

**Instituto Português de Corporate Governance (IPCG)
Comments on the Corporate Governance Code
Version 2012**

April 2nd 2013



ICGI Report 7/2013

Address delivered

by

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Introduction

Ladies and Gentlemen,
Dear Pedro (for IPCG and SRS&AA),
Dear Joaquim (for the INSEAD Alumni Association),

Thank you very kindly for inviting me and giving me the honour to address the members of both IPCG and the INSEAD Alumni Association on the subject of corporate governance, and in particular **on the 2012 version of the Portuguese Governance Code.**

Before I do so let me immediately apologize for my nearly nil knowledge of the Portuguese language. **“Aubrigado!”** is a big part of my very limited Portuguese vocabulary. Language is not unimportant in governance matters, for two reasons. Montesquieu, in **L’Esprit des Lois (1748)**, argued very thoughtfully that our laws reflect our culture, which has been shaped by a particular historical trajectory and context. Hence, any law or regulation is, to some extent, an emanation of that culture and of the specific contextual issues that triggered a particular piece of government or regulatory intervention. Not being Portuguese, I could be at a relative advantage (one knows a culture best from the outside), but to fully grasp the context that shaped this particular Code, I must plead guilty of not knowing the Portuguese culture sufficiently deeply, even though I have been coming to Portugal now for over 15 years.

Furthermore, I am in the exercise given to me today, tributary of an English translation of the current version of the Code, which, following Montesquieu, does not fully reflect the nuances of the original Portuguese text, and introduces the additional subtleties of what the text refers to as the “Anglo-Saxon” language. Language is not a minor point, it is never neutral and is actually a differentiator.¹ It is remarkable, for example, that there is no French translation for the English word **fairness**, as the French **équité**, the most usual translation for this English word, is too strong and has in any case has the English equivalent **equity**. The French appeared to have given up on finding the right word, and have thus adopted the notion of **“fair play.”** Working with a French multi-national on bringing more fair process in management inside the company, this company simply called their fair process campaign **“Faire Fair.”**ⁱⁱ My remarks pertain specifically to the English translation of the Code, and this will be clear to the reader.

I started my remarks observing that **context matters a lot** in regulation and law. It may thus be fitting to open my remarks with some comments on a global governance scene that is changing in front of your eyes, like a play, with different acts succeeding each other. In this play, we still are far from the final act.

One could say that a previous act opened with the US **Sarbanes-Oxley Act (SOX)**, announced as “the” definitive governance reform that would set governance on a new standard. It emanated from a US Prosecutor, Eliot Spitzer, eager to lead the world of business into safer waters, something that US businesses appeared to be unable to do by themselves. The fact that the 2007-08 financial crisis has led the economic sector into much more turbulent waters than any sensible person would have expected after the introduction of SOX, is a useful warning for anyone intent on “improving the world”, and in particular to regulators and writers of codes of good corporate behaviour. This is where the **Comply or Explain rule** is enlightened on the part of the regulator and engaging for the corporate side: it does not say what should be done, but suggests what **might** be done, and if a corporation refuses to follow the recommendation, that is not necessarily wrong, only explanation for the deviation needs to be given. It is flexible, puts responsibility to the corporation for the final compliance decision, and allows an **exploration into corporate life** through the motivations provided by corporations for non-compliance.

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Indeed, **the financial crisis of 2007-08** proved much more damaging than EnRon. Whereas the latter case only involved its external auditor (Arthur Andersen, which had to disband as a result), the financial crisis involved an entire industry, acting in active synchrony, and with a licence provided by regulatory and government authorities.ⁱⁱⁱ Being led by a Prosecutor, it had to have a big compliance flavour. SOX appealed to greater responsibility of the CEO and CFO, who now had to vouch for the accuracy of financial reports, thus giving in particular the CFO and also the external auditor much greater power. It also had a large **“paper-trail” of compliance**, instilling a number of “transparency” procedures that would induce corporate people to be more careful about manipulating evidence and allowing prosecutors to more easily establish responsibility and guilt.

What major evolutions in the world of governance?

The first major point is that, indeed as a consequence of EnRon (and other major scandals such as WorldCom and Parmalat) and particularly due to the continued governance issues affecting the financial sector, business and society have now opened another act, which we might call **“governance coming of age”** (again?). It is now recognized that corporations (which are legal entities) must truly be held accountable by society, that shareholder value is insufficient to hold shareholders and managers in line, that shareholders do not make corporate decisions in any case, nor do they sufficiently supervise them, and that executives come and go. Given that corporations do indeed have legal status, responsibility rests with the **Board of Directors**. Corporate governance is the subject that discusses how Board members exercise that responsibility. The multiple crises we have gone through over the last 15 years has at least yielded that awareness, and is indeed producing many reflexions, legislations, and finally legal action. It is in this context that one ought to see the latest effort of the IPCG, which is setting a standard for Portuguese companies to act responsibly, for the benefits of society.^{iv}

One of the main aspects of this debate is that of the **separation between the duties of Chair and those of CEO or Managing Director (MD)**. Several countries (Australia, Canada, Denmark, Germany...) have for some time already not allowed the combined roles, on the simple principle that the Board is responsible for supervision, whereas the CEO is responsible for Execution.^v The UK lies in the middle of this debate: the UK Chair can be Executive, non-Executive, without the title, but acting as such ... It is increasingly recognized that, at least for large listed firms, **the separation of Chair and CEO** is a good governance rule favoring **prudence and value preservation**.

The English have a cultural tendency for adaptation, intimately linked with their common law tradition and their expertise in argumentation. The UK tradition of **“Comply or Explain!”** reminds all that governance is more than **“compliance”** or regulation. **Governance is a spirit** of weighing the evidence, evaluating the trade-offs, finding the “right middle position” between the wishes and views of the directors and those in charge of execution. The UK tradition of **mixed boards** (comprised of both executives and non-executives) is a long established one. However, in my view^{vi} it is a subtle concept that risks failing in practice: such boards have a tendency to be dominated by executives, who know so much more about the business.^{vii}

To reduce the risk of non-executives not being heard in mixed boards, the UK have introduced the function of **Senior or Lead Independent Director**, whose role is precisely to inform the Chair and the CEO of the feelings of NED’s when these appear not to be able to assume their proper role. This makes the SID collegially responsible for governance, with the Chair. It has an interesting structural feature, making governance at the top what the French call *“un ménage à trois”* – but without negative undertones: indeed, one of the strong results of management science is to underline that **minimal**

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team size is 3, not 2! A good conversation needs 3 actively engaged people: the lawyer for, the lawyer against, and a judge (who should be truly independent). **Boards truly “sit in the middle”** between executives and shareholders (and indeed regulators, tax authorities, and other stakeholders). The UK preference for appointing a SID amongst the NEDs (apologies for the acronyms) makes great sense and is a move that other countries might do well to consider for adoption.

I will immediately add that the separation of CEO and Chair is a particularly good idea for **family firms**, where one is no longer responsible towards anonymous shareholders (making this responsibility so much more bearable), but where shareholders include mothers and fathers, aunts and uncles, brothers and sisters. This prohibits the possibility of an almighty single ruler of the family empire, and strengthens the notion of family governance, family being by definition a team concept. In a family firm, the team at the top is often a three-some: **Chairman, CEO and Vice-Chairman** where the latter often is the voice of the family (typically presiding over the **Committee of Family Shareholders**). In that tradition the Vice-Chair acts as an “inside” SID when the family is of the view that good governance practice is key to sustainable performance of the family business.

Another development is the increasing recognition of **the virtues of the German governance system**, where for firms with more than 500 employees, the Board is subject to co-determination by an equal number of shareholder and labour representatives. This system came as a consequence of World War II, where the leading industrial families had either lost their firms, or had lost their reputation due to alliances with the Nazi regime, and where workers claimed for greater power. In this system, the Chair is typically a shareholder representative, whereas the Vice-Chair is a labour representative. If one adds the CEO, one finds a team of 3 at the top! Long regarded as arcane, for quite **inefficient** (labour and shareholder representatives often meet separately before the board meeting to discuss their respective positions, boards comprising a large number of members, board meetings being lengthy and formal), **the effectiveness of the German system** is increasingly noted. The latest discussions in France on restoring the country’s competitiveness and favouring a more collaborative posture with labour have led the current French Socialist government to invoke the German governance system when suggesting mandatory worker representation at Board level.

The second point made by the German system is that in matters of governance, **effectiveness ought to be the prime concern**, efficiency considerations should squarely come second and trade-offs between the two avoided. Effective board work takes time. Directors ought to have a tolerance for some inefficiency, if that is required for effectiveness.

Many Anglo-Saxon voices state that **the compensation system is broken**, at least in large publicly held firms. The rather **negative role of compensation consultants**, too eager to link compensation with company size – or “**value at risk**”, is increasingly recognized. It is noteworthy that French CEO’s used US or UK-style compensation to justify their pay package; this tendency has subsided following the financial crisis. It is interesting to note that the German co-determined boards do not appear to face that issue, since typically the Vice-Chair has to agree to the CEO’s pay package – and it is him (or her) which has to explain the pay package to employees. This moderates pay packages at the top and can be regarded as an element of fair play by both shareholder and labour representatives. Another good point for the German system is the limitation of strikes, as labour issues do get sufficient air time at board level and are typically addressed without workers going on strike.

Another topic gaining attention is the **diversity of board members, and in particular that related to gender**. The major breakthrough has come from Norway, a tradition with a good (though relatively recent, the kingdom being created in 1905) democratic

tradition. The Minister of Finance having urged the business community to take the issue to heart became increasingly frustrated with the little progress on the issue. That led to an “edict” that 40% of board members of Norwegian listed firms had to be women. The desire was not only to break the “glass ceiling” keeping women away from the board room, but to make boards more representative of society (where women are a slight majority).

The Norwegian example fuelled similar legislation in other countries such as Belgium and France. Eventually EU Vice-President Reding also jumped in urging such a measure for all EU countries. The measure eventually adopted by the EU is a relatively weak one, but the debate has allowed the issue to be put squarely in front of boards. The issue with female board representation is not so much that one cannot find them (the initial response), but that **it takes a different approach to nominations.**^{viii}

Very closely related with the topic of gender diversity is that of **diversity more broadly**. It is by now a widely accepted fact that boards are too homogeneous, being composed of senior men drawn from the business elite of the country in which the company is headquartered. In that sense, the Norwegian example is edifying: if Norwegian companies had to draw only from Norway, its female quota would have led to a relatively small number of women sitting on many corporate boards. The solution came from attracting qualified board members outside of Norway (mostly Scandinavia and Germany). The result was an unanticipated consequence of the regulation: Norwegian boards became both **younger and more international**, both being regarded as pluses.

The Norwegian drive for gender diversity at corporate board level had one unanticipated negative: **the number of firms listed on the Oslo Exchange radically decreased by about half** (to about 300 firms). This is part of a general trend in western economies: stock markets appear to be shrinking, and I have not yet seen a clear study explaining this recent phenomenon. Several answers lie before us: i) public money earns less than private money (i.e. private equity); ii) huge monies are invested in derivative markets diverting investors from primary markets; iii) regulation has been growing, has felt constraining and possibly value destroying, leading firms to escape to less regulated areas.

One conclusion that has become clear as a result of increasing regulation concerns **the dark shadow of regulation**, namely the unintended negative effects. The Norwegian case is one, SOX is another^{ix} but the biggest one is the regulations forcing banks to have, on their balance sheets, a greater amount of less risky assets. This led many banks to invest in country debt (the more risky countries offering higher interest rates), which then, with the Euro crisis, led bank balance sheets to be much weaker than anticipated, and contributing to a system failure of unprecedented magnitude that governments and central bankers are still trying to remedy.

The major conclusion to me is clear: regulation cannot rely solely on uniform “rules of the game.” **More active, principled and enlightened intervention by the regulator is called for.** This is the position taken by the Governor of the Israeli Central Bank, Stanley Fischer, in his successful attempt to force the withdrawal of the Chairman of Bank Hapoalim.^x But this is an all too rare occurrence: market enforcement should be much more active, and it was good to finally see the “Anglo-Saxons” both admit this point. The SEC in the US is, under the stewardship of Obama appointee Mary Jo White, trying to regain some self-respect, coming out of a long period where it was amazingly passive, something that was clearly exposed in the Madoff scandal.^{xi} I have been told that the Canadian High Commissioner of Finance does exactly that, but behind closed doors, threatening banks with revocation of their banking licence in case of risky behaviour or non-compliance with the Commissioner’s recommendations. It may help explain why the Canadian banking system has largely escaped the 2007-08 financial crisis.

The move towards a **European banking regulation** (at least for the larger banks) is most welcome, as it appears that it is very hard for a country to be tough with its banks; this requires a certain degree of independence and principle, which the Europeans appear to be ready to grant to the European Central Bank.

The last point that ought to be mentioned is that of **director competence**, and I will add courage. If governance is going to matter, it is important that directors be appointed for their competence, wisdom and courage to exercise independent and difficult views, while at the same time not getting lost in a solo trip, where they forget they are members of a collegial body. And a key factor in board performance is the ability of Directors to contribute positively to the collective deliberations.

The **Nominating Committee** is thus gaining importance as Boards will only be as good as the members that are elected. Directors will increasingly be asked to show credentials of business leadership and credibility, as well as an ability to play team (with their fellow board members, but also with the executives) without necessarily providing unconditional support to the CEO and her or his team.

We end this review with a last caveat about **the collective nature of board work**. One of the results of the increasing recognition of the importance of governance in corporate matters is that it has now become fashionable to end a discussion with **“this was a governance failure.”** Having laid blame, one moves on. No, that statement ought to be the beginning of another analysis on how the board failed its duties. Similarly, I am a bit concerned that excessive responsibility for such failures is now falling on the shoulders of the Chair, with such discussion now ending with a **“Well, the Chair was not great! It was his fault!”** My point is the following: we ought not to forget that board work is collegial, it falls on the shoulders of both the chair and the directors; failures are collective, and if the Chair is not at par, then that is also the responsibility of those appointing him (fellow directors or others).

In sum – and this is one of the main points I have tried to argue - there is a lot of discussion and also change in the governance space. It is fair to say that governance has come much more to the forefront over the last (two) decade(s), as Kenneth N. Dayton, former President and Chairman of the Dayton Hudson company wrote many soon thirty years ago in the Harvard Business Review.^{xii} Had the article had more impact, we might have avoided many of the crises we have seen over these years. The more positive conclusion one might come to is to hope that the understanding Dayton came to after a life in business – and implemented as Chairman before retiring from the company - has finally dawned on business over the last two decades, and that it is proving not so easy to come to the right answers in more than conceptual ways. Governance codes are part of this effort.

Comments on the latest version of the Portuguese Governance Code (2012 Version)

Having indulged myself on commenting on some trends in the global governance scene, let me now turn to the second question I was asked to comment on, namely the latest version of the IPCG Governance Code. Allow me to use a feedback template that I find very useful, and that consists in providing answers to 3 questions:

- **KEEP:** What is it that I liked and that I would suggest keeping in further versions?
- **LESS:** What is it that I find less useful, and that could be reduced in emphasis, or eliminated altogether?
- **MORE:** What is it that I find could be beneficially given greater importance, or that is missing and could be added?

What is good about the current version (KEEP)?

- The code is **principle based** (and not procedural). My conviction is that governance is a spirit of check-and-balance that both guides and controls execution (and substitutes for it in crisis); indeed, governance is best described by a set of principles, and not by a set of procedures (only).
- Given that principles may not apply and have to be violated in particular circumstances, the adoption of the English **Comply or Explain** practice is a useful corollary of a principle-based code.
- The writing is **simple and succinct**. It focuses on **the essence of the governance exercise**. As the Americans, “it touches most bases.”
- The separation of principles and actual recommendations is useful, particularly with a Comply or Explain provision.
- I very much like **the glossary of terms**, for one needs to have clarity on what the meaning of the words used in the document are.
- The world is changing, and the appropriateness of any governance code depends on the nature of the context in which it is set. **Regular review therefore is mandatory**, and one ought to see a code as an evolving statement, just as is the case for the law (and a good middle between excessive change and too little change has to be aimed for).

What might be reduced or eliminated altogether (LESS)?

- There is in my view **excessive mention in the code of the vague term of “Management.”** Governance, except for its implementation inside the company (such as corporate values and whistle-blowing), is foremost about relations between shareholders (and their General Meeting), other principal stakeholders (like regulators, employees) and the Board of Directors, on which – in the mixed board tradition prevalent in Portugal (I assume derived from the English) – Executive Directors sit, as well as non-Executive Directors (NEDs). So I would qualify management by terms such as **“Executive” Management** (meeting in the Executive Committee) and would single out **Executive Directors** from those members of the Executive Management that do not sit on the Board. But mainly, the governance code is mostly about the relationship between the Board of Directors and the Executive Directors and the Executive Management; I would not provide “the Management” with a lot of attention in this document.

- The code mentions 3 governance models: **monist, Anglo-Saxon, two-tier**. First, I do believe that, with the right spirit, there is little one model can do that the others cannot. It may be informative (and this would I believe be a governance innovation) to ask companies to explain why they adopt one model or the other. **What I would not use is the term “Anglo-Saxon,”** for I find the term is confusing: beyond the fact that the Angels and Saxons are Germanic people (who were pushed to migrate to the British Isles), English governance differs substantially from that in use in the USA, and even Scotland differs in legal practice from that followed by the English. Keeping the bad fiction of an “Anglo-Saxon” governance model or practice alive is not helpful.
- It is ambitious to have a **single code for all companies**, including start-ups, family firms, single businesses, corporate, and multi-business or financial structures. I would agree that the general principles remain the same (e.g. governance is not execution - except in crisis). Except that start-ups are nearly continuously in crisis, and therefore boards are much more “hands on.” **The effort is worthwhile, but is it realistic?** This is more a question from my part, than a statement. As an academic, I am of course for general principles. But a code needs to come down with actual recommendations and that is where the recommendations may perhaps differ according to category of firm. In any case, I would find it useful in the pre-amble to underline more strongly in the pre-amble that a single, general code is presented here. More on this in the next section.
- Though the next remark might not apply in Portuguese (due to translation), I suggest omitting rather weak language: i) the verb “should” is used throughout and is weak – in particular for a code where one would prefer the verb “**will**” (after all, governance is a lot about checking whether what “should” have happened actually did happen, and if it did not, understand why it did not); ii) the repeated use of “due time” might similarly be interpreted as ambiguous (some will say that it is too late, others that it is early enough); iii) but the all time best is the use of “strict secrecy” which made me wonder what “not so strict secrecy” might look like (in section I.1.2).
- The deeper point of the above paragraph is that the style of writing (as inferred from the English translation) connotes a **degree of tentativeness** that leaves too much choice and freedom in whether to use the code or not. If the code is a generic document, and IPCG means it, then presumably it will want its member companies to abide by the code, which thus would give the Code greater force.

What might be given greater importance or even added (MORE)?

- Given that the Comply or Explain principle is adopted in this Code, I would recommend that IPCG be **more demanding from all IPCG members** eager to adopt good corporate governance provisions, by requiring IPCG members to agree to adopt the code. I would also make it stronger in tone, and less tentative, thus **underlining IPCG’s ambition in the level of corporate governance practice** and as set forth in its code. One can aim for a practice that only a subset of corporations will comply with, and allow corporations to explain why they judge a particular recommendation to be not so effective for them, too constraining, or too costly. I do find that the tone in the current writing is too tentative and I would suggest strengthening the tone (again taking account of the Comply or Explain provision).
- For example, I still view **separation of Chairman** (the Chief Governance Officer, unless another board member holds the responsibility) **and CEO** (as responsible for execution) to be a good value preserving governing practice. The Code could

recommend separation of roles (particularly for publicly listed companies). Companies unwilling to follow the recommendation could then explain why they decided to nevertheless merge the two roles. Again, my main point is that the Comply or Explain provision should lead to demanding or better practice (justified by too many corporate governance failures). A Comply or Explain provision with relatively average or usual practice is weak, unless the purpose of the exercise is to induce and familiarize Portuguese companies with the practice of governance first (which is indeed more difficult with a demanding Code). I am assuming here that Portuguese corporations are familiar with governance – and that the Code aims not just for governance, but for what are currently regarded as the better practices in governance; no reason, for Portugal’s corporate sector not aiming for the top!

- The Code suggests (Recommendation IV.1) that in case the Chairman has Executive authority that one of the non-Executive Directors be “*in charge of coordinating the duties of the non-Executive Directors.*” One of the innovative changes made in the UK Code lies in the appointment of a **Senior (or Lead) Independent Director (SID)**, who de facto has the responsibility to be, as the Code suggests, the voice of the independent Directors. The rationale for this in the UK was to provide a counter-balance to what often is a strong relationship between the Chair and the MD (or CEO). I would suggest making explicit this Senior Independent (or Lead) Director role (with an appropriate name), and I would recommend its adoption. It is worth noting that in family companies eager for good governance, a Vice-Chairman is often appointed who is asked to fill that role (as well as being a voice for the family). The SID also is a useful instrument to mediate disagreements between the Chair and the CEO. A little known fact is that minimum team size is 3 - and not 2, as it takes a third person to be a mediator between two extreme positions.
- I stated above that it was ambitious to have a **single code for all companies** - from start-ups, to family firms, to single businesses, to corporate, multi-business or financial structures – and that particular recommendations might differ across these structures. I would at least add a **section on specificities for particular types of corporate structures**, indicating that, depending on the category of firm, one might wish to go further than what the general code recommends. For example, for family firms, it is a good idea, as an annex to the corporate structure, to have another structure that is called a **Committee of Family Shareholders**. This is the place where the family shareholders discuss and define their single voice on a particular issue. **For government owned structures**, the need for the government to appoint truly independent and competent directors (in lieu of government administrators without the proper skills or experience, but with hierarchical dependencies) is fundamental. ^{xiii}
- It would be worth it to **try to clarify and specify to a greater extent** the terms “*in due time*” or “*depending on size and complexity,*” and any other similar possibly ambiguous language. My view is that the Code ought to be as clear as possible, and positive – omitting any conclusions of tentativeness on the part of IPCG. I might add a final comment, which I make repeatedly: one often speaks of “too big to fail,” but one should introduce a notion of “**too big and too complex to govern.**” If governance is a must, then corporations might not be allowed to operated if deemed too big or too complex to govern.
- I would provide stronger indications that shareholders are, with management and employees, fundamental pillars of any corporation. I would thus provide more force to *Chapter II – Shareholders and General Meeting*. In particular, it is not just that “*shareholder involvement in corporate governance is a positive factor in*

corporate governance for the efficient functioning ...” (see Principle II.A). I would state that the organization of **an effective shareholder democracy is essential** for a well functioning corporate sector. And not only do “*general meetings ... serve as a space for communication with the ... shareholders*” (Principle II.B), I would add that this space is also a space for **decision making and exercise of proper respect of shareholder rights**. In this vein, “*the remuneration of the Chairman shall be reported*” (Principle II.2), and again taking as context the Comply or Explain principle, I would recommend that the remuneration of both Chairman **and of all Directors be submitted for approval by shareholders** in their General Meeting. And that Directors would ask, at some point, for a release of responsibility (subject to full disclosure, which would mean that release could be withdrawn if it was clear that important information had been withheld in the request for release). A discussion about release would certainly improve the quality of discussion between Directors and shareholders – and promote greater shareholder rights. My point here is first conceptual, as I do agree that concrete provisions and ways to make this happen ought to be further validated.

- One critical aspect of governance concerns the conditions and context for their appointment. Poor Directors make good governance impossible. Shareholders cannot be assumed to always agree, some investing for the long run and risk, others for the short run and being quite averse to risk. That can lead to shareholders disagreeing due to a conflict over time horizons and risk. It is thus important that corporations be safeguarded from conflicts of interest amongst shareholders. A **Nominating Committee** often is given the authority to review the nominations for competence and special interests before submitting the names of Director appointment to the General Meeting. Such a committee often doubles up as a **Governance Committee**, reviewing governance practices and organizing the periodic evaluation of governance practice within the corporation, as well of the functioning of the Board and of its Director, and of any particular **ethical and conflict of interest issues** that may arise, or of the procedures, roles, and processes (e.g. whistle-blowing, fraud ...) that exist to contain them. Introducing recommendations of a Nominating Committee, and of a Governance Committee (that may or may not coincide with the Nominating Committee) appears to be a good idea.
- There is little that mentions the contribution that the Board might make to **value creation/preservation and performance management**. Though this link is not obvious, it might nevertheless be worth mentioning. The point that might be worth making is that the way in which performance is measured has a direct link and causality on the actual performance of the company. This is also linked with executive compensation, another area where evidence of average contribution to value creation is haphazard.^{xiv} So I would have the Code draw the attention of boards on the fact that performance management is a key task of the Board, and that in turn the way performance is measured is fundamental. I would address these issues before speaking of supervision and inspection, and also remuneration, to put the latter in line with value creation and preservation. That would suggest a revised title for *Chapter V*, such as “*Chapter V – Performance Measurement, Evaluation, and the Remuneration of Directors.*” Regarding *Chapter VII*, one could argue that financial information is necessary, but that one of the essential board functions is indeed to determine which information (including financial and non-financial) the board requires to exercise its responsibilities in an effective manner.
- Finally, one could add the section on External Audit (currently in *Chapter VII*) in *Chapter IV* – which deals with inspection and supervision. That would put all the

supervisory functions in the same chapter. That line of argument might suggest merging the two chapters.

- Nothing is said about **strategy**, nor for that matter about **goal setting** and **corporate purpose**. The latter seems fundamental and the code ought to make it a requirement for a company to communicate about those. Regarding strategy and the means to pursue and achieve purpose, it is now increasingly agreed that strategy is best (but not always) initiated by the Executive Management, that the most important about strategy is that board and executives agree and commit to it, and that, particularly in a unitary board, strategy ought to be a main point on the agenda of most board meetings. Some mention of strategy, and how the topic is addressed at board level, belongs in the document, with some link to risk as well since a change in strategy typically changes the company's risk profile.
- **Foreign investors** are key for Portugal's economic development - and that of Europe more generally: foreign direct investment is one of the key measures of a country's economic health and prospects. Foreign investors are keen to benefit from solid governance provisions protecting shareholder investments. An excellent code, widely implemented, contributes to a good investor climate; **an English version of the code is thus a must**, as well as translations in the languages of countries investing into Portugal (such as China).
- As stated above, I very much like the Glossary, and would **expand the list of terms defined for meaning** to include *corporation, board, general meeting, affiliate companies, conflict of interest, insider information, ...*
- The Comply or Explain practice, well executed, is in itself a **feedback mechanism on the Code**. If many companies do not comply with particular provision that by itself is feedback that a particular provision does not appear to work for these companies. The Explain provision in addition provides IPCG with interesting rationales, provided by corporate members themselves, for these deviations from recommended practice. This exercise is useful and allows real-time comment to IPCG of the wisdom and salience of its provisions. IPCG, by enforcing the Comply or Explain provision on its members, would thus have created a very useful feedback mechanism for continued evolution of the Code and for input into the discussion of its regular updates. I would suggest that a **Commission** be created to review the benefits of the Code and the issues generated by it, coming out with a report at regular intervals.

ⁱ I have participated, for a number of years, with little progress I should add, in the **Association pour la Langue du Droit Européen**, that argued that if the law is to be fully clear and unambiguous, there ought to be a single reference text written in a single language. Given Europe's civil law tradition (which dates back to the French Revolution), this cannot be English (and there is much to be said for French), since the English legal culture is built on common law (which indeed is not common to the non-English people of Europe).

ⁱⁱ For details on fairness in management, we refer the interested reader to two articles: "*Fair Process: Striving for Justice in Family Business*," published in **The Family Business Review (March 2005)**, by L. Van der Heyden, C. Blondel and R. Carlock, and "*Why Fairness Matters*," published in the **International Commerce Review (Fall 2007)**, by L. Van der Heyden and T. Limberg.

ⁱⁱⁱ For a great account, we refer the interested reader to the article "*Capitalist Fools*," written by Nobel Prize winner Joseph Stiglitz and published in the US magazine **Vanity Fair (Jan 2009)**.

^{iv} Indeed, the US financial crisis showed that segments of the financial world had lost sight of the fact that they were there to serve and progress society, seemingly convinced that society was there to pay them bonuses and make them wealthy.

^v It is interesting to note that these countries are mostly Protestant (except for the US). UK being Protestant, Anglican (hence Catholic), and Catholic, it may not be surprising that the country sits clearly in the middle of this debate.

^{vi} Flemish people (of which I am one) typically do not cultivate the fine art of “reading between the lines.” Hence, they would be suspicious of mixed boards, for it would not be clear whether

^{vii} A number of recent facts underline the failure of the UK governance system: the nationalization of UK banks, the LiBor scandal, and, more importantly, the admission by the UK Government that the FSA, its main UK regulatory body, failed.

^{viii} For a detailed analysis of the issue, we refer the interested reader to *INSEAD Corporate Governance Report 5/2012*, submitted on May 28th 2012 in response to the EU Call for Public Consultation on Gender Imbalance in Corporate Boards in the EU.

^x See article by Sharon Shpurer, «*Bank of Israel gives Hapaolim Chairman an Ultimatum*», published in **Haaretz**, May 17 2009.

^{xi} Madoff was a former Nasdaq President and a regular visitor to the SEC. Though the SEC received whistleblowing statements that should have led it to investigate Madoff's operations, no thorough investigation ever took place. See article by Matt Taibbi, “*Why Didn't the SEC Catch Madoff? It Might Have Been Policy Not To*,” published in **Rolling Stone**, May 31 2013. On whether the SEC will be tougher under Mary Jo White's leadership, see “*Tightening the Nose: Can the SEC and its New Chairman be Tougher on Wall Street?*” published in **Knowledge@Wharton**, March 13 2013.

^{xii} See Kenneth N. Dayton, “*Corporate Governance: The Other Side of the Coin*,” in: **Harvard Business Review (Jan-Feb 1984)**.

^{xiii} On the appointment of government representatives of “state-held” companies, see the article *Welcome “Stateholder”*, by R. Gogel and L. Van der Heyden, published in **Strategy+Business**, October 12th 2009.

^{xiv} INSEAD colleagues have studied the links between life-time CEO compensation with corporate value added (over the same period of the CEO's tenure). Remarkably, they could not establish any correlation, which is rather regrettable given time spent on the issue by boards. The result suggests that for every board that is able to positively link CEO compensation with corporate performance, there is another one where the link goes the other way. See the article by M. T. Hansen, H. Ibarra, and U. Peyer, “*The Best-Performing CEOs in the World*,” published in: **Harvard Business Review (Jan-Feb 2010)**.