Boies, to Richard Beattie, who represents AIG’s independent directors. “To that end, Mr. Greenberg recognizes the need to promptly and cooperatively resolve all inquiries and investigations by regulators and other authorities.”

Mr. Greenberg had been at the company’s helm for nearly four decades and was a prominent and influential member of the global insurance industry. There had been widespread speculation about how long New York-based AIG would continue its relationship with Greenberg, as investigations by the Securities and Exchange Commission and New York State Attorney General Eliot Spitzer have intensified in recent weeks.

Greenberg, 79, was replaced as chief executive two weeks ago - though retained as chairman - as scrutiny mounted over a 2000 transaction that appeared to have been used to boost the company’s reserves artificially. The separation between Greenberg and the company he built comes as the SEC has sent subpoenas to a dozen AIG executives. A source said that federal investigators know of 10 transactions that warrant review. In a statement, Spitzer praised AIG board’s for making “difficult decisions: “While there is a long way to go before this investigation is complete, the wise actions of the AIG board will help set this investigation on a path toward resolution,” Spitzer said. “I commend AIG board for acting in a way that sets it apart from other boards that have faced similar problems in recent years. ■

Green issues to drive UK economic policy

Gordon Brown cloaked himself in green yesterday, pledging to put environmental issues at the heart of economic policy and promising support in today’s Budget for technologies to tackle climate change. The chancellor said: “Environmental issues - including climate change - have traditionally been placed in a category separate from the economy and from economic policy. But this is no longer tenable.” In an attempt to help Britain take world leadership

on the environment, he called on finance and industry ministers around the world to put environmental concerns at the centre of economic policy. Their chief way of achieving this was through energy policy, which ought to encourage energy efficiency and the uptake of renewable energy, he told a meeting in London of finance, energy and environment ministers from 20 countries .

He backed his call by promising action on climate change through investment in research and development on methods of capturing carbon dioxide and storing it underground and the creation of a “high-level energy research platform”. His previous measures, such as the climate change levy on businesses, had produced greater results than projections had suggested.

Invoking the spirit of John Maynard Keynes, the economist, Mr Brown laid out a new economic and political philosophy. The twin foundations of economic policy had been high and stable levels of growth, and full employment. To these, he added a “third objective on which our economies must be built, and that is environmental care”. “Across a range of environmental issues, from soil erosion to the depletion of marine stocks, from water scarcity to air pollution, it is clear now not just that economic activity is their cause but that these problems in themselves threaten future economic activity and growth.” Yesterday was the first time Mr Brown had spoken publicly on environmental issues as chancellor. He tied his new-found enthusiasm to an older refrain, saying: “Well designed environmental policies can actually stimulate innovation and improve productivity, particularly in the field of energy efficiency.”

The chancellor returned to another favourite theme: poverty reduction and social justice. Climate change weighed most heavily on poor countries, giving richer nations an obligation to assist them in tackling it.” It is a problem caused by the industrialised countries, whose effects will disproportionately fall on developing countries,” he said. Steve Howard, chief executive of the Climate Group, an environmental charity, said: “This is a very strong message from Gordon Brown. It has taken climate change firmly out of the environment box and put it in the mainstream.” But Tim Yeo, shadow environment secretary, said: “Given this government’s record of all talk and no action on the environment, we can hardly believe a word this chancellor says. The chancellor praised Britain’s record on carbon emissions reductions but the reality is emissions have gone up since 1997.” ■

FSA to widen naming and shaming

Consumer groups are urging the Financial Services Authority to do more naming and shaming of companies that produce misleading promotions for products. Which?, the consumer lobby, says it is in the public’s interest to make these

companies known. Which? says there should be more public censuring, instead of private warnings, for companies that break the rules on financial promotions.

The FSA has just said it has acted against a number of companies in the past nine months, and this has led to fines or other enforcement procedures. These moves followed an examination by the regulator of promotional material on websites, television and radio, as well as on direct mail offerings, branch leaflets and promotions for guaranteed equity bonds. The crackdown coincides with a separate announcement from the City watchdog that it would probe the recently regulated mortgage industry, including mainstream lenders, equity release providers and debt consolidation lenders and brokers for possible regulation breaches.

The FSA - which set up its financial promotions unit less than 12 months ago - says: "We want firms to consider whether... promotions provide a balanced picture of the product or 'Promotions need to be clear, fair and not misleading, says the FSA service; whether the marketing matches what the product or service delivers.'" "Promotions need to be clear, fair and not misleading, as otherwise they may do no more than promote misunderstanding."

The FSA will also look at products in the general insurance industry which it believes are high-risk, such as those targeted at "vulnerable" consumers who may be sold cover they don't need or can't afford. Material produced by some Child Trust Fund providers will also be examined where there are concerns about the inadequacy of product descriptions and risks to capital not being made clear. A common breach is the use of the FSA logo on company web-sites without permission. Some investment companies have been found not to be indicating clearly what their product or service is, leaving many consumers confused about what they are buying or the possible risks involved. One of the most serious breaches was by Axa Sun Life, which was publicly censured and fined £500,000 for misleading promotions that gave little prominence to key information about product risks. Cantor Index was fined £70,000 for running a misleading campaign about spread betting. Hem-scott Investment Analysis was fined £50,000 for a misleading promotion that used the slogan: "We even make a bear market soft and cuddly".

The FSA comments: "As the recent disciplinary action against Axa, Cantor and Hemscott illustrates, real issues remain with firms' systems and controls, and recent monitoring has shown that there is much to do in encouraging some firms to comply with our rules." The FSA is not required to censure publicly every company that breaches its regulations, but it can issue "private warnings" and other disciplinary actions. Of the investigations it has concluded, it has asked 44 companies to amend promotions. A further eight have been asked to contact customers who have bought their products and to offer them the chance to withdraw at no cost if they

think they have been misled. No further action has been taken in 64 cases.

Which? says that, while it is pleased that the FSA is setting its sights on the mortgage and insurance industries, it would like to see more public censuring of companies that flout the rules. "A firm will change its behaviour if it is getting bad publicity," says Laurence Baxter, a senior policy officer with Which? "Brand reputation is a vital stimulus, and naming and shaming is a significant aspect of this".

The FSA defends its policy on censure, saying it has to balance the nature of the breach against the damage that extensive publicity could do to a company. The FSA is also soon to launch a new section on its website giving regular updates on the results of new and continuing investigations. Its aims to release information about its current investigations in the first half of this year. ■

IFRS - is it stifling growth?

The head of one of Europe's largest insurance companies, who was earlier publicly censured and fined £500,000 by FSA, has launched a blistering attack on International Financial Reporting Standards. Using a lot of rhetoric, Henri de Castries, chief executive of Axa, said so far, international accounting standards as they applied to insurers had neither improved the transparency of accounts nor made them more comparable, and were stifling European growth."Have we actually achieved transparency and convergence? The answer is No to the first and No to the second. The process has been expensive and long for an outcome that is a very disappointing one," he said. He said the requirement for assets to be shown at fair, or current value, as opposed to historic cost, risked creating artificial volatility in the accounts of long-term investors, such as insurers. This was driving them out of equities, depressing share prices and generating less money for companies turning to the equity markets to raise capital. "At the end of the day, this is decreasing the growth rate in Europe," he said. The question that he must address is why US despite Sarbox achieved a growth rate which is spectacular when compared to Europe's. In a survey by PwC two third of the participants felt that the transparency triggered by Sarbox could be a competitive advantage. ■

Why 80% of global aid goes missing

ONLY a fifth of global aid is reaching the world's poorest countries, it is revealed today. Poverty-stricken people are being short-changed because of red tape and overpriced goods and services, a new report alleges. Wealthy countries are failing to deliver on pledges to halve world poverty by 2015. Just

half of aid is spent on health, education and basic services, it adds. Jointly authored by Oxfam and ActionAid, the study calls for wide-scale reforms of how the £30billion annual handouts are distributed. Billions of pounds are swallowed up by administration costs every year, the report says. About 80 official agencies handle distribution, generating huge amounts of red tape. Up to 40 per cent of aid is tied to overpriced goods and services, the report claims. And most recipient countries are given no say in how cash is spent. 'Our report tells a sorry tale of muddle and hypocrisy, dithering and stalling,' ActionAid spokesman Patrick Watt said. The world's poor are cast unwittingly in the role of fall guys.' Oxfam policy adviser Max Lawson added: 'You hear a lot of talk about the need for good governance and accountability in developing countries. ■

Disclosure requirements could land up companies in huge fines

Few companies are aware that the new reporting requirements introduced in the UK under the 2003 Finance Act make it obligatory on the part of employers to report on employees with shares in the company. This requirement also applies when shares are issued on incorporation to directors of new companies. UK's Inland Revenue recently confirmed that a bonus issue, a rights issue, a script dividend, a dividend reinvestment plan, a share split, or an exchange of securities on a takeover was likely to give rise to a reportable event for listed companies.

"Most people are aware of the radical overhaul to the tax regime for share awards made to employees contained in the act, but very few companies know about the obligation to report on employees with shares in the company," said Alison Hughes, a solicitor at CMS Cameron McKenna. "And we believe even fewer still will be able to compete the task in time to meet the Inland Revenue deadlines." "The complication arises because companies must identify all shareholders who are employees or who have been employees in the preceding seven years – even if that employee inherited his shares or bought his shares in the market," said Ms Hughes.

"It can be almost impossible to identify such people from a share register because many shares will be held in broker or other nominee accounts."

The accountants Grant Thornton predict that the smaller companies will be worst affected.

"Tax agents will be aware that this needs to be included on companies' tax returns, but for those that do their own affairs it is easy to overlook," said Mike Warburton. "It's simply another example of the ridiculous over-complication of our system for share ownership arrangements." The Inland

Revenue said it would not be able to produce practical guidance on how and to what extent listed companies could comply until many more companies had come forward to talk to them about it, "Companies that fail to comply with their reporting obligations or even to enter into discussions with the Revenue risk penalties -even where employee shareholders do not incur any actual income tax charges," Ms Hughes said. ■

Emerging markets reach record levels.

The net buying of the emerging markets equities reached 1.3 bn dollars in the week to February 9, the biggest weekly inflow since 2000, according to E merging Portfolio Fund Research, a US- based data provider that tracks funds managing \$3 trillion in assets. This is the strongest weekly investment flow into the asset class for 5 years.

The FTSE All-world emerging markets equity index rose to a peak of 271.01, up 3.1. per cent since the beginning of the year. But the performance of individual emerging market countries has varied dramatically.

The European Union's new member countries Hungary, the Czech Republic and Poland have been among the best-performing stock markets in the past 12 months, up nearly 50 per cent.

Meanwhile, Russia and Chian have ranked among the worst with negative returns.

"EMEA [Europe, Middle East and Africa] funds continued their run of stronger-than-usual inflows this year- perhaps due to last year's stellar returns in Hungary, Poland and the Czech Republic. These countries continue to show strong growth and fiscal discipline as they integrate further into the European Union," said Brad Durham, managing director at EPER. ■

Kyoto finally comes into force

The UN-brokered treaty that has been the subject of much controversy during the last 7 years has finally come into force in the teeth of US opposition the world's biggest polluter. What was not being projected properly is the fact that protocol has been effectively ratified by more than 140 countries. Australia is the only country other than US who opposed it though it intends to meet its Kyoto target and participate in future negotiations.

Kyoto binds developed nations to cut emission levels by 2012 by 5% when compared to those of 1990. Recognising that the developed countries emissions are greater than poorer countries counterparts, the protocol placed reduction targets only on rich countries.

The clean development mechanism that the protocol incorporates allows companies and governments in developed countries to buy emissions reductions 'credits by investing in projects in the developing countries that reduce emissions.

"I am happy that all these pessimist have been proved wrong," says Klaus Topfer, UN under-secretary general. "We have proved that in this globalised world there is also the chance of globalised action."

The event was marked by a clash between Brussels and UK over green house gas emissions amid fears that London could lose it dominant position in the carbon trading market. ■

US assets shunned by central bankers: Problem for Bush as reserves are shifted to eurozone

Central banks are shifting reserves away from US assets and towards the eurozone in a move that looks set to deepen the Bush administration's difficulties in financing its ballooning current account deficit. In actions likely to undermine the dollar's value on currency markets, 70 per cent of central bank reserve managers said they had increased their exposure to the euro over the past two years. The findings emerge from a survey of central bank reserve managers published today which was conducted between September and December. About 65 central banks, controlling assets worth \$1,700bn (£909bn), took part and the results showed a marked change in attitude over the past two years.

Any rebalancing of central bank reserve portfolios has serious implications for the global financial system as the US has become increasingly dependent on official flows of funds to finance its current account deficit, estimated at \$650bn in 2004. At the end of 2003, central banks held 70 per cent of their official reserves in dollar-denominated assets and central bank purchases of US securities had financed more than 80 per cent of the US current account deficit in 2003.

Any reluctance to increase exposure to dollar assets could cause the greenback to plunge on currency markets. "The US cannot take support for the dollar for granted," said Nick Carver, one of the authors of the study conducted by Central Banking Publications, a company that specialises in reporting on central banks. "Central banks' enthusiasm for the dollar seem to be cooling off." In a further worrying sign for the greenback, 47 per cent of reserve managers surveyed said they expected the growth of official reserves to slow to less than 20 per cent over the next four years.

Between the end of 2000 \ and mid-2004, official reserves increased by 66 per cent. Slower reserve accumulation growth implies the supply of official finance is likely to become more limited but few expect US demand to slow. The consensus among economists is that the US current account deficit will

increase to \$694bn in 2005. More than 90 per cent of central bank reserve managers said the income from reserve management was "important" or "very important". In the two years since a similar survey was conducted, reserve managers had begun to seek higher returns for the money under management. Dollar assets have become less attractive for these managers because the fall in the dollar since 2002 has reduced the yield they received and, in some cases, led to negative real returns. Alan Greenspan, the chairman of the US Federal Reserve, warned in November that there was a limit to the willingness of foreign governments to finance the US current account deficit. ■

New sub-class of poorly paid workers in Japan

Huge changes in Japan's labour market are creating a dangerous divide between well paid, well trained workers in permanent employment and a sub-class of poorly paid workers with low skills and fragile job security, the Organisation for Economic Co-operation and Development has warned. The report, which continues to argue in favour of the need to tackle deflation and assert fiscal control, branched off into an unusually gloomy chapter about the downsides of what would normally be considered the positive effects of greater labour market flexibility. "Employment flexibility is being achieved through increased hiring of non-regular workers," whose numbers had sky-rocketed from 19 per cent to 29 per cent of the total workforce in a decade, it said. Temporary staff earned about 40 per cent as much as regular workers.

"The" increasing dualism is creating a group, concentrated among young people, with short-term employment experience and low human capital." The OECD concern chimes with growing anxiousness within the Japanese government that the postwar employment model is dying but has not been replaced by a tenable alternative.

One government official said the number of suicides had not fallen since Japan's economic recovery began three years ago, a phenomenon he attributed to greater despair caused by the collapse of the old labour market system. The Bank of Japan recently put out an influential report on labour market changes, which it said were partly responsible for the tenacity of deflation, now into its seventh year. Wages have continued to fall in spite of three years of economic recovery, interrupting a transmission mechanism by which greater economic activity normally feeds through into higher prices.

This weekend, the government produced a draft of the 21st Century, in which one of the main recommendations was to change pension and other laws to make it easier for workers to move between jobs. It also recommended making it easier for women to work full-time and for people to work until 75. One of the OECD's main concerns, said Randall Jones, the

OECD's chief economist for Japan and South Korea, was that labour flexibility was being introduced in only one part of the market, creating an unbridgeable divide between workers in non-regular and regular employment. "The equity concern is magnified by the lack of movement between the two segments of the workforce, trapping a significant portion of the labour force in a low-wage category from which it is difficult to escape," the report said. Mr Jones contrasted the situation with that of Australia, where it was fairly easy to move between the two categories of employment. Because Japanese training largely took place within companies that offered lifetime jobs, those outside the walls of permanent employment could fall further and further behind.

The burden falls disproportionately on the young because many companies, which have sought to slash costs since the late 1990s, have preserved the jobs of existing employers by freezing the hiring of graduates. The youth unemployment rate is about twice the national average at 10 per cent. The OECD said it did not favour putting a brake on the creation of non-permanent employment - a remedy favoured by Japanese unions, many academics and even some government officials. ■

Rebuilding of Iraq rife with corruption

The authors of a new report on post-conflict reconstruction have given warning that efforts to rebuild Iraq have so far proved wasteful, ineffective and rife with corruption. The report, released in London, was funded by the United Nations Development Programme and draws on examples of previous post-war efforts to rebuild countries including Bosnia, Lebanon and Sierra Leone. The study, carried out by Tiri, the London-based governance campaign group, and the Lebanese chapter of Transparency International, has found that such reconstruction is viewed by much of the international community as a "state of exception" in which the normal rules of business conduct do not apply. The need to spend funds pledged for rebuilding makes it acceptable to bend the rules, award contracts without competitive tender and turn a blind eye to profiteering and conflicts of interest. The authors are particularly critical of donors' tendency to use large western contractors to repair infrastructure damaged in the war, importing foreign personnel and equipment at a huge cost.

In Iraq, that policy has proved disastrous, one of the authors said in an interview. Mr Carver, who as head of international law at Clifford Chance, was a frequent visitor to the region, said: "The ordinary Iraqi - even if they were passionately against Saddam and delighted to see him go - feel that there's nothing left for them after 18 months of occupation. The Americans have brought them, precisely, nothing." The damning report follows growing criticism - both official and unofficial - of efforts to rebuild Iraq and Afghanistan.

The UK's Christian Aid and George Soros' Iraqi Revennewatch have said that billions of dollars in Iraqi oil revenues have been spent on reconstruction with few discernible results. A UN watchdog, the International Advisory and Monitoring Board, and the Coalition Provisional Authority's own inspector-general have also sharply criticised the former occupation authority's handling of Iraqi oil funds for reconstruction projects. ■

German bill promises much needed executive pay disclosure

Germany's listed companies have proved so resistant to revealing the remuneration of their top executives that 21 left-of-centre parliamentarians yesterday tabled a draft bill to make disclosure compulsory. The legislators from the Social Democrat party of Gerhard Schroder, the chancellor, have lost patience because only 10 of Germany's top 30 blue-chip Dax companies have so far complied with a three-year-old voluntary disclosure code. That the parliamentarians should act is understandable.

Getting Germany's listed companies to follow the code drawn up by Gerhard Cromme, supervisory board chairman of Thyssen-Krupp, the steel and engineering group, has become the corporate governance equivalent of pulling teeth. The hard-core refuseniks include some of Germany's premier companies, including DaimlerChrysler and Munich Re. Yet it is also true that pay disclosure rules need careful handling. Legislation can give huge incentives to the remuneration industry to find and exploit loopholes. Disclosure of executive pay - by law or a voluntary code - can also unleash an unedifying and socially divisive ratcheting up of pay as executives gull remuneration committees into granting income and benefit packages that leapfrog those of rivals. The UK has experience of this. On balance, however, the draft legislation in Germany is welcome. True, 10 other Dax-30 companies have already promised to comply with the Cromme code this year. But that was only because Brigitte Zypries, the justice minister, threatened legislation if fewer than 80 per cent of Dax companies complied by mid-2005. Even if the 10 companies fulfil their pledges, the number complying with the code will still fall short of the government target.

Unlike the Cromme code, the draft legislation promises to create a level playing field. It applies to executive board members of all listed companies. It specifies that all sources of income, including bonuses, options, pensions and compensation in the event of a company takeover, be disclosed. One common objection is that such disclosure breaches individual privacy. But top executives in listed companies are in a position of stewardship and should be accountable to shareholders. Executive pay levels, and especially the structure

of incentive packages on top of basic salary, give investors important insights into how a company is run and the targets that motivate top managers. Transparency in executive pay, therefore, helps create efficient and liquid capital markets. To their credit, the authors of the German bill emphasise this point. They also noted that the drive to greater transparency in executive pay is catching on elsewhere in Europe. It has the support of the European Commission. It is, in short, an idea whose time has come. The refuseniks among Germany's corporate elite should recognise this and follow the lead of their more enlightened peers. ■

Enron trio lose court bid to move trial

Kenneth Lay and two other former Enron executives will stand trial in Houston after a judge rejected their request for it to be moved to guarantee an impartial jury. Mr Lay and his co-accused, former chief executive officer Jeffrey Skilling and ex-chief financial accountant Richard Causey, had all pushed for an alternative venue, citing negative local publicity about their case. Atlanta, Denver and Phoenix had been suggested as alternatives, but US District Judge Sim Lake yesterday said it would be possible to secure a fair trial in Enron's home town.

"Although news coverage about Enron's collapse, this case, and these defendants has been extensive, the court is not persuaded that it has been so inflammatory or pervasive as to create a presumption that there exists a reasonable likelihood that pre-trial publicity will prevent a fair trial," the judge wrote.

The decision marks a further setback for the three men, who unsuccessfully sought separate trials on the grounds that their cases could be "tainted" by evidence produced against their co-defendants. Mr Lay also failed to secure an expedited trial without jury.

Mr Skilling and Mr Causey face more than 30 fraud and conspiracy charges related to their alleged role in Enron's collapse, while Mr Lay faces seven counts. The men deny all charges against them. The trial could start this spring, though Mr Skilling is pressing for a delay to as late as next year. The defendants had waged a publicity blitz at the end of last year in an attempt to secure a new venue. "Clearly the jury pool in the southern district of Texas is compromised," said Mr Lay in a filing last November. The claims were refuted by government prosecutors.

They argued that two Houston-based federal judges had successfully appointed juries in the 2002 obstruction of justice trial against Arthur Andersen, Enron's auditor, and last year's trial of six former Enron and Merrill Lynch executives. Andersen was convicted, though has secured an appeal. The so-called Nigerian barge case brought guilty pleas against five defendants, with the sixth cleared of all charges. ■

Google billionaires draw one dollar salary

The trio of billionaires who run — and own much of — online search engine leader Google Inc. reduced their individual salaries to \$1 last year and rejected a recent attempt to give them a raise, according to documents filed Friday.

Google co-founders Larry Page and Sergey Brin and the company's chief executive, Eric Schmidt, dramatically lowered their salaries last spring — right around the time that the Mountain View-based company filed its plans for a much-anticipated initial public offering of stock that made their paychecks largely irrelevant.

Before the concessions, Google paid Page and Brin an annual salary of \$150,000 apiece. Schmidt collected a \$250,000 annually before lowering it to a buck. In the months leading up to the pay cuts, Page and Brin each collected \$43,750 of their former salaries while Schmidt pocketed \$81,432, according to a filing with the Securities and Exchange Commission.

Last month, Google disclosed that Page, Brin and Schmidt weren't paid a bonus last year except for a \$1,556 holiday reward paid to all company employees. Foregoing a regular paycheck isn't difficult for Brin, Page and Schmidt because they own two-thirds of the company's highly prized stock.

Page and Brin each own a 27.8 percent stake worth \$7 billion while Schmidt's 10.6 percent stake is worth \$2.7 billion. All three men already have reaped big windfalls by selling a small portion of their holdings since Google completed its IPO at \$85 per share last August. The company's shares declined \$1.71 to close at \$192.05 Friday on the Nasdaq Stock Market.

Despite the immense wealth of their leaders, Google's board offered to raise their salaries earlier this year and make them eligible for a 2005 bonus. Page, Brin and Schmidt declined. Schmidt apparently isn't having trouble making ends meet. In February, he bought a corporate jet that he leases to the company for \$7,000 per hour — a below-market rate, according to the company's evaluation. Google has agreed to reimburse Schmidt up to \$2.1 million this year for using his jet.

Other prominent executives have limited their salaries to \$1 in the past, usually because their company was struggling or they owned a treasure trove of company stock. ■

Intrigue at Morgan Stanley leads to exodus

Philip J. Purcell, who secured his position at the top of Morgan Stanley by ousting a rival in a bitter power struggle, now faces a revolt of his own.

A long-simmering dispute over the direction of Morgan Stanley erupted in a public brawl Tuesday, as two senior

executives resigned under pressure in a shake-up intended to reassert Purcell's control.

While Wall Street is no stranger to palace intrigue, the infighting at one of the world's biggest investment houses is remarkable for an industry that puts a premium on discretion and loyalty. Eight former Morgan Stanley executives have now spoken out to urge the board that Purcell be replaced immediately as chief executive.

The turmoil reflects the longstanding divisions that have riven the firm since the 1997 merger of the investment banking half of the House of Morgan and the Main Street financial retailer Dean Witter.

Purcell, 61, was a Dean Witter executive who rose to the top nearly eight years ago after a power struggle. A potential rival, John J. Mack, was outmaneuvered and left the firm in 2001. Purcell, who is one of Wall Street's longest-serving chief executives, is still seen by many of Morgan Stanley's bankers and traders as a Dean Witter man at heart.

Purcell's leadership has come under fire by some investors, as well as employees, who blame him for the stock's lackluster performance in recent years.

On Tuesday, Vikram S. Pandit, the president of the firm's institutional securities business, and John P. Havens, who ran the institutional equity business, resigned after two other executives were appointed co-presidents above them. The two executives come from the firm's blue-chip institutional business, which is responsible for trading and investment banking and generates 60% of Morgan's profits. The two could also represent the first of a wave of management departures.

While power grabs and abrupt firings are not uncommon on Wall Street, the campaign carried out by the former Morgan Stanley executives - which includes a former president and chief executive - is a highly unusual example of a united group of former executives turning publicly on their old company, and especially their chief executive officer. The conflict also comes as Morgan Stanley's areas of expertise in the market - equity underwriting and mergers and acquisitions - are experiencing lulls.

"This is not a business where you can tell people, 'Since I'm the CEO you will give me your loyalty,'" said Robert G. Scott, a former president of the firm and one of the eight former executives to question Purcell's leadership.

The Morgan Stanley board is dominated by directors that either hail from Dean Witter or have been picked by Purcell. Nonetheless, with such a public challenge by the executives, Purcell's timetable to improve the returns of Morgan Stanley's lagging units has shortened, say institutional shareholders. Indeed, the turmoil raises the possibility that a weakened Morgan Stanley may be forced into a deal with another bank.

"There is a strong feeling out there that the franchise of the firm is being torn down," said Robert F. Greenhill, a former Morgan Stanley banker who is advising the group of former executives. ■

Erring US CEOs shown the door

Corporate boards are shedding their sleepy images and becoming more proactive when something's not quite right at the top. The result: Top US executives are being knocked off their pedestals faster than ever. Boards are asking high level officers to hit the road for anything, ranging from financial scandals, lackluster results, improper insider trades or even an affair with another executive.

In February, US companies announced 103 CEO changes, compared to 92 in January, according to Challenger, Gray & Christmas, an out placement and employment research firm. It was the fourth consecutive increase in monthly turnover and the first time in four years that more than 100 CEO changes were announced.

A few years ago, most boards only rubber-stamped the decision of the executive team. But today, they are flexing their muscles and digging into every area of the company,"said Johan Challenger, the firm's chief executive. " they are scrutinizing results and second-guessing every decision the CEO makes,"he added..

Last month, Hewlett-Packard's board dismissed its chairman and chief executive, Carly Fiorina, as HP's merger with Compaq Computer had failed to deliver results. Office Max also ousted its CEO in February after less than four months on the job after a billing scandal at the office products retailer.

There is no sign of the trend slowing in March. Boeing's Harry Stonecipher was ousted for his romance with a female executive, while Fleetwood Enterprises fired its CEO following lackluster results and bleak outlook.

One reason for the no-nonsense attitude is the increasing independence of boards from management. New rules mandated by the NYSE, the Nasdaq Stock Market and the Sarbanes-Oxley law require greater director independence and expertise. Directors are becoming more fearful of facing legal action if they let fraudulent behavior go unchecked. ■

Czarinas don't come cheap - Fiorina's \$21 m hole in HP

Like a hot baseball free agent, Carly Fiorina demanded and got a rich pay package when Hewlett-Packard lured her away from Lucent Technologies in 1999.

Her 1999 pay included almost 1.5 million shares of stock, then valued at \$65.5 million, plus a \$3 million signing bonus. Since then she has piled up millions more. And while HP's board ousted her yesterday as chairman, president and chief executive, she won't be leaving poor: Her severance package is worth at least \$21.1 million.

Those who agitate for CEO pay to be linked to performance said they are disgusted by her severance package. "What would she get if the firm had done well? A country?" asked Jeffrey Sonenfeld, associate dean of the School of Management.

While Fiorina's 2003 compensation was nowhere near the heights of Silicon Valley Apple Computer Inc CEO Steve Jobs cashed in \$74.8 million in options in 2003 and eBay Inc CEO Meg Whitman took home a total of \$42.6 million, HP's performance hasn't come close to those companies' results.

Just look at stock market performance: HP's stock has been almost flat for two years and is down two-thirds from its 2000 peak while Apple's share have quadrupled in the last year and eBay's are still a high flyer even after a big drop in recent months.

The HP board shoulders much of the blame for both Fiorina's pay and her failure, according to Paul Hodgson, a senior research associate at the Corporate Library, which monitors corporate governance.

"The board delivered this compensation to her in the beginning, front-loaded, with a massive value not related to performance," he said. It has not instituted proper pay systems for her and now finds itself in the position of having to terminate her without cause because, like every other company, they don't include a 'poor' performance' clause a reason for termination in their contract.

"The board has really betrayed the trust of the stockholders," Hodgson added. "If the board had exercised proper oversight not only of the strategy she was adopting but also of her compensation, we wouldn't be in this situation. ■"

Coke resolves US accounting probes

Coca-Cola Co., the world's largest soft drink maker, said on Monday it has resolved the embarrassing U.S. government probes into claims it engaged in accounting fraud and other wrongdoing in key markets, including Japan.

Coca-Cola, which had been under a regulatory cloud since the allegations surfaced two years ago, said it did not have to admit guilt or face fines or penalties as part of a settlement with the Securities and Exchange Commission.

The Atlanta-based company added that the Department of Justice had closed a separate investigation, which began after

ex-Coke worker Matthew Whitley accused the company of fraud in a 2003 wrongful dismissal lawsuit.

The company, however, did agree to keep in place unspecified reforms that it has implemented in the past two years and to undertake remedial actions in the areas of corporate compliance and disclosure as part of the SEC settlement.

"We continue to expect all our operations around the world to adhere to the highest ethical standards," Coca-Cola Chairman and Chief Executive Neville Isdell said in an internal memo to employees made public by the company.

The SEC probe centered on accusations that Coca-Cola engaged in a legally murky practice known as "channel stuffing" by asking Japanese bottlers to make additional purchases of soft drink concentrate between 1997 and 1999.

Federal investigators, who had interviewed current and former Coke workers as part of the probes, were told the company used incentives to make the overshipments of concentrate more palatable to the Japanese bottlers.

In so doing, the company was able to boost its revenues and meet profit targets, according to the SEC. Japan accounts for about 20 percent of Coca-Cola's annual operating profit.

"Coca-Cola misled investors by failing to disclose end-of-period practices that impacted the company's likely future operating results," Richard Wessel, head of the SEC's Atlanta office, said in a statement.

Coca-Cola also agreed to conduct an internal review of how its financial statements are prepared and report back to the SEC.

The end of the investigations came as welcome relief to Coca-Cola and its investors, who had worried that the probes might leave a stain on the company's reputation as one of America's corporate titans. ■

SEC split could undermine reforms

The three Republican commissioners on the Securities and Exchange Commission (SEC) have been urged by a leading US lawmaker to bury their differences or risk undermining the regulator's reforms programme.

Richard Shelby, the republican chairman of the Senate banking committee, is concerned about a split between the SEC chairman, William Donaldson, and fellow Republican commissioners Paul Atkins and Cynthia Glassman.

Shelby, who has been a vocal supporter of Donaldson, told the Financial Times:

“Where there is greater consensus on the SEC I think the message is stronger- the rules that come from it are not disputed, not challenged. That’s not the case here.” SEC chief in line of fire.

Donaldson’s focus on enforcement policies was initially praised in the wake of a slew of corporate scandals and the turbulent tenure of his predecessor Harvey Pitt. But Critics in the business community and in Congress say Donaldson’s support for a proposal, known as Regulation NMS, that would overhaul stock trading rules, is the latest example of how the SEC has gone too far.

The rule requires a market that initially receives an investor’s stock order to find the best price, whether that is on its own system or elsewhere. Atkins and Glassman have criticized the rule, describing it as damaging to competition and innovation.

Richard Baker, Republican chairman on the house subcommittee on capital markets, said last month that he would consider sponsoring legislation to override the proposal if Donaldson proceeded with a vote.

People close to Donaldson say no final decision has been taken on the fine print of Regulation NMS, or on the SEC chairman’s stance towards it. But Donaldson is believed to be prepared to push through the reform on a three-two vote if necessary. ■

Citigroup, J P Morgan & Amex fined

In their continuing effort to clean up mutual fund sales, US federal and industry regulators have fined three large brokerage firms and a fund company a total of \$81 million for improper sales practices and required them to make restitution to tens of thousands of investors. The regulatory actions covered alleged abuses sharing a common theme: investors were steered into fund purchase that benefited their brokers, often at the investors’ expense.

SEC and industry regulator NASD have been investigating the cases for more than 18 months. Citi group, JPMorgan Chase and American Express Financial Advisers paid a total of \$21.25 million to the NASD to settle allegations that they collected excess commissions from more than 50,000 households. Fund company Putnam Investments agreed to pay \$40 million penalty for failing to tell its board and investors that it was rewarding brokerage firms for pushing Putnam products. ■

Citi, Morgan Stanley in Parmalat probe

Prosecutors investigating the Parmalat scandal have accused four foreign banks and an Italian asset management

firm of helping the dairy foods giant mislead investors, moving closer toward a possible trial.

The prosecutors made the accusations against U.S. banks Citigroup Inc. and Morgan Stanley, Germany’s Deutsche Bank, Swiss bank UBS, and Nextra, the asset management arm of Italy’s Banca Intesa. In the report, seen by Reuters, the prosecutors also accused 13 bank executives, including an employee of Credit Suisse First Boston, of the Italian crime of market rigging.

Parmalat collapsed under 14 billion euros (\$18.7 billion) of debt in late 2003, triggering one of the world’s biggest financial scandals. A spokeswoman at Citigroup said the claim “if pursued against Citigroup cannot be proven.” UBS said its actions were legal and that any proceedings would be “vigorously defended.”

Morgan Stanley said there was “no factual or legal basis for seeking any indictment.” CSFB declined to comment. Deutsche Bank denied any wrongdoing and said it fully supported its employees in the matter. Nextra was not available for comment. The banks have previously denied wrongdoing. In a separate action in a New Jersey state court on Thursday, Citigroup countersued newly installed Parmalat Chief Executive Officer Enrico Bondi, accusing him in his capacity as the dairy company’s representative of fraud, taking money owed to the world’s largest bank, and negligent misrepresentation. The prosecutors in Milan last year closed an initial inquiry, asking a judge to put on trial nearly 30 ex-Parmalat executives, auditors, and bankers plus three financial institutions.

The same prosecutors have been looking for months into whether banks helped Parmalat to mislead financial markets to help it raise billions of euros in now nearly worthless bonds.

Recent end of the probe into the banks, which had been expected last year, paves the way for prosecutors to request a separate trial for them.

Several of the financial institutions are set to become key shareholders in a new, slimmed down Parmalat when it relists after a 12 billion-euro (\$16 billion) debt-for-equity swap.

Under Italian law, the prosecutors’ report must now be sent to the companies and the individuals accused. They then have 20 days to ask for more documents and further investigation. ■

Top firms blamed for Parmalat probe

Milan prosecutors have started legal actions against four of the world’s largest financial institutions as part of investigations into the collapse of Parmalat. The accusations of misleading the market, which move criminal trails in Milan

a step closer, were sent on Thursday to Citigroup, Morgan Stanley, Deutsche Bank and UBS.

Nextra, the asset management arm of Italy's Banca Intesa, was also accused, as were a number of individuals linked to some of the banks. The accusations, which were expected, signal the end of the investigations by Milan prosecutors, but they must request a judge in Milan to bring charges. That would then lead to hearings on whether to bring charges, followed by a possible trial. The process is already advanced in investigations regarding Bank of America and some of Parmalat's former auditors, although no charges have yet been brought.

Prosecutors have been investigating allegations that the banks helped mislead investors by assisting the dairy company in making false communications to the market and regulators while seeking to raise billions in bond issues.

Prosecutors in Parma are also investigating broader fraud allegations while Enrico Bondi, Parmalat's administrator, has launched legal actions against many banks seeking to recover billions of euros.

Citigroup filed its counter claims on Thursday in a New Jersey court, accusing Bondi of fraud, negligent misrepresentation and taking money owed to it.

"Citigroup is a victim of Parmalat's fraud and has lost more than \$500 million (\$670 million) as a result," said William Mills, chief executive of its corporate and investment bank in Europe, Middle East and Africa. "Citigroup had nothing to do with these frauds and was not aware of them. If Citigroup had known the truth, it would not have done business with Parmalat."

UBS said it had taken part in only one transaction with Parmalat in the months before the company's collapse. It said it thought the transaction was legal. Morgan Stanley said "there is no factual or legal basis for seeking any indictment." Deutsche Bank and Nextra have also denied wrongdoing. ■

Rosneft sues Yukos for \$11b in Russia

Russia's cash-strapped oil firm Rosneft, facing payment demands on international loans worth \$1.4 billion, is suing stricken oil firm YUKOS for \$11 billion in damages in a Moscow court, Vedomosti daily said. Quoting papers filed by the state oil firm at Moscow's arbitration court, Vedomosti said the company was demanding YUKOS pay the money to its former unit, Yuganskneftegaz, in compensation for losses caused by its tax mismanagement.

Rosneft ended up buying Yugansk for \$9.4 billion after a forced state auction in December to recoup some of the \$27.5 billion in back taxes owed by YUKOS. Rosneft, soon to merge

with gas monopoly Gazprom, says it has inherited \$5.1 billion of tax debts at Yugansk for which it holds the previous shareholders of the company responsible.

Bankers say Rosneft is desperately seeking to recover cash from YUKOS as it faces the threat of global litigation as well as potential damage from a chain of cross-default provisions in international liabilities if it does not pay up. Vedomosti said the suit, filed by Yugansk, alleged that Yugansk suffered losses as a result of YUKOS's "illegal and unscrupulous" tax policies. "The tax debts of Yuganskneftegaz have arisen from the management policies of YUKOS, and this loss has to be compensated for," a Rosneft official told Vedomosti, a business daily.

Nobody answered calls to Rosneft's press department. The suit alleged that YUKOS's use of offshore trading firms to buy oil from its subsidiaries at below-market prices, and then sell it at world prices, led to losses worth 304.3 billion roubles at Yugansk in 1999-2003, Vedomosti said.

Rosneft was also claiming that most of the infrastructure at Yugansk's Siberian oilfields actually did not belong to the company because YUKOS had taken ownership of it already, and was now seeking their return.

News of the Moscow court action follows a motion filed by Rosneft at a Houston court earlier this month when it demanded YUKOS pay it \$3.8 billion and threatened to take it to court if it fails to do so.

International banks made two pre-export credit facilities worth a total of \$2.6 billion available to YUKOS, which were secured against Yugansk's crude exports.

The banks hit YUKOS last month with a demand for immediate repayment of the outstanding \$540 million loan, which YUKOS had stopped servicing after it filed for Chapter 11 bankruptcy in Houston in December. The filing was dismissed in February. ■

Indonesia probes Shell for data violation

Indonesia is studying whether Royal Dutch/Shell violated regulations by taking oil exploration data on waters disputed with Malaysia out of the country, Jakarta's energy minister said.

Malaysia last month granted Shell exploration rights in the potentially oil-rich Sulawesi Sea off Borneo island, in an area that partially overlaps with waters Shell explored under an Indonesian contract in 1999.

Under Indonesian law exploration data produced by an oil company becomes the exclusive intellectual property of the government if the company abandons the block, as Shell did.

In theory, firms may not even take photocopies of this raw data away with them, oil industry experts said.

“We are studying whether they (Shell) took the data abroad. According to our law, that data should not be taken abroad without the Indonesian government’s knowledge,” Mines and Energy Minister Purnomo Yusgiantoro told reporters late on Monday.

“The Anglo-Dutch oil giant withdrew from the Indonesian contract in 2001 after drilling dry holes,” Purnomo said. Shell Malaysia denied the company had done anything illegal. ■

Microsoft in fresh antitrust row

The Commission, the European Union’s competition watchdog, wants Microsoft to reduce substantially the royalties it plans to demand from rival software makers in return for granting access to sensitive information on its flagship Windows operating system.

Microsoft was also told to allow this information to be used by vendors of open source software - a move that the company is certain to resist fiercely.

The regulator’s demands look set to escalate the long-simmering dispute with the software giant over how to implement the Commission’s antitrust ruling. They open yet another acrimonious chapter in the long history of conflict between the Commission and Microsoft.

Last March, Microsoft was found guilty of abusing its dominant position in the market for personal computer operating systems. The Commission said Microsoft had frozen out competitors in adjacent markets such as server software and media players, and fined it a record EUR497 million (\$667 million).

In order to create a level playing field in the market for server software, Microsoft was told to license to its rivals some 80 communication protocols which would allow them to improve the inter-operability between their servers and Windows PCs.

But following consultations with industry rivals, the Commission has rejected Microsoft’s proposed licensing system for these protocols.

A Commission spokesman saying Thursday: “First, Microsoft is making it very difficult for potential beneficiaries to have access to the technical documentation for the purpose of evaluating whether it is worthwhile to take a license. Secondly, even if potential beneficiaries decide to use the technical information to build compatible products they are obliged to take an all-in-one license and pay for things they don’t need.”

“There are also problems of unjustified royalties being requested,” the spokesman said.

It is understood that the Commission wants the royalties better to reflect the innovative value of the protocols, for example the degree of patent protection they enjoy. The regulator feels the royalty level envisaged by Microsoft unjustifiably reflects the monopoly value of Windows.

It is also understood that the commission feels Microsoft has excluded open source software vendors from the licensing arrangements “without justification”.

Microsoft said it remained “fully committed to complying with the Commission’s decision”.

A spokesman for the company said: “we will work through the issues raised with the commission over the coming days.” ■

Sony ropes in foreigner CEO to lead turnaround

Sony Corp named Howard Stringer as its chairman, a decision that marks the first time a foreigner will head a major Japanese electronics firm and comes as the company seeks to improve results at its faltering core electronics business.

A native of Wales and former CBS president, Stringer has overseen Sony’s entertainment business, one of the company’s few bright spots in recent years. He replaces Nobuyuki Idei, who has led the Tokyo-based company for a decade.

The shake-ups comes as fears over whether Sony can revive its electronics operations in the face of cheaper competition from Asian rivals. The decision was made at a board meeting, subject to shareholders’ approval in June, Sony said in a statement. Kunitake Ando will also step down as Sony president and will be replaced by Ryoji Chubachi, an executive with experience in Sony’s electronics and networking divisions.

“Sony has an unparalleled legacy of boldness, innovation and leadership around the world,” Stringer, vice chairman at Sony and chief executive of Sony Corp. of America, said in a statement. “Together we look forward to joining our twin pillars of engineering and technology with our commanding presence in entertainment and content creation to deliver the most advanced devices and forms of entertainment to the consumer,” he said. ■

US poor to pay for war - Healthcare and Educations budgets slashed

President George W Bush is sending Congress a \$2.5 trillion spending plan, constrained by war and record deficits, that seeks to slash spending in a number of popular

programmes from farm subsidies to poor people's health care. About one-third of the programmes being targeted for elimination are in the education department, including federal grant programmes for local schools in such areas as vocational education, anti-drug efforts and Even Start, a \$225 million literacy programme.

Bush's budget also advocates restraining growth in Medicaid, the big federal-state programme that provides health care for the poor. Critics say Bush's plan achieves its deficit reduction goals only by leaving out big ticket items such as the cost of keeping troops in Iraq and Afghanistan and paying for overhauling social security, the government pension programme, by permitting younger workers to set up private accounts. Also omitted was the cost of making Bush's first-term tax cuts permanent or fixing the problem of the alternative minimum tax, which was designed to tap the wealthy but is ensnaring more and more middle-income taxpayers.

The budget's arrival sets off months of contentious debate, with lawmakers from both parties expected to fight to protect favourite programmes. Bush has targeted 150 programmes for either outright elimination or severe cutbacks as part of an effort to meet his campaign pledge to cut the deficit in half by 2009, the year he leaves office.

For the 2006 budget year that begins next October 1, he proposes spending \$2.5 trillion as he seeks to put the government on a path of declining deficits. That would occur, however, only after the government has recorded three straight years of record deficits, in dollar terms, including a projected \$427 billion in red ink this year.

Senator Kent Conrad of North Dakota, the top Democrat on the Senate Budget Committee, called Bush's budget the "tip of the iceberg" because once beyond its five-year window "the cost of everything he advocates just explodes." Bush's proposal restrains the growth in discretionary programs to less than 2.3 percent. Defence and homeland security are slated for large increases, meaning many other programs will face either outright cuts or only tiny increases. One of the most politically sensitive targets on Bush's hit list is the government support programme for farmers, which he wants to trim by \$587 million in 2006 and by \$5.7 billion over the next decade. Price supports would be reduced for a wide range of crops, from cotton and rice to corn, soybeans and wheat. Others targeted for cuts include several health programmes. ■

Ambani Jr rakes up governance issues with reliance panel

Anil D Ambani has criticised the corporate governance practices of Reliance Industries, India saying that the transactions of the company with affiliate Reliance Infocomm had proved 'detrimental' to RIL shareholders .

Mr Ambani, in his 500-page report to the newly-formed RIL corporate governance committee earlier this month, has also said that past decisions and investments in Infocomm had been done without disclosing the relevant facts to the RIL board.

Sources said the younger Ambani suggested that there be an "arm's length" shareholder agreement between RIL and other shareholders of the Infocomm group dealing with preservation of ownership pattern and governance and management among other issues.

Such an agreement should also deal with minority protection, divestment and avoidance of conflict, they said. Alleging a clear conflict of interest between RIL and Infocomm group, the note said this was enhanced owing to related party transaction of substantial magnitude, leading to substantial loss of value for RIL shareholders.

Sources said the note also questioned the accuracy of the minutes of board committee proceedings for RIL investment in Reliance Infocomm and said the flagship company's ownership in Infocomm needed to be substantially increased from 45% so that RIL enjoyed significant and direct majority and control.

Mr Ambani submitted his report some time earlier this month and YP Trivedi, member of the RIL board and of its corporate governance committee, had said that the committee is studying it and will decide soon. ■

Ex-AIG boss gifted wife \$2b of co stock

Former American International Group Inc. Chief Executive Maurice "Hank" Greenberg gave his wife more than \$2 billion worth of AIG shares three days before he stepped down last month.

The transfer of the insurance company's shares was recorded in a document filed by AIG with the U.S. Securities and Exchange Commission.

According to the document, known as a Form 4, Greenberg's transfer of shares to his wife Corinne "represents a gift of 41.399 million shares." The document says the transfer occurred on March 11.

An AIG spokesman declined to comment on the stock transfer and Greenberg's attorney, David Boies, was not immediately available for comment.

On March 14, Greenberg gave up his role as chief executive of AIG, which he headed for nearly 38 years. AIG's business practices are being investigated by New York Attorney General Eliot Spitzer.

According to Reuters data, Greenberg owned about 43.55 million shares of AIG.

Greenberg recently met with Spitzer for about 45 minutes, but refused to answer questions from regulators looking into improper accounting at the insurer.

Greenberg's meeting with the New York attorney general came a day after billionaire investor Warren Buffett told Spitzer's office about his role in a 2000-2001 deal between the General Re Corp. unit of his Berkshire Hathaway Inc. and AIG. ■

Steve Jobs takes home \$1 again

Steve Jobs, chief executive of Apple Computer Inc, was again paid \$1 in salary and received no stock options or restricted stock for the company's fiscal 2004.

For years, Jobs, who cofounded Cupertino, California based Apple, has taken a salary of \$1. In March 2003, Jobs voluntarily cancelled all of his outstanding options, excluding those granted to him in his capacity as director.

Fueled by the success of its iPod portable digital music player and stronger sales of some models of its signature Macintosh computers, Apple's stock price surged 80% in fiscal 2004, which ended September 25 of that year.

Also in March, 2003, the board granted Jobs 10 million restricted share of Apple's common stock that will vest in full on the third anniversary of the grant date.

Apple employees, led by Jobs, in 2003 moved to swap out of stock options plans into new ones. Apple said Jobs options exchange and employee options program would reduce Apple's issue stock options as a percentage of total options and shares outstanding known as stock-option overhang.

Jobs, who is also CEO of Pixar Animation Studios Inc, is the second-largest shareholder of Apple, holding 10.1 million shares, or 1.23% of the company's shares outstanding, according to Apple's annual proxy statement filed with the SEC. Forbes in its annual list of the world's 400 richest people, ranked Jobs at no 74, putting his worth at \$2.6 billion. ■

Sarbanes Oxley begins to pinch America Inc

Two and a half years after the implementation of a sweeping set of governance reforms in the Sarbanes-Oxley act, the corporator is wondering whether the costs are greater than the benefits. The momentous act, which came into effect in the wake of accounting scandals that lead to the meltdown of corporate giants such as Enron Corp and WorldCom, calls for more accountability and transparency in US companies.

But to some in the corporate sector, the requirements of Sarbanes-Oxley come with a hefty price tag and mixed results.

Thomas Lehner, director of public policy at chief executive lobbying group the business roundtable, said, "compliance costs ran in the millions and hurt small companies the worst. However, well intentioned these measures, we want to make sure money isn't diverted from growing the business".

"Others also questioned the reforms benefits. They took much of the self out of self regulation and created a gold rush for lawyers and accountants," said Marc Lackritz, president of the Securities Industry Association. "We need to find a balance for cost-effective regulation.... And a methodology not what we may consider is enough now will never be enough.

"It has created a new era of accountability where directors are concerned about investors and executives know it's not their money," Campos said, underlining requirements for independent directors, thorough auditing rules and tougher rules on executives.

"The reason the legislation is so tough is that the American people rose in fury, it felt the leadership of the US public sector had let them down," said William McHonough, former president of the Federal Reserve Bank of New York and chairman and chief executive of the Public Company Accounting Oversight Board.

Mutual Fund Reforms : Shortly after Sarbanes-Oxley, the hitherto scandal free \$8 trillion mutual industry, which manages the investment of half of the united States households, was tainted when securities regulators uncovered improper trading at some of the country's largest firms.

Since then an extensive reform agenda was set, which includes a rule calling for a super majority of independent directors on the boards of mutual funds.

"This is a very over reaching regulatory action to deal with the behaviour of a few bad apples," said Kenneth Griffin, chief executive of asset manager Citadel Investment Group. "However much regulation there is there will always be bad apples".

Independent directors, who regulators say would reduce the risk of conflict of interest in the boardroom, were "an extra layer of costs to investors, one that is just not needed", he said. But the SEC's Campos disagreed. "we will never have a perfect metric of what is gained," he said. "We are in a transition period where people are still learning and I predict that the cost of compliance will come down in the future."

In addition to weighing on companies bottom lines, the new compliance climate has led to an increased fear of liability and competition among state securities watchdogs, Lackritz said. "There's real risk in the process," he said.

The notion of having 50 regulators competing for settlement is not a pristine of an open process. People don't tend to negotiate well at the point of a gun. ■

Putting our planet to the end of its tether

Humans are damaging the planet at an unprecedented rate and raising risks of abrupt collapses in nature that could spur disease, deforestation or "dead zones" in the seas, an international report said yesterday.

The study, by 1,360 specialists in 95 nations, said a rising human population had polluted or over-exploited two-thirds of the ecological systems on which life depends, ranging from clean air to fresh water, in the past 50 years.

"At the heart of this assessment is a stark warning" said the 45-member board of the Millennium Ecosystem Assessment.

"Human activity is putting such strain on the natural functions of Earth that the ability of the planet's ecosystems to sustain future generations can no longer be taken for granted" it said.

Ten percent to 30 percent of mammal, bird, and amphibian species were already threatened with extinction, according to the assessment, the biggest review of the planet's life support systems.

"Over the past 50 years, humans have changed ecosystems more rapidly and extensively than in any comparable time in human history, largely to meet rapidly growing demands for food, fresh water, timber, fiber, and fuel" the report said.

"This has resulted in a substantial and largely irreversible loss in the diversity of life on earth" it added. More land was changed to cropland since 1945, for instance, than in the 18th and 19th centuries combined.

"The harmful consequences of this degradation could grow significantly worse in the next 50 years" it said. The report was compiled by specialists, including those from UN agencies and international scientific and development organizations. UN Secretary General Kofi Annan said the study "shows how human activities are causing environmental damage on a massive scale throughout the world, and how biodiversity — the very basis for life on Earth — is declining at an alarming rate."

The report said there was evidence that strains on nature could trigger abrupt changes, like the collapse of cod fisheries off Newfoundland in 1992 after years of overfishing. Future changes could bring sudden outbreaks of disease. Warming of the Great Lakes in Africa due to climate change, for instance, could create conditions for a spread of cholera.

And a buildup of nitrogen from fertilizers washed off farmland into seas could spur abrupt blooms of algae that choke fish or create oxygen-depleted "dead zones" along coasts.

It said deforestation often led to less rainfall. And at some point, lack of rain could suddenly undermine growing conditions for remaining forests in a region.

The report said that in 100 years, global warming blamed on burning of fossil fuels in cars, factories, and power plants might take over as the main source of damage. ■

Golden Peacock Global Awards for Excellence in Corporate Governance and Corporate Social Responsibility



The Golden Peacock Global Award for Corporate Governance and Corporate Social Responsibility was instituted by the World Council for Corporate Governance in January 2001 to foster competitiveness among businesses to improve the quality of corporate governance.

The selection process involves a two tier evaluation. The initial assessment is done by a team of independent assessors on the basis of criteria given in website www.wcfcg.net. The final decision is taken by a jury comprising eminent persons such as Dr Ola Ullsten, former Prime Minister of Sweden, James McHugh, CBE, former Managing Director British Gas, Justice A M Ahmadi, former Chief Justice Supreme Court of India and Chancellor of Aligarh Muslim University, James McRitchie, Publisher Corporate Governance, California and Prof Vivienne de Beaufort, ESSEC Business School, Paris & Director of the European Executive MBA.

Previous winners include Pfizer, Coca-Cola of USA and Infosys Technologies of India.

The last date for completed applications for above awards is 02 May 2005.

The awards will be presented on 12 May 2005 at the 6th International Conference on Corporate Governance which will be attended by movers and shakers of corporate world from 35 countries. ■