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FOREWORD

Corporate governance has traditionally been associated with large, predominately listed, companies. There is, however, a growing acknowledgment that corporate governance can play a crucial role to support the life-cycle evolution of businesses of any size. The governance challenges faced by companies change as their businesses evolve as do their stakeholders and their expectations.

This 13th Hawkamah Journal focuses on the role of corporate governance in corporate transformation. It features articles on the navigating the governance challenges through the various stages of company evolution from various perspectives.

We are pleased to feature an interview with Ms Abir Leheta, the Chairman and CEO of Egytrans, about the company's transformation from a family business to a listed company, and how good governance practices were fundamental in this transition. Ms Ritva Kassis, in her interview, discusses the process for IPO preparation.

We are also pleased to feature two articles on the corporate governance codes for non-listed companies. James Wates CBE shares his thoughts on the Wates Principles to improve corporate governance standards among private companies which were issued in December 2018 to promote long term success in the private sector in the United Kingdom. Similarly, Stathis Potamitis outlines the development of a similar code in Greece in 2016.

I hope you will find the articles in the current issue to be interesting and insightful.

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PREPARING FOR AN IPO

Ritva Kassis
Interview by **Frank Dangeard**

Becoming publicly listed is a major event in the life of a company. An Initial Public Offering of shares ("IPO") requires months and sometimes years of preparation and hard work on the part of the company's management and key shareholders, surrounded by armies of external advisors, lawyers, accountants, bankers and PR consultants. During the preparatory phase, interactions with regulatory and stock exchange authorities, which have to approve the IPO documents and the quality and level of the disclosure, are frequent and detailed. Almost everything and everyone in the company becomes subservient to the IPO process and timetable.

Therefore, embarking on a going-public transaction - either to raise funds from the public markets or to provide liquidity for the company's shares through a public listing - is not to be undertaken lightly. The challenges are numerous, mistakes can be expensive and correcting them is always time-consuming. Mediocre IPO processes lead to uncomfortable lives on the public markets.

The views, thoughts, and opinions expressed in the text belong solely to the interviewee, and not to her employer/s, or any other committee or group she serves on.

Ritva Kassis talks to Frank Dangeard about her experience as deputy company secretary during the preparation of the listing of DP World, one of the largest marine terminal operators in the world, on Nasdaq Dubai in 2007 and again a few years later on the main market of the London Stock Exchange in 2011. She draws on these experiences to reflect on what makes an IPO process successful.

Contrary to general belief, the technical aspects of an IPO and the amount of work required are not the main challenges faced by a company getting ready for a listing. External advisers are there to provide the required advice, and these processes are standard for all experienced firms.

In Ms. Kassis' experience the real challenges are internal – cultural and managerial. Senior managers and board members (if a board is already in place) almost never realize the amount of change they are going to have to go through in order to adapt to a world where they become a publicly listed entity.

So what does it mean for a company to be "public" as opposed to "private"?

A listed company uses funds belonging to investors. It therefore becomes accountable to these investors, and generally to the public markets, about how it operates, about what it discloses and the quality of its disclosures, and about the way its governance works and the check-and-balances it has in place. Its reputation, and that of each member of the senior management of the board, is at stake if it disappoints. Regulatory authorities, whose purpose it is to ensure the protection of investors, the integrity of the public markets and the reputation of their stock exchange, will be quick to question, audit and, if necessary, impose penalties.

With this as background, how does a company deal with these challenges?

Ms. Kassis insists on the need to discuss these issues with senior management and board members right from the start, when the idea of a listing is first mooted. The presence in the top management of executives who have gone through an IPO process or have worked for listed companies is a must – in the case of DP World, several were experienced in public company processes, and played an essential role in putting all the issues on the table and discussing them openly with the CEO and the Chairman.

Ms. Kassis believes that a strong and IPO-experienced company secretary is important for a successful IPO process. The company secretary can act as the key architect of the governance and compliance strategy - this includes everything from managing the corporate lawyers and regulators to drafting governance policies and contributing to reviewing the IPO prospectus.

These senior managers also need to have the trust of their colleagues and the personality to encourage an open dialogue about complicated issues, which Ms. Kassis believes are mainly in the areas of disclosure, control, governance and communication.

Disclosure: The amount of information a publicly listed company must provide often comes as a shock to the management or board of a privately-held company. And it is not only financial information, but also information about products and market shares, competitors, future plans and strategy. Disclosure documents also include information regarding individual remuneration, careers or current activities. Senior management and board members have to reconcile themselves with these obligations – they are not optional.

Control: A public listing entails some dilution of control, or at least the obligation to explain publicly what was before left to the privacy of closed-doors sessions between the management and its main shareholder, or needed no explaining at all. Decisions are scrutinized and have to be explained in the open. Shareholders comment, loudly and often unkindly, on performance and managerial decisions. Regulations weigh on the complete autonomy of decision-making, and always require a degree of formality rarely encountered in private settings, even with demanding shareholders.

Governance: A board is always accountable to its shareholders. But the amount of obligations and responsibilities of a public-company board are very significant indeed, and seems to be increasing every day. Board members have to realize that they can come under pressure from regulatory authorities, investors and the press. Each director suddenly becomes somewhat of a public figure. Not all board members are either willing or able to adapt to that new situation and status.

Communication: Disclosure does not stop at the IPO documents – those are only the beginning. Regular external communication becomes mandatory. It is highly choreographed and regulated. To understand what investors need, to know what to say and when to say it, is both a science, which must be mastered from the start, and an art, which comes with practice. The pressure is particularly strong on the Chairman and the CEO, who become the "faces" of the company to the outside world, and whose every words are scrutinized and analyzed. They must learn to act the part, and rehearse multiple times before investor meetings and press conferences, whatever their experience in business and their seniority in the business community. Some of these sessions can feel like the rehearsal for a movie audition or a TV interview.

What about the role of the board? "Simply fundamental". In addition to an experienced IPO working group and senior involvement, a competent board is a major success-factor in any going-public process. For Ms. Kassis, this starts with appointing the right board early in the process, then ensuring board and committee oversight of all aspects of the IPO process, and also putting in place the right due diligence for board members to take responsibility for the IPO documents.

Appointing the right board early: Privately held companies can accommodate very different styles and levels of governance, and therefore end up with boards of varying competence. This cannot be the case of publicly listed companies. A company should have from the start a very thorough recruitment process for new experienced directors. The independent directors and committee chairs should all have relevant domain expertise and years of publicly listed company experience. At DP World, the board was able to play a very active role in overseeing the many months of preparation.

Oversight of the process: The board gets involved progressively as its approval is required, but the number of formal approvals is quite mind-boggling, from terms of reference to financial statements, remuneration structures and specific remuneration packages, IPO documentation (prospectus, investor presentations, PR statements), etc. A lot of the oversight and of the approvals are delegated to committees - the Audit Committee, the Remuneration Committee and the Governance Committee - because of the sheer amount of work required and the pressure of strict timelines. In the last months of the IPO process, meetings are frequent, even weekly, and approvals by circulation are the only way for the board to keep up.

"Induction" of the board: The board takes responsibility for what is said about the company and its financial statements. All directors must therefore be brought to the same level of comfort with the disclosures in the IPO documentation. This requires that a high quality "due diligence" or "induction" process be put in place, during the preparation of the IPO itself, adding to the workload of both senior management and directors.

In short, says Ms. Kassis, setting up a board for an IPO is not simply "window-dressing". The right board will add value and become the arbiter of the "right thing to do" whenever different options are discussed.

Ms. Kassis also notes that an IPO process lasting 18 to 24 months necessarily has an impact on how the company is managed. Because every process is scrutinized by the IPO advisors and has, to some extent, to be described and explained, the management team often makes changes for the better during that time.

There may also be changes to the management team. In the same way as a shareholder and a chairman must put in place the "right" board, the board and the CEO must ensure that the "right" management team is in place for this new phase of the company's life. Some members of management will adapt and learn, indeed thrive as senior executive of a listed company, whilst unfortunately the challenge will not suit others to the same extent.

Ms. Kassis finally points out that the issues that come up during an IPO process can be difficult, leading to engaged discussions amongst senior executives, between them and the advisers, between them and the board, or amongst the board itself. The main shareholder also gets involved, sometimes creating another degree of complication. For the process to be successful and seamless, experience and trust between those involved is the only option – it has to be created early on and maintained for many months in a row.

INTERVIEW WITH ABIR LEHETA

Eng. Abir Leheta
Chairman & CEO, Egytrans
Interview by **Alec Aaltonen**

Egytrans is an Egypt-based provider of integrated transport and related services such as freight forwarding, project logistics and warehousing. The company was established in 1973 and it started as a family business until it became listed on the Egyptian stock exchange in 1998. Alec Aaltonen spoke to Eng. Abir Leheta, the Chairman and CEO, about the company's transformation.

Your father set up Egytrans in 1973 and your own brother became involved in the business early on while you were growing up. What are your first memories of the company?

I think I always associated the company with the passion both my father and brother had for the business. The way they were discussing the business, even over dinner table, was always passionate. There was this desire for the business and what it can become. I think I always wanted to be part of this.

Was family involvement in the business encouraged?

Encouraged? Yes, definitely. But it was by no means mandatory. My brother and I joined the company, while my other two siblings didn't, although my sister did become a board member in the company, but this was at a much later stage.

When did you become involved in the business?

After graduating in computer science, I joined a software company which was developing an information management system for Egytrans. This software was designed to improve the company's operational efficiency and through developing this platform, I got to know the company and its operations very well. About two years later, in 1996, I joined Egytrans and my role initially was on the IT side, but subsequently I managed quality and organizational development before moving into strategic planning and implementation.

Egytrans is well-known in Egypt for its early adoption of good governance practices. Could you describe the company's governance journey?

The journey really started with my brother, Hussam who was the CEO at the time, attending a workshop on the topic of managing boards, which was held in Sweden. He became convinced that governance is the key to the growth of the company.

When he came back, he asked for my help in drafting a letter to our father, who was the Chairman, which set out the roles different people play in governance. For example, what is the role of the shareholder vs the board vs management. But much of this letter focused on what is the role of the Chairman vs the CEO. We had separated the roles of the Chairman and CEO, but my father as the founder of the company was not accustomed to such delineations.

How was this received by your father?

Hussam was the driver of good governance but I would say it was my father who had set up a culture in which it was easy for governance to take root. His mindset was that we wanted to be the best. We wanted to be the ones bringing new best practices to Egypt. For example, we were the first services company in Egypt to be ISO 9001 certified, the same with implementation of the Integrated Management System combining ISO 9001, ISO 14001 and OHSAS 18001. We were also the first company in the world to achieve ISO 10002 certification. This mindset was also evident in many of the new services we started offering as well as in corporate governance.

When the Egyptian Institute of Directors started providing the Director Development course, Hussam was in the very first intake of participants. Afterwards, he started sending people from the company to the course, including the board members, the company secretary and others. I believe I was in the third intake. We still encourage and provide an opportunity for all our new board members to join the course.

We also invited the International Finance Corporate (IFC) to benchmark our governance practices against international standards, as a result of which we added independent directors to our board. I believe we were one of the first ones to do so in Egypt. A couple of years ago, we had the IFC re-assess our practices in our effort to continuously improve our practices.

In other words, the family values were such that it was relatively easy for your brother to advance governance in the organization. What are your family values and have they been translated into corporate values and culture?

I don't think we ever consciously set about identifying our family values. But this is a great question, and looking back, I think you see family values visible on the corporate side too.

Our family taught us that life is about choices and that we should make the right choices and then do those things in the right way and with passion. I would say these are the principles we adhere to on the corporate side. Do the right things right.

Secondly, we believe in the value of working collaboratively and building partnerships. On the corporate side, I think this is evident with our partnership with our employees. Even today, when the family owns mere 12 percent of the company, I would argue that our approach to our employees is more akin to a family business than a pure corporation. We want them to know that the company has their back when they go through difficult personal circumstances and that we are there to support them. As a result of this, we have employees who have been with us for decades.

Our corporate values are integrity, innovation, learning and personal growth, and building partnerships, which I believe are all congruent in one way or another with the family's original values.

Let us turn to the IPO. What was the driver behind the IPO and did you, as is often the case with family businesses, struggle with the demands of the listing requirements?

The driver for the IPO was clear: we had bigger dreams for the business that we could achieve on our own. As I mentioned earlier, we have always believed in the value of partnerships, and the IPO provided an opportunity to create win-win partnerships.

As for the disclosure requirements, these can be difficult in the beginning as there are many deadlines to adhere to but it eventually becomes simply a part of how you do things. Another challenge is that none of our competitors in Egypt are listed so they are able to see all of the information we share with the public while they have no such disclosure requirements.

But judging by the level of your public disclosure, you have not been holding back.

That is correct. In fact, we have won numerous awards for our disclosure practices over the years. Disclosure and transparency are important pillars if you want to build successful partnerships with your stakeholders.

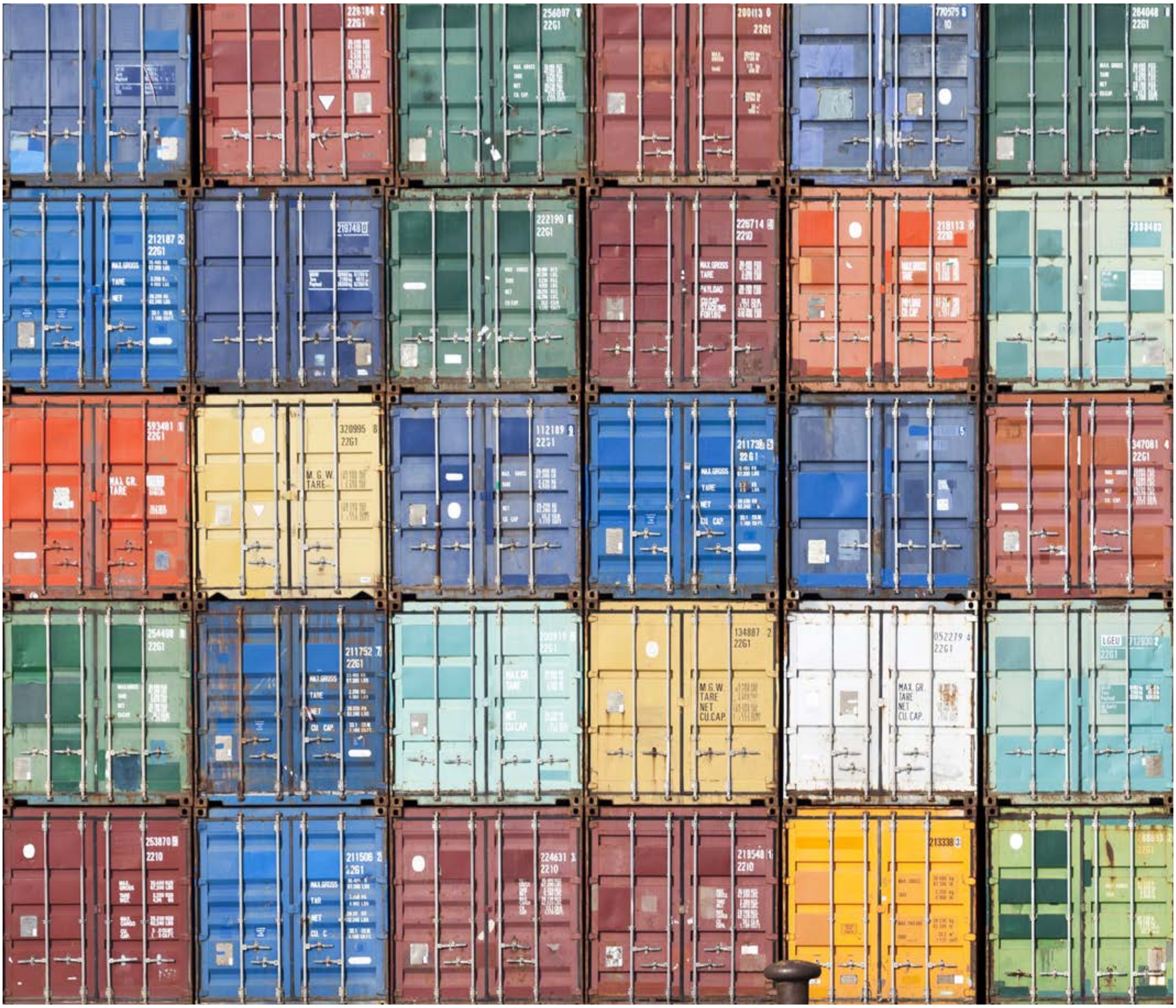
We recently did a review of our disclosure practices and I guess you can tell that our annual reports are getting longer, we are providing more and more disclosure, both financial and non-financial. And as these reports are becoming longer, it is becoming harder to tell a unified, compelling story of our business. We want to continue expanding our disclosure in a smarter way in order to give our minority shareholders in particular a deeper insight into what is happening in their company. This is what we have been working on and I'm very happy with the results.

Every year, we try to improve at least one aspect in our shareholder communication. Last year we upgraded the report we present to our shareholders at the AGM. This is something which is mandated by the regulators and usually this follows a set format covering the financial results. We felt that this report could be expanded to provide a more comprehensive view of the business, and this now forms a 30 minute visual presentation to our shareholders at the AGM. This year we are also performing a complete overhaul of our annual report, streamlining it, deepening the information provided and upgrading the visual design to reflect our corporate personality as a growing and forward-moving company.

As a consequence of the IPO, the company now has the state as major owner. How well does state ownership combine with family ownership?

State ownership can sometimes introduce a level of bureaucracy, and yes, we are subject to state audit as are many wholly or partially state-owned entities in Egypt. However, in our case, I think our goals and our approach are very much aligned. Firstly, the National Investment Bank of Egypt is a long-term investor who have been with us since the IPO. Secondly, our corporate purpose is aligned with their goals. I mentioned earlier that Egytrans always wanted to bring new best practices to the country and if we do our job well, we serve the Egyptian economy by contributing to the country's competitiveness and indirectly to the quality of life in Egypt.

I really think the onus is on us to engage with the state. This is to understand their needs but also



to keep them engaged on our vision – what we want to do with the business in terms of purpose, vision and strategy. And when they understand the company's vision, this also gets reflected on their nominee directors, in terms of their caliber and skill sets, and the company benefits from this.

What are the characteristics you most value in a board member? How have they added value to Egytrans?

Having the right people in the boardroom makes a big difference. After the IPO, most of the board members were non-family and when we started appointing independent directors, the family membership on the board was reduced to two seats by 2008-2009. As such, you want directors who bring real value to the business, so you need directors who have integrity, who bring strategic thinking, and who add value through their knowledge and experience as well as relationships. But fundamentally, you want directors who are willing to engage openly and deeply in the difficult, transformative discussions that lead to real growth.

I think Egytrans has benefited from the board as it has focused on true corporate governance – it has helped in strengthening systems, managing risks, focusing on growth and sustainability, engaging creatively in vision and strategy-building, as well as by providing oversight.

Let us discuss the topic of succession planning, which is typically a great challenge for many family businesses. How did you manage the transitions?

When my father passed away in 1999, my brother was already the CEO while my father was the Chairman. Hussam had achieved this position after 15 years in the company, during which he amassed a huge amount of experience so he was the natural choice. Therefore, this was a relatively easy succession.

When Hussam passed away suddenly in 2015 after a short illness, the transition was not as easy. Yes, I had been working for the company for a long time, but the succession decision could have moved in more than one potential direction. Not least because the family no longer controlled the ownership of the company.

However, the entire board of directors as well as the major shareholders of the company asked me to step in due to my long experience in the company, their trust in the family's management of the company and their desire for stability and continuity. I became the Chairman and CEO, but we did restructure the business in order to create a General Manager position responsible for the commercial and operational management of the company and together we have been able to form a strong leadership team.

I think this difficult succession process was made much smoother because of the support and collaboration of all stakeholders - management, employees, board, and shareholders. In fact, the company was able to go on and achieve record performance in 2016 and 2017. I attribute this to loyalty of the company team and the strong base that had been built over the years and had become a part of the company DNA.

How do you see the family involvement in the business in the future?

The business is a huge priority for the family - it is our legacy and also the foundation of our financial stability. But I'm not sure it is meaningful to speak of the company as a family business anymore. After all, I'm the only family member in an executive position in the company.

The family's priority is to see the company managed professionally with good governance practices which safeguard its sustainability and enable it to grow and flourish while retaining its values that have made it a success. This is regardless of whether the family continues to have an active role in executive management. We will continue to serve the company for as long as this role is needed and valued.

Looking at your company's history, what do you think are the key takeaways for other business owners?

My advice is that you need to build trust. You can do that by demonstrating integrity and transparency and a willingness to forge partnerships. Secondly, you need to insist on strong systems that do not depend on specific individuals so that you make the company sustainable for the long term. Thirdly, have a deep sense of purpose then focus on excellence and building competitive advantage.

EVOLVING CORPORATE GOVERNANCE CHALLENGES OVER A FIRM'S LIFE CYCLE

Mak Yuen Teen
Associate Professor, National University of Singapore

There are two commonly cited findings about family businesses that highlight the pitfalls and potential of such businesses. First, most family businesses have a short life span beyond the founder's stage and it has been estimated that 95 per cent of family businesses do not survive the third generation of ownership. Second, family businesses (those that do survive) tend to outperform non-family businesses. In other words, they either die young or they thrive.

Family businesses need to pay attention to both family governance and business governance issues in order to survive and thrive. As a business founded by a family evolves, it will face different governance challenges that pose both opportunities for its continued growth and threats that may cause its demise.

In this article, I discuss the key corporate governance challenges faced by the following types of businesses:

Family-managed private company; family-controlled professionally managed private company; family-controlled public company; jointly-controlled public company; and public company with dispersed ownership.

Family-managed private company

During this stage, most of the challenges faced by a family business are likely to be internal. It is not tapping outside capital, except perhaps for bank loans, and therefore does not have to deal with complicated relationships with outside investors.

The success of family businesses often has to do with the commitment, knowledge continuity, and the importance placed on preserving the family reputation and family pride. These give it an advantage over other forms of business. However, family businesses may also suffer from the lack of preparation of the subsequent generations to handle the demands of a growing business and a much larger family. As a family business grows, it needs to pay attention to both family governance and business governance issues.
A 2013 survey by KPMG Singapore identified the following five major causes of conflict within a family business: competence of family members working in the business; future strategy of the business; lack of family member communication; remuneration; and succession.

Ernesto Posta's Family Governance: How Leading Families Manage The Challenges of Wealth published by Credit Suisse Group AG in 2012 and the IFC Family Governance Handbook published in 2008, have identified a number of challenges of family businesses: loss of family identity and values; family conflicts; current leader's inability to let go; an entitlement culture; dilution of wealth (due to personal consumption and breakup of business interests); informality (lack of clear business practices and policies and procedures); lack of discipline (such as lack of succession planning); lack of transparency; and lack of oversight/self-dealing.

Conflicts in a family business tend to increase as it moves through generations because different members of the extended family may be involved in different capacities as shareholders, directors, executives or employees. Some may be shareholders relying on dividends while others may be executives or employees drawing salaries, and therefore, criteria for employment in the business and the setting of remuneration become important.

As a family business grows, having proper family governance becomes increasingly important. Family governance mechanisms such as a family constitution (which sets out the family vision, mission, values, and policies regulating family members' relationship with the business), family meetings, family assembly or forum, family office and family council may become necessary.

Failure to properly plan for succession is a common failing of family businesses. This often happens because of family members delaying the decision in order not to create potential friction among family members or because no current family member or outsider is deemed capable of replacing the current CEO; avoiding awkward discussions of the eventual loss of a family leader (the current CEO); and the current CEO refusing to admit that the company can survive without him or her and who is afraid of retirement.

In terms of business governance, some of the challenges faced by early-stage family businesses are similar to those faced by small and medium enterprises (SMEs) generally. Being relatively small and more informally managed, they suffer greater exposure to risks such as fraud risk. Good corporate governance and sound internal control and risk management are often seen as business costs and merely good to have. Therefore, they may pay insufficient attention to issues such basic internal controls and internal audit.

According to the biennial global reports on occupational fraud and abuse published by the Association of Certified Fraud Examiners, the most common organisational victims of fraud are private companies and small companies (which include many family businesses). In 2014, 38 per cent of victims of fraud are private companies and 29 per cent are small companies with fewer than 100 employees. Of course, such companies also make up by far the largest number of organisations. What is more interesting, however, is that the median loss from fraud in dollar terms for private companies and small companies are generally no smaller, and often larger, than for public companies. For small businesses, such fraud risks can have business-ending consequences.

I asked the managing partner of a mid-tier accounting firm that has many SME clients for a list of the most common internal control deficiencies in SMEs. Many of these deficiencies are what we would call Internal Control 101 stuff, such as improper access rights; lack of credit limits and credit terms not in place; unauthorised credit adjustments to customers' accounts; invoices not sufficiently supported with documents; petty cash system not properly maintained leading to excessive cash kept in the office; staff claims not sufficiently supported with documented evidence; payments via cash instead of cheques and bank transfer to vendors' accounts; three-way matching not performed prior to making payments; double payments made for the same invoice number; and discrepancies in salary amounts between employment contract and payroll details.

Family-controlled professionally managed companies

Some family businesses remain largely family managed as they grow because they continue to have qualified family members who are interested in the business. For others, the family may retain ownership control but engage professional managers. Some family businesses that do not yet have family members suitable to run the business may bring in professional managers as a transition, and part of the role of the professional managers is to help prepare family members for future senior management roles.

Family businesses can certainly benefit from hiring professional managers but need to address certain governance challenges. They include how to preserve the family/founder values; treatment of family members versus professional managers; "agency" problem of divergence of interest between the family owners and professional managers; and mechanisms to put in place to foster performance and commitment of professional managers while preserving the family/founder values.

Those who have watched Christopher Nolan's Batman Begins may recall the poignant scene of a young Bruce Wayne travelling into the city with

his dad, Thomas Wayne, on a train built by Wayne Enterprises, on that fateful night when Bruce's parents were murdered. As the train passes the Wayne Enterprises building in the distance, Bruce asked his father: "Is that where you work?" His father, a doctor, replied: "No, I work at the hospital. I leave the running of our company to much better men." Bruce asked: "Better?" His father then added: "Well . . . more interested men."

In the course of the Batman trilogy, we can see that these "more interested men" – who were professional managers – took the company on a very different path. It started making all sorts of weapons purely for the sake of profits, which was clearly at odds with the values of the founder-owner.

Professional managers may be motivated but may not share the same values as the owners.

Some family-controlled private companies, whether managed by family members or professional managers, appoint independent directors to benefit from a greater range of expertise and perspectives.

Family/owner-controlled public companies

As a family business evolves and grows, the family owners may decide that it is time to go public and get listed. Some do so to divest part of their ownership, others to improve the image of the business, but the most important reason to go public is when the business truly needs additional external capital to grow and public capital markets are the preferred means. It is not a decision that should be casually taken because a public listing comes with great responsibilities and expectations from public shareholders, regulators and other stakeholders. When a business becomes public, the owners are no longer just owners – they are also stewards of other people's money.

Corporate governance issues that become especially important at this stage include adequate separation among the roles of owners, directors and senior management; having suitably qualified and truly independent directors; a robust internal audit function; high quality financial reporting and external audits; proper disclosure and governance of related party transactions; and equitable treatment and regard for the rights of minority shareholders.

The problem with many family businesses that become public is that they fail to shed legacies and mindsets that are no longer appropriate for a publicly listed company. For example, a founder of a venture capital firm in Singapore has this to say about SMEs, which apply to many family-controlled listed companies: "More often than not . . . SMEs see the board as a regulatory conformance and overlook the fact that the board should play a key role in the firms' performance . . . With the lack of resources being a common issue for SMEs, SMEs are usually heavily dependent on the vision, capabilities and network of their founders. This dependence, if not managed properly, can potentially limit the growth of a company. At the same time, if the company wants to expand its business outside of (the country), it will have to manage a whole new set of challenges that it may not be equipped to handle. In my opinion, it is at this stage of growth where SMEs can benefit from having a strong board. As the business grows, an owner-manager needs to be aware of the immense benefits that an NED (non-executive director) can bring to the company and consider bringing one or more NEDs on board to take the business forward."

Some years ago, I spoke to the Asia CEO of a large multinational, who was an independent director in a listed subsidiary within a group that was controlled by a founder. The founder was a brilliant entrepreneur, but did not have the financial and management skills necessary as the business grew, was not open to different views, and continued to exert control over all key decisions. This highly successful executive had resigned as a director and predicted at the time that the group would eventually collapse. Fast forward a few years and the company is going through restructuring to avoid bankruptcy. The company had grown too fast – diversifying into other sectors and markets – and taken on too much debt. During that meeting, we talked about this scenario being repeated over and over again – and how this is preventing many family businesses from becoming global businesses.

In a study that I did some years ago with a first class NUS BBA (Accountancy) Honours student, we found that many listed family companies in Singapore have independent directors who only serve on one board – the board of the family company. These directors are not sought by other companies – we inferred that they are invited to serve as "independent directors" because they are family friends. Others make another mistake – they recruit what we might call "the usual suspects" – those who sit on many boards but who may not necessarily have the commitment or the right competencies.

In another study of Singapore listed companies, I found that it is not uncommon for these listed companies – often family businesses – to have directors who are over 70 years of age and who have served for a long time. Often, there are several of such directors. I have no bias against older directors but would caution that while many companies are facing disruption, boards often remain static.

It is understandable for a family owner to want to retain control, but they must remember that it is not just their company anymore. Therefore, while they are perfectly entitled and it is often desirable for them to have themselves or their nominees on the board, it is also important that the board is allowed to do its job without over-interference from the owners. The board needs to effectively transition from one that may heretofore be involved in management, to one whose role is more setting the general direction, oversight and providing guidance to management.

It would be almost unfathomable for any publicly listed company not to have a robust internal audit function in place. Unfortunately, many listed SMEs today have internal audit functions that are of doubtful value. Some are essentially "one-person" in-house outfits with the internal auditor lacking the necessary training and experience. For SMEs, outsourcing the internal audit function may make a lot of sense because it is often too expensive to maintain an in-house function that has the breadth and depth of experience necessary to implement a robust internal audit programme and retention of key internal audit talent may be a challenge. However, when outsourcing, they need to ensure that the service provider is capable of supporting the needs of the business.

A few years ago, I led a group of NUS students in a governance review of a listed SME. It was not a family business, but it was owner-managed in the sense that the CEO (who was also the chairman) owned nearly a quarter of the firm.

It had outsourced its internal audit to a very small service provider. The SME started in Singapore but had branched into Malaysia, Indonesia and Thailand. It had grown beyond what we thought the service provider was able to support. We recommended that the company review its internal audit arrangements and consider sourcing for a service provider with the regional footprint to support it, and the company subsequently replaced its internal auditor.

Being a publicly listed company, having high quality financial reporting and a robust external audit become especially important for building and maintaining investor confidence. For such "public interest" entities, financial reports and audits of public-listed companies are also subject to greater regulatory scrutiny.

Family-controlled listed companies need to be especially watchful about related party transactions that benefit the family at the expense of public shareholders. Stock exchanges, therefore, not surprisingly often put in strict rules around such transactions.

They also should not under-estimate the importance of equitable treatment of minority shareholders and respecting their rights. Today, there are more minority shareholders who are willing to question the actions of the board and management in shareholder meetings, the media and online forums. They may not be able to significantly influence the decisions of the board and management, but they can certainly cause embarrassment and investors to lose confidence in the company. Some may hold enough shares to call meetings and propose resolutions to get the board's and management's attention. Where a company counts institutional investors and fund managers among their investor base, these investors may also expect to be able to have private meetings with the board and management.

Jointly-controlled public companies

Not all family or owner-controlled businesses stay that way after they become public. Some of these businesses end up with other major shareholders in addition to the family or founders. Each major shareholder may have its own representative on the board. There are pros and cons with companies having multiple large shareholders. If they share common values and vision, then such an ownership structure may be sustainable. It can also lead to better corporate governance through better mutual checks and balances among the major shareholders.

The earlier mentioned SME was an example where having multiple substantial shareholders each represented on the board has worked out well. In the course of the governance review, I asked the CEO whether the fact that he was also the chairman and a large shareholder meant that he had too much power. He pointed out that the other two large shareholders on the board together own as much of the company as he does, and they provide a check and balance on him. But there are also examples of companies with multiple substantial shareholders torn apart by differences among the shareholders and shareholder disputes. It is important to have the right partners who share the founder's vision, but the founder also needs to be open to the viewpoints of others who also have significant investment in the business.

Public companies with dispersed ownership

As the need for public capital continues to grow, the ownership of the family or founder may be diluted to such an extent that it becomes a minority shareholder, just like everybody else – or the family or founder may even have sold out completely. Companies without one or more major shareholders are common in countries such as in the United States and United Kingdom but relatively rare in many other parts of the world.

Some view dispersed ownership as corporate governance nirvana because there is no dominant controlling shareholder who essentially calls the shots but it is not necessarily the case that corporate governance will be better. The corporate governance challenges just tend to be different ones. With dispersed ownership, the key corporate governance issues revolve around the lack of accountability and oversight, with no one with enough of a stake to make the board and management accountable. In this situation, there is often reduced accountability of the board to shareholders and reduced oversight of management by the board. The result is often dominant management and excessive management remuneration. As this kind of ownership structure is common in US public companies, it also helps explain why these are common corporate governance issues in companies there.

It has often been said that corporate governance is a journey and that is true in a number of ways. There is always room for improvement. The issues faced as the business evolves also change. It is important that families and business owners understand the most pertinent issues they have to address at different stages of their business life cycle – which hopefully will be a very long one.

This article is a revised version of the article titled "Navigating corporate governance challenges over a firm's life cycle" first published in Business Times in Singapore on 29 March 2016.

PURPOSE-LED GOVERNANCE: *PRINCIPLES FOR PRIVATE COMPANIES*

James Wates CBE
Chairman, The Wates Group

Corporate governance codes and reporting are often seen as the province of the listed company. In the UK, the UK Corporate Governance Code, to which premium listed companies must adhere, is a well-known and respected standard.

Unlisted companies, on the other hand, have largely operated without such reporting requirements. Private companies, so the assumption goes, should be able to run themselves as they wish. After all, they are risking their own capital, not that of distant shareholders. Of course, it goes without saying that many of these companies already recognise the importance of good governance, but reporting on it was broadly seen as an optional extra.

But that line of thinking has been changing. In the UK, the collapse of the retailer BHS left thousands without a job and placed their pensions in jeopardy. Such a mainstay of the British high street was a noticeable loss, and media and politicians piled on the scrutiny, asking questions about how such a large business could be allowed to exist (and die) without the sort of checks and balances that are required of listed companies. Private companies enjoy the benefits of limited liability but are not subject to the same level of reporting and accountability requirements as publicly listed companies. So they should bear some of the responsibilities of having a potentially sizeable impact on the wellbeing of numerous employees, suppliers, customers and others.

Of course, the situation is not so simple. Even private companies are subject to numerous regulations and reporting requirements of UK Company Law, but the collapse of BHS nonetheless did expose the lack of a level regulatory playing field when it comes to large private companies and governance.

Government response

In 2017, the UK government announced in its response to a wide-ranging consultation on corporate governance that they would introduce a new reporting requirement for large private companies, a group they defined as those with more than 2,000 employees or meeting certain financial thresholds (having both a £2bn balance sheet and more than £200m in annual turnover). This group of companies represents a sizeable portion of the UK economy. About 1,700 companies currently meet those thresholds, having a combined turnover of £1.6 trillion and employing 6.2 million people – about 13% of the UK's working population.

To satisfy the legislation, such large private companies would have to submit, as part of their annual Directors' Report, a statement as to whether (and if so, how) they follow a code of corporate governance.

Problem was, corporate governance codes for private companies were scarce. True, the Institute of Directors had in 2010 issued a set of guidance and principles for unlisted companies in the UK, but more recently (in 2017) had called on the government to formally support the development of a new code. Notably, there was also a prominent code developed by The Instituto de Consejeros-Administradores" (IC-A), the Board Directors' Association based in Spain. This had been adopted by the European-wide [IOD] organisation and gained some prominence.

But the UK government's new legislation meant that an extremely wide range of companies would need to state their adherence to a code, with no clear candidate for which code that may be.

The way the legislation was drafted meant that it included not only companies one would normally associate as being 'private' – eg, those owned by an individual, a family, or a private equity fund – but also wholly-owned subsidiaries of larger, listed companies, including subsidiaries of PLCs in the UK and foreign-owned entities. This meant that extraordinarily diverse companies would be looking for a corporate governance code that they could report against in order to comply with the new legislation.

Anticipating this, the government had approached me in January 2018 to ask if I would lead a coalition group of organisations in the development of a new code.

I was pleased to accept. I do understand the need for government to be seen to respond to the existence of bad apples falling from the corporate tree, but I am aware that the law of unintended consequences often means that government regulation bears a risk of killing off the entire tree.

The Wates Principles

Throughout 2018, I worked with a coalition of organisations to delve into the fundamentals of what good governance is really about, and how the government's broad category of 'large private companies' might benefit best from a set of principles and guidance.

With the Financial Reporting Council serving as secretariat and a member of the coalition, this group included the British Private Equity and Venture Capital Association, the Confederation of

British Industry, the Climate Disclosure Standards Board, the Institute of Business Ethics, ICSA: the Governance Institute, the Institute for Family Business, the Institute of Directors, the Investment Association, Mark Goyder (in a personal capacity) and the Trades Union Congress.

We developed a set of six principles, now known as the Wates Corporate Governance Principles for Large Private Companies. They are:

Purpose and leadership – An effective board develops and promotes the purpose of a company, and ensures that its values, strategy and culture align with that purpose.

Board composition – Effective board composition requires an effective chair and a balance of skills, backgrounds, experience and knowledge, with individual directors having sufficient capacity to make a valuable contribution. The size of a board should be guided by the scale and complexity of the company.

Director responsibilities – The board and individual directors should have a clear understanding of their accountability and responsibilities. The board's policies and procedures should support effective decision-making and independent challenge.

Opportunity and risk – A board should promote the long-term sustainable success of the company by identifying opportunities to create and preserve value, and establishing oversight for the identification and mitigation of risks.

Remuneration – A board should promote executive remuneration structures aligned to the long-term sustainable success of a company, taking into account pay and conditions elsewhere in the company.

Stakeholder relationships and engagement – Directors should foster effective stakeholder relationships aligned to the company's purpose. The board is responsible for overseeing meaningful engagement with stakeholders, including the workforce, and having regard to their views when taking decisions.

In the document published in December 2018 and now available on the FRC website, we also included a short amount of guidance on each principle – not a list of requirements, but examples and further explanation to make the principle clear and to aid companies in interpreting and reporting on them.

These principles and guidelines were the result of some rigorous debate amongst Coalition Group members, a three-month public consultation, and review by an Executive Sounding Board consisting of representatives of UK companies that will be covered by the new reporting requirements.

Hopefully the principles' logic is clear – purpose is at the pinnacle; and it is underpinned by practical characteristics of good management, plus an obligation to address certain specific matters. Boards are ultimately responsible for good governance, and underlying everything is a long-term perspective.

Benefits to companies

These principles provide businesses with a practical framework for ensuring that their companies are well managed and aligned behind a clear purpose. Essentially, they provide a tool to help companies look themselves in the mirror, to see where they have done well and where they can raise their corporate governance standards to a higher level.

The principles also provide a structure for reporting, regardless of whether companies are obliged to do so under UK law. Many companies are justifiably proud of their corporate governance already; many have extensive programmes already in place to consult with stakeholders, for example. These principles are flexible enough to allow just about any organisation to show off the good work they are doing, linking that good work to governance structures.

And if companies follow these principles as they were intended – as principles, not as boxes to tick – companies will be forced to think seriously about why they exist and how they deliver on their purpose. Then, crucially, they will need to put such analysis into their own words. That should result in a compelling narrative – a sales pitch, if you will – that speaks directly to the people who a company needs to have on side to achieve its mission.

At its heart, purpose and transparency

Globally, we are seeing a movement towards businesses placing purpose first. This is not just good PR; it is good for the businesses themselves. Purpose doesn't supplant profit; it promotes it. It is all about articulating why a company should exist, and how profit is necessary to allow a company to keep doing what it does well and sustainably deliver its social value.

Transparency on corporate governance, whether or not guided by the Wates Principles, puts the key questions and issues into the public domain. It recognises that stakeholders are partners in delivering on the company's purpose, and provides the foundation for healthy dialogue on how best to deliver.

This is the sort of movement that we need all organisations to join if we are to improve public trust in institutions and pre-empt potentially damaging government intervention. We may never rid the business world of bad apples, but we can raise the tide of behaviour by the many well-meaning, tax-paying businesses that are the bedrock of the economy.

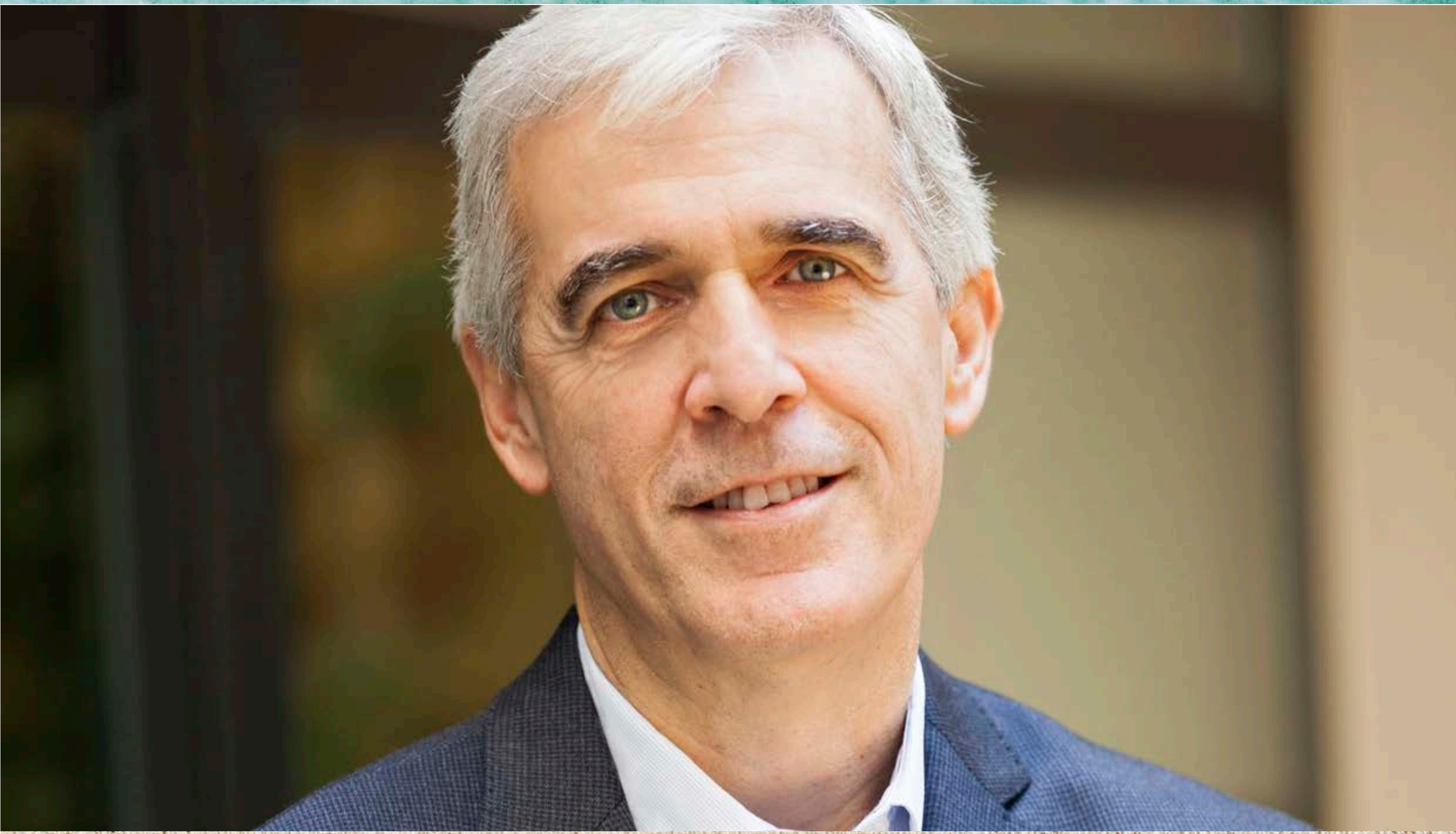
Looking forward

It's still early days since the Wates Principles were published, but to date they have been well received. I see it as a good sign that some commentators say that they go too far; some say they don't go far enough. While the government cannot dictate that companies follow the Wates Principles, Secretary of State Rt Hon Greg Clark MP warmly welcomed them at the launch.

My own company, The Wates Group, has become an early adopter of the Wates Principles as a structure for reporting on corporate governance in our 2018 Directors' Report, but under the legislation, large private companies in the UK will not be required to report on their corporate governance arrangements until they publish their Directors' Reports for 2019. So we won't see exactly how they are being interpreted for some time. Moreover, I am sure that there will be a period of reporting cycles in which companies explore different approaches and properly integrate the principles into their board agendas. So it will take some time before clarity on good practice in reporting matures.

In the meantime, the coalition group, the Financial Reporting Council and I will continue to promote the principles and seek dialogue with those who share our aspirations for raising the tide of corporate governance, in the UK and internationally.

CORPORATE GOVERNANCE PRINCIPLES FOR NON LISTED COMPANIES IN GREECE



Stathis Potamitis
Managing Partner, POTAMITISVEKRIS
Member, Greek Corporate Governance Council

Shareholders of non-listed companies are typically restricted in making their shares available as they are not trading in organized markets. Moreover, there may be additional restrictions in making their shares available, under the provisions of the company's articles of association. Therefore, shareholders of non-listed companies may find themselves "trapped" in the company and with a significant investment risk. An effective corporate governance framework partly offsets this risk, while ensuring maximum possible protection of the interests of minority shareholders by the management. Also, a corporate governance framework can include an exit strategy for minority shareholders who may wish to withdraw from the company. All this shows that the adoption of special practices of good governance by a non-listed company can make the company more attractive to minority investors.

Additionally, non-listed companies, can, by means of adopting special practices of good governance, seek funding not only from associated persons (shareholders, parent companies), but also from banks, investment funds, as well as individual investors. External financiers of such type seek validation that their investment shall be treated equally vis-à-vis the interests of majority shareholders. In this sense, corporate governance can become for non-listed companies a significant tool for identifying new funds.

It is for these reasons that the Hellenic Federation of Enterprises ("SEV") set up a committee to consider the promotion of corporate governance principles and practices to non listed entities. This committee delivered its work product to the Greek Corporate Governance Council which, in 2016, approved it and published it.[1]

What the committee proposed and the Council adopted was not another code for non listed companies but the presentation of the main principles governing good corporate governance and certain best practices that non listed entities could adopt (the "Principles and Practices"). Needless to say, as a category, 'non listed companies' is very broad and inclusive and there are tremendous differences among its members. This was one of the factors limiting the specificity of the Principles and Practices. Proposals are based primarily on identifying the common risks, such as the possibility of abusive exercise of shareholder rights by the majority and of the failure of corporate organs to exercise their power and authority fairly and without bias in favor of the majority. The drafters of the Principles and Practices were also driven by their conviction that good corporate governance is not accomplished by imposition but by persuasion, by convincing

1 *The author was the head of that committee. Alexia Tzouni, an associate with the POTAMITISVEKRIS, an Athens based law partnership contributed substantially to the draft text of the Principles and Practices.*

the interested parties of the applicable principles and approach and by inducing them to apply that reasoning and perspective to the organization of their affairs.

The Principles and Practices are purely voluntary, there is no obligation by any party to accept or apply them. This is why one of the main aims of that document is to identify the benefits to companies from improving their corporate governance practices, which relate to:

- Long term financial performance

- Access to new sources of financing

- Reputation enhancement

- Access to know-how

- Improved understanding of governance challenges

- Self-assessment and benchmarking and the ability to take corrective action where deficiencies are identified

- Enhancement of trust by minority shareholders whose rights are better protected and their visibility on corporate matters increased

- Reducing dependency of the corporate entity of specific key-persons

- Generally, greater trust and transparency for all stakeholders.

Given the variety of entities they are supposed to serve, the Principles and Practices propose that non listed entities may choose to implement recommendations gradually and introduce a process that can span two stages.

Stage 1 includes best practices that can be implemented by all non listed entities. However, Stage 2 best practices are recommended only for the larger and more complex entities within that group.

Principles and Practices is divided thematically in 8 parts, some of which have two stages, as explained above, while others are addressed to and may be applied by all non listed entities.

Part A concerns the board of directors and its members. Stage 1 calls for the clear identification and demarcation of the powers and duties of directors and officers, as well as shareholders. The company is also recommended to ensure that the board is composed of persons with the suitable knowledge and experience and that it shall take into account the obligation of equal and fair treatment of all shareholders. In stage 2, the entities are recommended to specify the role and qualifications of the chairman of the board of directors and to also introduce the performance assessment of directors and officers.

Part B concerns remuneration. Here the guiding principles concern the adequacy of remuneration to attract and retain necessary talent and the transparency to shareholders of the company's remuneration policies and cost. Setting and following such policy is not only helpful for the company's performance but also underlines the necessary separation of the corporate interest from that of the controlling shareholder. Remuneration should be set on the basis of clear and transparent criteria which take into account the performance of the company as well as its achievement of short and longer term goals. Shareholders must be given meaningful information from the company to allow them to assess that those criteria are satisfied and that remuneration policies are respected and applied.

Part C concerns the introduction of a system of internal control ("SIC"). The Principles and Practices adopt a two stage approach for SIC. At the first stage, the board of directors is expected to set up SIC, among other things to identify the nature of the risks threatening the company and the acceptable level of risk taking by the company, as well as control activities, information and communication and monitoring. At the second stage, the company is recommended to set up an audit committee composed on non executive board members, to whom the internal auditor shall refer and report.

Part D deals with risk management; boards of directors are expected to compile a risk manual.

Part E concerns compliance. Stage 1 focuses on the protection of the interest of corporation by ensuring compliance with legal requirements and specifically with the avoidance of corrupt practices. This involves the articulation of relevant policies and procedures and ensuring that all parties involved receive proper training. Stage 2 involves the creation of oversight by and regular updating of the board of directors on implementation, as well as the monitoring of events of non compliance and the adoption of measures to avoid similar future incidents.

Part F concerts the treatment of shareholders, specifically communication and dialogue between the board and shareholders, with special care for the protection of minority shareholder rights. Companies are also encouraged to review their constitutional arrangement and consider the introduction of provisions to address risks and problems that have been identified.

Part G concerns other stakeholders. In stage 1 management is directed to assess the impact of the operation of the company on the market and consumers, human resources, the local economy, the environment, its suppliers and society more broadly and to make suitable adjustments to its activities and action plans. In stage 2, the company is expected to elaborate a special programme that will identify all material issues, set specific goals and the means for measuring performance and success in reaching such goals. Those goals and their performance must also be communicated, for instance by means of a report on corporate responsibility.

Of increasing importance for most companies are its information systems. Part H of the Principles and Practices concerns the assurance that the company adopts the proper practices regarding information technology governance. In stage 1, the board is expected to appoint a person with responsibility for information systems that has the requisite training and experience, and to also elaborate a strategy for its information systems in support of its overall business strategy. Among other things the information strategy shall set out current and future information infrastructure needs. In the stage 2, the company is expected to develop detailed policies and procedures for the operation and management of information systems; should address access, data protection, system protection, daily use and user support, information project management, a business continuing plan and a disaster recovery plan.

The Principles and Practices also discuss special challenges confronting family enterprises. Their recommendations concern primarily conflict avoidance and resolution among the family members, equal treatment including also access to information about the company, ways to resolve deadlock that may involve exit strategy for family members, as well as rules and procedures to ensure smooth succession. More generally, it is recommended that the family members develop a common vision for the future of the enterprise, as well as identifying clearly the roles of each member in the company, clearly distinguishing roles within the family from roles in the company. Another important issue is the fair and non discriminatory treatment of non family members who are engaged by the company.

Greece is slowly coming out of a profound economic crisis which left it with a loss of nearly 33% of its GDP, a contraction of 83% of its capital market, a mountain of non-performing loans and other liabilities, a much weaker banking system and a large number of enterprises in distress. As Greece attempts to rebuild its economy on a sounder basis and to produce its new set of stars and champions, the adoption of the Principles and Practices by companies that have not yet approached the capital markets may prove to be of great assistance.

PASSAGES: GOVERNANCE IN CORPORATE TRANSITIONS

Teresa Barger
Co-Founder & Chief Executive Officer, Cartica Management

Cartica Management, LLC is a concentrated, "active owner" in small and mid-cap companies in the emerging markets, actively engaging with management teams, boards, and shareholders to drive long-term, value enhancing improvements in corporate governance, environmental and social factors.

In 1976 Gail Sheehy wrote a best-selling book entitled Passages: Predictable Crises of Adult Life. No crisis ever seems predictable, but that corporations, like people, will have to transit, transform, or tweak is inevitable. And the process is now faster than ever. The average age of an S&P 500 company is now less than 20 years, down from about 60 years in the 1950s. For many companies the mantra is "change or die."

Whether a company is widely held or a family company, it will likely have to shape shift due to fast growth, a change in leadership, a change in its business model (forced or voluntary), or a crisis/turnaround. No matter the scenario, the various components that we collectively call "corporate governance" will likely raise their hands to be counted – or slouch away from their responsibilities. And simply because all companies face their own "passages", it is best that all the elements of the governing mechanism have a degree of flexibility and adaptability.

On fast growth, I think of an Asian industrial company (some details changed for anonymity) whose second-generation patriarch took it from good to great. He built out the best locations, set up the most cost-efficient plants, and created a corporate culture that solicited and valued ideas (good and bad) from every employee. Its period of great expansion was 2013-2016. The stock price tripled over those years. But there was virtually no change in governance. The average age of the Board remained high - 76 years excluding the heir and the compulsory woman. The Board members were all from the same ethnic group. The obsession with cash so common among family companies continued, with cash at close to 20% of assets. ROIC started to slip and dividends started becoming erratic. As investors, we became alarmed when the company was forced by regulation to change auditors. We thought, “Terrific. Now we can get a Big Four auditor!” But nope. The fellow who ran the one-man auditing shop they used before simply closed his shop and formed a two-man auditing shop and that was their new auditor. We had to ask: “Where is the Board? Where are the controls?”. Will some dirty news come out once the third generation takes over or the regulators smell a rat? We do not know. It is possible that all the accounts are pristine, but how can we as investors without access to non-public information know?

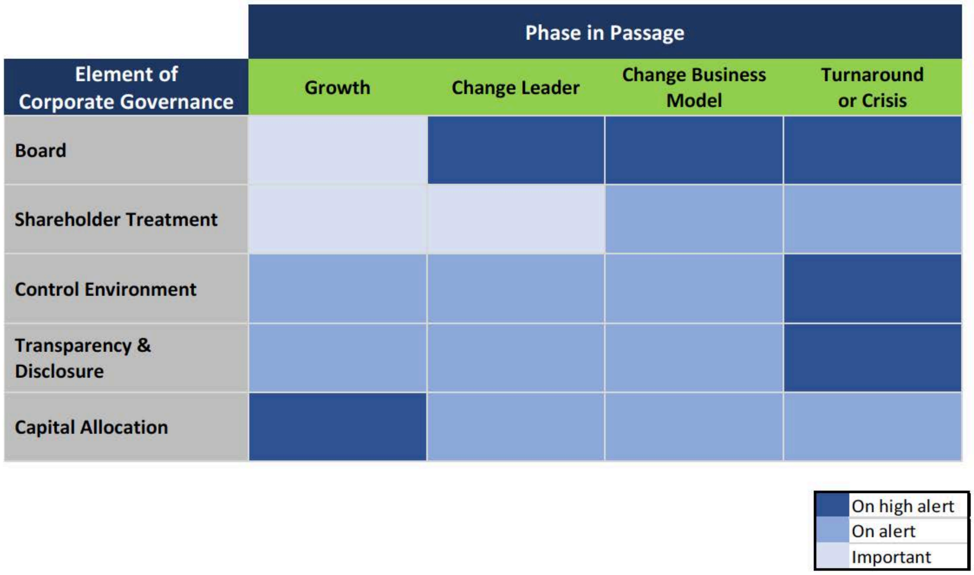
A change in leadership usually requires some shifting of boxes and maybe of mindset. We are in one family company where the executive committee consists of six members – five are family and one is a professional. The announcement that the lone professional is going to leave has been a catalyst for change. Since the professional was the only member of management who talked to the markets, who would now be the face of the company? This has caused the family to rethink all the tenets of a family business. Why do they own the company? What will happen in the next generation (that is not represented in the company)? Is the end game to have a company that endures 100 years or will they sell to a multinational once the youngest sibling reaches age 65? How do they give scope for promotion to younger professionals when all the VP spots are filled by family? And, as often in family business … what is the role of the mother? Should she remain Chair of the Board or would having a sibling take that role free up a VP slot for another professional?

Companies famously have lived or died on whether they changed business models as the world changed. Nokia started out as a shoe company before it was a telecom company. IBM was a hardware company before it was a services company. And sometimes the changes are less dramatic. Natura was a Brazilian company making natural body care products before it was a global company making natural body care products (Aesop’s and The Body Shop).

One truly remarkable shift came when Siddhartha Lal was given control of his family’s company, Eicher, at age thirty. His first act was to sell 11 of the 13 lines of business and focus solely on trucks and motorcycles. To get a Board of Directors to take such bold steps can be exceedingly hard. Gradual evolution is always easier than dramatic deletion or accretion. There’s more visibility on an escalator than in an elevator. From a governance point of view, selling assets and focusing makes many governance elements easier: the control environment is less rangy, transparency and disclosure is less cumbersome, and capital allocation should be easier. But the Board will have to determine if this is the right step for the shareholders.

In the case of Gruma in Mexico, the change of leadership from the father to his two sons resulted in a new focus greatly welcomed by minority shareholders. The sons shifted the major metric from market share to ROIC. They ceased selling Mexican tortillas in Singapore and concentrated on Mexico and the US. The strategy was highly successful.

A crisis is famously the thing you do not want to waste. We have seen companies flounder in crisis: a packaged food company in Asia which was accused (rightly or wrongly) of contaminated



products; a big box retailer in Russia which never recovered from the blow Russia took following the 2014 Crimea invasion, sanctions, and the oil price drop; a Latin American health care company that could not survive regulatory change to insurance rules. Some did not have the financial space to change strategies, some may have taken the wrong decisions, and some may have been blindsided by policy.

We have recently had a ringside seat at a corporate turnaround of a railroad in Brazil. The prior owner had let the assets deteriorate through capex starvation and the new owner was bent on a turnaround. There was no crisis per se, but the owning group created a crisis-like atmosphere. There was a strict five-year capex and turnaround plan as the company adopted Precision Railroading and the highest global standards (which happen to be North American in freight railroading.) The success of the turnaround was reflected in the company's stock rising 1200% from its early 2016 low. This feat required a visionary Board which hired the right leader and set the goals; a steady focus on shareholder return over the long run; a tight control environment; and strict capital allocation. The other element of corporate governance, transparency and disclosure, was also at play – the public knowledge of the five-year plan and the team's performance against plan created a culture of transparency. In addition to meeting plan, the firm, led by the Board, also adopted sustainability metrics as part of both internal KPIs and external disclosure by publishing a Sustainability Report.

When we look at the five elements of corporate governance against these four "passages", we have to say they all matter, but there are times when certain elements may take on accentuated importance.

Using this simple, stylized analysis, one could say that the Board is important in all phases but tends to be more relaxed when earnings are climbing and on alert when the challenges are not just growing pains. In my experience, in the growth phase it is capital allocation that trips companies up most often.

In turnaround or crisis where fundamental change is called for, most of the five elements of corporate governance are being challenged. And, given the constant change and disruption in a world roiled by technology and global flows of information, money, and competition, I am afraid companies are going to need to sharpen all five tools in the corporate governance arsenal. Passages will be constant and tough and probably not as predictable as Gail Sheehy thought.

HOW TO DRIVE EFFECTIVE CHANGE IN YOUR ORGANISATION

Wissam Adib
Advisor, UAE Prime Minister's Office

Wissam is a change expert, advisor and executive coach. For the last 20 years he has been leading or supporting large-scale change, including organizational restructuring, turnaround and institutional reform programs in both the private and public sectors. He is currently the advisor on agile government at the UAE Prime Minister's Office.

"This year we're keeping things more or less the same," declared no CEO in the history of business.

Organizations are vehicles of change. And yet, there remains so little understanding on how to effectively drive change. A statistic that gets mentioned a lot is that 70% of change programs fail to deliver their intended value. Why is this the case, and what more can leaders and boards do to more effectively support change?

The views expressed in this article are the author's and do not represent the views of the UAE Prime Minister's Office.

I've spent almost my entire career either leading change or coaching executives who are leading change. Throughout this time I've noticed behaviors that undermine change programs and prevent organizations from unlocking the maximum value they could. And while boards do not directly manage transformation, they nonetheless have an important role in creating an enabling environment and in supporting the chief executive through it.

One executive I coached had been newly appointed as the general manager of a well-known retail chain in the UAE. The company's performance had been declining over the previous years and the new GM was brought in by the owners to turn things around after the previous GM was ousted. After putting together his turnaround plan he declared that he expected the organization to be running optimally in six months. I shared my expectations that it would more likely take two years, but he was more confident in his estimate than he was in mine (they all are the first time around). This ambitious estimate led to months of frustration with his team, and a perception that they were "underperforming" and "inadequate". They "didn't believe in the organization", and "only wanted a lazy job and a paycheck". Two years later, this executive was moved to another business within the group that had a more urgent turnaround need. I asked him how much he felt he had achieved from the plan he had first put in place. His answer: about 80%.

The story doesn't end there. Just before starting in his new role, he also estimated six months until the turnaround is complete. Luckily, having proven my estimates were more accurate, he listened to me this time before sharing his expectations with the owners.

I see this pattern play out time and again. I certainly made this mistake early in my career. Executives significantly under-estimate the time needed and the level of complexity of the change that they are embarking on. These estimates are then shared with the owners or the board. The result of all this is that the organization spends most of its change journey with the feeling that things are late and that people are resisting the change. This is hardly the kind of environment that fosters the kind of creativity and teamwork needed to implement complex change.

Why does this happen? Why are the people at the top of the organization, who have the most experience, so bad at estimating how long change takes?

The reason is that the change plan, on which time estimates are made, only shows part of the change journey. There is a far more complex, far less visible transition taking place in the minds of those affected by the change. But you won't see this hidden part of the plan in any consulting decks. It is this transition that takes time, and not much can be done to fast-track it.

A relatively new field of study in management and leadership (starting in the 1970's), has been looking at the psychodynamics of organizational behavior, including during times of change. This field is concerned with studying the intersection of organizational behavior and psychology. It was this path of exploration and study that led to discoveries around what differentiates leaders from managers, and how organizations respond to different kinds of leadership.

Work on organizational psychodynamics as it relates to change has uncovered three phases that organizations of any size go through when they undertake change: the ending, the middle, and the beginning.

The Ending

The first phase is the ending. Everyone who has started a diet knows that the first thing you do is have a big dinner and eat everything you desire the day before the diet actually starts. Change begins by saying goodbye to the status quo. This step is often skipped over by leaders eager to get the change underway. Unfortunately, an aborted ending results in months or even years of having to deal with doubts, frustrations, and employee pushback.

Change impacts the habits, relationships, and working practices that employees have established to maximize their productivity. A new organization structure or process can disrupt these, making employees have to work with people they don't know very well and following an approach that is unfamiliar to them. Even the most motivated employees will have some feelings of irritation and inadequacy as they struggle to perform tasks that were once second-nature.

I have seen many leaders interpret the frustrations of employees as resistance to the change, or lack of commitment to the organizational vision. As a result, they push harder, and punish those who speak up. Finally, the commotion dies down, and leaders see that as having succeeded in getting people aligned with the change. In fact they have just created an environment where honesty and openness get punished, and where problems get covered up.

Instead, leaders should speak openly about the difficulties of change. They should acknowledge that change is hard, frustrating, and scary. They should show that they understand that where we are today is somewhere very comfortable and safe, but not for long, and that if we don't act now things are going to get worse. They should also listen deeply to their employees, and not to respond with judgment, but to make their employees feel that their struggles are understood and acknowledged by their leaders.

The Middle

After the Ending comes the Middle, the longest phase and where the real work happens. Different parts of the organization will enter this phase at different times. Here, the organization is thrown into chaos as people try new practices, work with different colleagues, and solve problems in new ways. Not all the new ways will succeed. Some will require persistence until they are understood and mastered, others will turn out to be failures and different solutions will have to be developed. This phase is a highly creative period in the life of the organization where new ideas blossom and real innovation can take place. It is also a period of reduced productivity as a result of the energy spent on experimentation and learning.

I've seen cases where leaders expect employees to hit the ground running with the new change, and they increase the pressure. If failure is punished or look down upon, experimentation will stop and employees will fall back on their tried and true practices. Can you imagine Edison inventing the light bulb with just one chance to get it right and the threat of losing his job or being publicly humiliated if he failed? I would be writing this article by candlelight if this were the case.

The role of the leader here is to provide confidence and safety. As employees try to implement the change asked from them, they still cannot see the finish line and they need their leader remind them that the finish line is real and that they are moving towards it. Creativity requires a feeling of safety. If I am going to take a risk on your behalf, I expect you to catch me when I fall. Failure means that people really are engaging with the change, and trying to develop ways to make things better. Therefore, failure in this phase should be celebrated.

This phase can take months or even years. Eventually practices that work will stick and become new routines, and employees will learn and practice new skills until they become second nature. When this happens, you enter the third and final phase, the Beginning.

The Beginning

The sense of fear and insecurity is behind us now, and the organization experiences renewed confidence in its ability to deliver. If the change is good, productivity will be higher than before the change started. This increased focus on results and a shift back towards work rather than experimentation also means that creativity will drop from the highs of the Middle back to normal levels.

The Beginning is a time for celebration. Leadership should mark the end of the change with an event, an announcement, or another meaningful marker. This boundary event signals the end of experimentation, a lower tolerance for mistakes than during the change, and a shift of focus to future ambitions rather than present struggles. Employees should begin this new era of their organization's life with a renewed commitment, high energy and excitement for what the future can bring.

The Board plays an important role

The role of the board is essential in ensuring effective change takes place in the organization it governs. Too many boards create environments that are not conducive to success, and are then quick to blame the CEO for failing to deliver the results they were hoping to see. Three CEOs later, members of the board start wondering why all leaders are ineffective, rather than looking at what they should do to support the change they are seeking.

There are three things that boards can do to ensure that transformative change programs are executed effectively: they position the change effectively, they take ownership of the corporate culture, and they provide the CEO with the level of executive support her or she needs to succeed.

The signals boards send have echoes throughout the organization. Words travel powerfully through official and unofficial channels, and can undermine the CEO's efforts at change. Therefore, it is important that the communications that boards make are aligned with the change strategy, and that they display their confidence in the CEO and in the organization's ability to implement the change effectively. In cases where a new CEO is brought in to implement the transformation, the messaging around the exit of the previous CEO and the entrance of the new leader should be carefully managed to ensure that a constructive, supportive message is sent to the organization.

As the change plan begins to materialize, boards often feel that their role boils down to pressuring the CEO for quick results. Instead, boards would do better to take ownership of overseeing the changes to the corporate culture. CEOs, being caught deep in the change, will have a harder time noticing these shifts, especially if they are an external hire. Is the change being implemented in a way that is true to the organization's culture? What are the elements of the culture that we are deliberately looking to change, and how do they relate to the history of the organization? For example, in an organization with a culture of rigid cost control that developed during a previous financial crisis, leadership might feel that a more relaxed culture is needed for the next phase of rapid growth. But this change may surface repressed anxiety from the days of the crisis, and this anxiety should be addressed in the change program. Indicators such as staff turnover, absenteeism, and themes emerging from employee surveys and exit interviews provide important information to boards in addition to the official reporting by the CEO.

Finally, boards should ensure that the CEO and the executive team have the right level of support throughout the change. Any change programme involves many surprises and setbacks. On top of that the executive leadership team has to deal with the high volume of feedback and emotions that are channeled its way from within and without the organization. While all this is happening, they also need to have the mental capacity to see the big picture and process their own feelings about the progress of the change. If there are leaders who can do all of this effectively all the time, I have not yet met them. Leaders need someone they can speak to in confidence, and who will not judge them, to help them understand and process everything that is happening and to develop a clear action plan going forward. Usually this means working with an executive coach or a mentor who has previously gone through a similar experience. Time and again my clients tell me that the biggest value they get out of the coaching they receive is clarity about what's happening and confidence in what they need to do.

Change is never easy, but there is so much that can be done to make the results more effective, and more rewarding to shareholders and stakeholders. Understanding the phases of change and the type of leadership that needs to be demonstrated in each phase is essential. Add to that governance that understands the complexity of change and that can create an effective enabling environment, and you've set your organization on the path to extraordinary results.

INTERVIEW WITH PHIL ARMSTRONG

Phil Armstrong
Director for Governance, Gavi Alliance

Phil Armstrong has wide experience of corporate governance starting with large listed companies in South Africa where he was closely associated with the King Reports, notably King II. He has held senior positions with the International Finance Corporation and has been adviser on governance to the Commonwealth Association. Currently he is director for governance at the Gavi Alliance in Geneva.

In this wide-ranging interview he talks to Peter Montagnon about why companies need to work on their relations with society from which they derive their licence to operate. This need applies to both listed and unlisted companies in a world where news travels fast often prompting an instant response from corporate activists. Viewed from this perspective, there is a big difference between corporate responsibility and corporate philanthropy.

Why should companies worry about their relations with society?

Relations with society will determine business success in one way or another. Generally in this very much more transparent world people don't want to think they are being exploited by companies. So it's the old adage about having a licence to operate.

However, the question of what sort of relations depends on the type of business you are in. With banks there are questions of integrity and fair treatment of customers. It's important for a bank to have a measure of trust in the broader community. If you're a large multinational, people need to trust your products and think they're getting a fair deal. It may be different for small IT companies that perhaps have a targeted client, but even they may well be a supplier to a larger company that can be affected by its relations with society – you only have to look at Facebook and Google.

Is this true for privately and state-owned companies just as much as for listed ones?

State-owned companies very rarely get this right because political considerations determine the way they operate. That said, I don't see why there should be a distinction. At the end of the day, it's the way the company is perceived by the public which matters. Privately-owned companies are not necessarily immune and their public image can still face exposure to the media and civil society activists.

Yes but surely family-owned companies start out with the strong values represented by the founder….

At the beginning of their lives, family-owned companies have a better understanding of community and society, because they started life in a community to which they were attached and by which the founding family wanted to be held in respect and had a strong relationship. Later they grow and move away from this and as new generations succeed they take on a broader perspective and their focus may become a lot more economic. Yet the decisions and choices made in the board and by management are still an investment in the long term, probably more so than professionally managed companies. You see that in Latin America, for example, where family businesses make up a strong component of the corporate sector.

So what exactly do shareholders and stakeholders expect?

Of course, there are different types of investor – hedge funds, private equity, asset managers and so on. They all have different approaches, but the general point is that the days of investing in a company and holding for the long term seem to be something of the past and you have this large churn rate. The point is that shareholders are still looking at economic return. They talk about stakeholder issues but I'm not fully convinced.

Yet stakeholders do put pressure on them….

Yes investors do need to be seen to be playing a role in this process. They are themselves increasingly coming under scrutiny. They are being told that they have the power and the authority to make companies do what they're supposed to and the stewardship code movement in some ways demonstrates this point. The very large investor firms have a degree of self-interest in responding. At the end of the day we shouldn't complain about this if it produces a good outcome.

So what do companies have to do?

Companies have to respond. Rules and regulations don't necessarily determine behavior. Shareholders, the media, civil society are all part of the process that does. Society is becoming much more vocal. Technology has created huge access to information which is available in a split second. That gives society a much greater insight, opinion and influence on how things are dealt with. Companies, boards and investors can't ignore that.

Thirty, forty or fifty years ago the Vale disaster in Brazil would have been an issue only for the company, national regulators and local community. Now it's headline news all over the world. This quickly leads active engagement and coalitions between the local community and local and international activists. It happens much more quickly than it used to and can become very difficult to manage.

Who are boards accountable to in all this?

The board is accountable to the company. Directors display this through their reporting as required by the law and regulations and that then starts taking you into the realm of governance and governance standards. Directors have to understand that they are appointed to ensure the continuing success of the company and that they are therefore accountable to the company.

There can be conflicting choices. You have to start looking at what makes a successful business. This is not solely a question of economic return. If you get a bad reputation, people won't buy your products.

I can understand why this process holds good in developed markets, but surely the reputation risk you describe is less in emerging markets.

Western society consumers are much more sensitive to corporate conduct. In the emerging markets it's much less developed, though you do see it in Brazil and South Africa. Elsewhere it's not so widespread, partly sometimes because the media is inhibited from challenge, but even in China you are starting to see a sense of increasing consumer sensitivity with the growth of the middle classes, who are looking for a high quality of life. In China, India and Indonesia the new middle classes are millennials, who are increasingly much more sensitive and socially aware.

The game changes for companies as they expand internationally, especially into Western markets, even if they are not facing civil society pressure at home.

In some markets people consider corporate **philanthropy important. Is this different from corporate responsibility and is it a substitute for it?**

Corporate philanthropy can be an important tradition founded on deeply held social, moral and religious conviction. But this is not always the case, and it can simply become another way of confirming a licence to operate. We need to be careful to distinguish between philanthropy that supports good causes such as the social benefits funded by Tata in India as an example and companies that often use it to favour certain vested interests and seek to buy public respectability.

We also have to look at history. In the early 20th century you saw the development of large corporations in the US. The "robber barons" who ran them were big philanthropists but they were buying respectability.

This has evolved into something much more sophisticated over the course of the 20th century in a society that has become much more demanding in its expectations of companies and those who lead them. Companies operate in a much more sophisticated environment and it is incumbent on the board and management to be very clear about the scope of interests in its activities and how to respond. I should add that philanthropy does not equal social awareness.

How can boards tell if the company is getting its relationships with society right?

It's not just a question of whether your products are rolling off the shelf. You have to be aware of what's being said out there in the market and which is not coming through in internal memos. Consumer surveys are one source, also what investors say. Essentially boards should also be aware of what's being said on social media and use the many tools it has at its disposal to trace public opinion and identify communication gaps and potential risks, especially reputational, among other things.

And when social media has got it wrong?

Companies can't just sit there and say it's all a lie. Part of their risk strategy has to be about how they manage misleading reports. You have to have a communications strategy that understands the risks of very visible social media posts and the extent of mischief around that and misinformation.

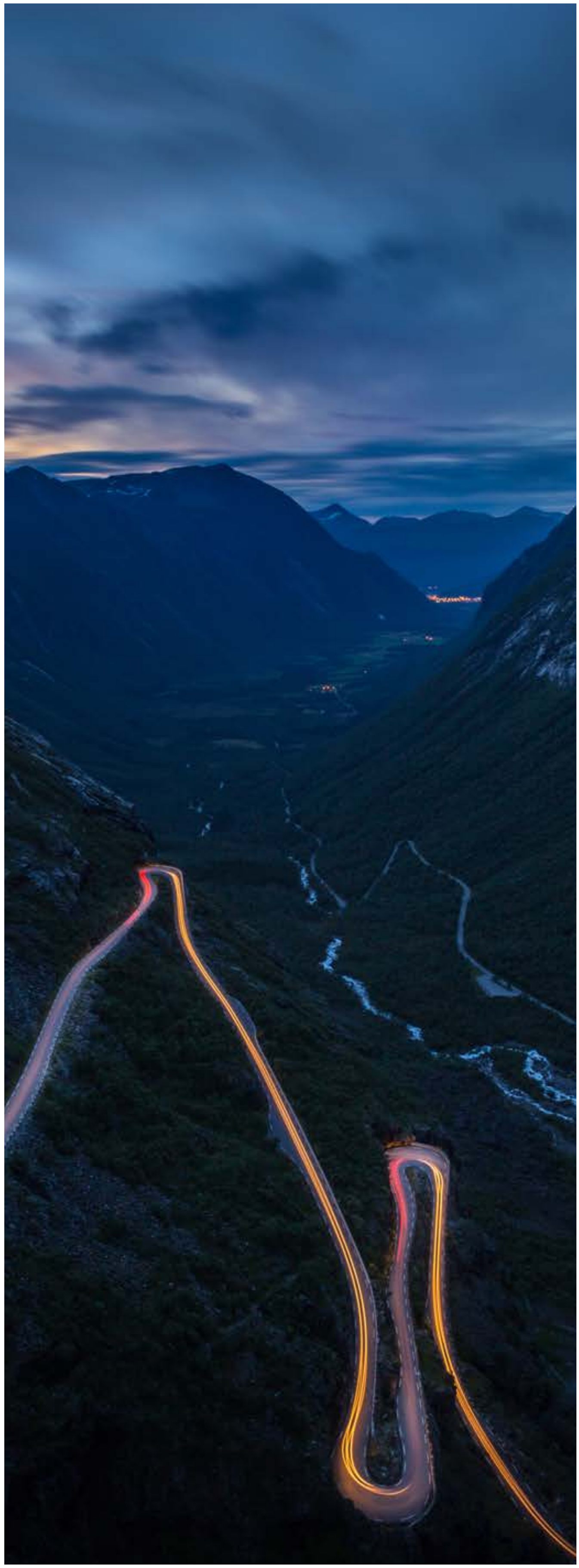
Surely employees are a very important stakeholder.

Yes, very important. In these days when you have massive disparities of income between the lowest paid and senior executives, these things get picked up. Employees want to feel they're not being exploited. That's another reputational issue for the management of the company and for the company itself. It's important to civil society and to investors, but it's also important to the welfare of employees and their communities. That's where the more traditional family companies are often successful given their close affinity with the communities from where they originate.

Employee sentiment surveys can be an important source of information, especially if they are carried out independently and can highlight disparities between what the company believes about itself and what employees may themselves believe. It takes a certain measure of courage. Management may not be very comfortable, and it can be even more difficult in family businesses, but boards need to be clear about the importance. Satisfied employees are an important window on the company.

Are all these social issues particularly important for companies which aspire to public listing?

In the old days that was the big driver. For example, the need for higher standards of governance was why the Novo Mercado was created in Brazil. This is still true today but nowadays it's more about the fact that we live in a global economy where information and events are no longer a matter only of local interest and can become a matter of global interest with potentially significant consequences. The struggle that the banking sector has had in redeeming its credibility since the financial crisis in 2008 illustrates the challenges when the school of public opinion turns against you.



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