The Guide to Global Corporate Governance Developments
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THE ACG REPORT

ACG Company Watch | Corporate Governance | Press Review

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Introduction

It is becoming increasingly widely accepted, fashionable even, to acknowledge that corporate governance needs to take account of the wishes and needs of a wider group of stakeholders than simply the owners, and must recognise a social responsibility. More recently, the idea is spreading that the employees need to recognise their personal responsibility to act in an ethical way and that the example should be set by those who lead the company.

In the last few weeks we have seen a number of examples where companies have been taken to task for bad corporate behaviour and fined large sums by way of penalty. But corporations are impersonal beings, not human, and can only act as driven by the people who work in them.

Golden Rules

The Key to Good Corporate Governance

Do you know the rules?

Our simple approach to corporate governance focusses on running an organisation well for its continued survival, growth and the good of all. Here's a reminder of our fundamental principles of good governance:

- **Ethical culture** espoused by leadership and extending throughout the organisation
- **Clear, congruent goals** aligned with the agreed values of stakeholders
- **Sound strategy** for achieving the agreed goals, taking into account all stakeholders
- **Organisation** resourced and capable of delivering the strategy
- **Transparency** and accountability through effective, two-way communication.

Compliance to external codes is not an indication of good governance. Living and running your organisation by these principles will naturally lead to compliance.

If you need help with either the implementation of these principles and/or ensuring this also demonstrates compliance with the specific codes in your region, contact us at info@applied-corporate-governance.com

In the headlines this month

Volkswagen

VW has been in the news for nearly 18 months, but recently the shells have been falling closer to home. Early in January, former CEO, respected engineer, Martin Winterkorn, was told by a Californian judge that he had to face an investors' lawsuit in the US for misleading investors about the emissions trading scandal. Later, US prosecutors filed criminal charges against VW's former head of compliance. And, back home, German prosecutors are now investigating Hans Dieter Pötsch, chairman of the Supervisory Board, and Mr Winterkorn. In response to questions from a committee of German MPs, Mr Winterkorn, a manager with a reputation for meticulous attention to detail, said he was surprised no-one had told him about the emissions problems earlier [before it all blew up]. Sadly, he's surely damned if he's lying about not knowing, or damned for incompetence if he really didn't know.

Equally, the aura of cosiness in the governance of VW between the controlling families, the unions and the state government surely created the culture which has led to three scandals over the past twenty five years. And the growing notoriety of VW's governance tarnishes the reputation of its top managers, who will be seen to be complicit in reprehensible behaviour. It's not VW which is behaving badly. It's the people who run it.

Samsung

On the other side of the world, Samsung, one of South Korea's leading chaebol business groups, has been in the news for different reasons. In recent years there has been growing public concern at the huge wealth of the controlling families of these chaebols and the complex measures adopted to maintain this control between generations, despite a 50% inheritance tax. Indeed, Samsung was criticised for such a transaction in the late 1990s which was seen as hugely benefiting the heir apparent, Lee Jae-jong, at the expense of minority shareholders.

The current Korean president, Park Geun-hye, was perceived as taking a relatively benign approach to the chaebols in her time in office. However, this month, the chaebols have been drawn into the scandal which may cause President Park's resignation.

The President's long time personal adviser, Ms Choi Soon-sil, has been accused of using her personal influence to direct funds towards her private interests and some have accused the President of assisting these alleged actions. Now prosecutors have secured the arrest* of Samsung's Mr Lee in connection with the scandal surrounding the President on the grounds that Samsung made a big donation to a charity controlled by Ms Choi, supposedly under pressure from the President, to get a favourable verdict over a planned company merger. The arrest puts further pressure on the governance of the chaebols, and the potential next president has promised to introduce new laws to weaken the power of the controlling families.

Once again, though, there is nothing, in principle, to prevent a change in corporate behaviour now – except that turkeys seldom vote for Christmas. The people who control companies need to take personal responsibility for the behaviour of their companies. Disproportionate wealth doesn't accrue to the controlling families by companies responding to some independent law of nature.

Toshiba

Also in that part of the world, we have another giant brought low by the creators of a bad culture. Two years ago, a panel of external lawyers and accountants found that Toshiba had been overstating its results since 2008, despite layers of compliance procedures and controls introduced in response to government pressure to further good governance. A relentless focus on profits proved too powerful for the good intentions. But the subsequent write-off cost Toshiba's shareholders over $1bn, relating to its nuclear and semiconductor businesses. Nearly half the board, including the CEO, left as a result.

But the costs continued to rise as the investigations proceeded under new management, including a large fine from the Japan Stock Exchange. By the end of 2015, losses were being projected at $4.5bn and the Securities Exchange and Surveillance Commission were seeking to levy a fine of nearly $60m. Its Secretary General was quoted as saying that "the problem will occur again unless we fix the root cause", and was considering filing criminal charges against former executives. The next head to roll was that of the boss of EY's Japanese firm, whose audit staff had failed to spot or act upon the accounting malpractices.

By the middle of 2016, Toshiba had a new CEO and was facing many lawsuits. It was also facing questions over its capital strength and having to cut jobs and sell businesses. And by the end of 2016, there were headlines that Toshiba was facing a fight to survive after it announced a multi-billion dollar write down of its US nuclear business. Its solid gold reputation was now lost forever and in 2017 it is facing some kind of state-sponsored rescue. But it was the culture that brought it down. That culture was created and fostered by the leaders of the business over many years, and it is surely right that the law suits it is facing name some of the key executives in addition to the company itself.

Wells Fargo

Now we go across to the Western hemisphere for another example of egregious behaviour by the controlling elements of a major company. Here are two current quotes from the Wells Fargo website:

Wells Fargo's reputation as one of the world's great companies for integrity and principled performance depends on our doing the right thing, in the right way, and complying with the laws, rules and regulations that govern our business. We earn trust by behaving ethically and holding all team members and directors accountable for the decisions we make and the actions we take.

Then a message from Tim Sloan, the current CEO:

Ethics and integrity are as critical as ever while we work to rebuild trust and restore pride in our company and mission. As one of our five shared values defined in The Vision & Values of Wells Fargo, "Our ethics are the sum of all the decisions each of us makes every day"

This Vision and Values document was first published twenty years ago. So how did it come to pass that the board and top executives allowed all this to be put at risk by permitting a widespread practice of creating sham accounts in its community banking division?

Wells Fargo had been built from a small regional bank into the most valuable bank in the world by market capitalisation. It had come through the banking crisis well and had built a reputation for very successful cross selling of its products. All this carefully built reputation was badly damaged when an investigation published in mid 2016 showed that for a number of years, over 5000 staff at various levels had been fired for hitting sales targets by creating 2m client accounts without telling those clients.

The sums involved were trivial in relation to the bank's nearly $2 trillion assets, and even multi-billion dollar litigation costs won't make a dent in its c$25bn annual profits, but the reputational damage is incalculable. The actions taken to mitigate this (resignation of the CEO, scrapping of share entitlements and public apologies) haven't taken the stain away. Blaming "rogue employees" doesn't wash. And, as so often happens, the problems keep coming. In December, the insurance giant, Prudential, was drawn into the scandal as it was alleged that its policies had been sold without the customers' consent. Prudential then suspended its distribution agreement with Wells Fargo while it investigated. Meanwhile, new account openings continued to drop, and the insurance company's own reputation risks being damaged.

There can surely be no question that the (erstwhile) much lauded high pressure sales culture was actively supported (driven) by the top management, and employees who failed to deliver were put under very great pressure to achieve their targets. In this situation bad things happen. So 5000 staff get fired, and ultimately the CEO resigns in his mid 60s with assets beyond most peoples' wildest dreams. Is this fair?

Swedish corporate governance

Finally, back to Europe. In early January of this year, the FT ran an article about Fredrik Lundberg, the respected chairman of Industrivärden, one of the two huge Swedish investment companies. He had been brought in towards the end of 2015 to clear up a messy situation after a corporate scandal in which his predecessor had been accused of making improper use of the corporate aircraft for personal benefit. Following his arrival, Mr Lundberg executed a major clearing of decks, appointing a new CEO and commencing an unravelling of cross shareholdings in the corporate portfolio in the interests of better governance. He ran his own family investment company in a hands-on way, and set himself the goal of creating value at Industrivärden through taking a long term view. Hence, he approved of the controversial use of multiple classes of shares, having different voting rights, as the means of securing the company's long term future through the implicit power of a select group of long term investors. All very commendable and to be applauded.

But what happened next was a surprise, though possibly an accident waiting to happen. In an FT article less than four weeks later, it was reported that Mr Lundberg was being questioned by the anti-corruption prosecuting authorities on suspicion of bribery.

It sounds very dramatic, but the matter under investigation seems to have been no more than standard "networking" practice by leaders of industry. Mr Lundberg had elk-hunting interests and apparently elk-hunting parties are enjoyed by all classes of Swedish society (much as fox-hunting is in the UK). However, Mr Lundberg's problem is that a couple of years ago, he invited a former finance minister and old friend to one such gathering and, following his friend's resignation as a minister, he allowed one of his companies to pick up the bill, instead of charging the erstwhile minister.

The issue here is really that the leaders of business are seen as using these hunting expeditions as business networking occasions, to be paid for by their companies. And this is surely the unacceptable aspect to an egalitarian Swedish society.

Mr Lundberg denies any wrongdoing, and he's probably correct. But his mistake, surely, is to have set a bad example when leading a cleaning of the Augean stables at Industrivärden after just such inappropriate exploitation of company privileges.

These are just a few cases where top management and directors have shown poor judgement and set a bad example to their employees. And the poor old company gets the blame for the actions of its drivers. There will be more such cases next month, sadly.

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We hope you have found this first ACG Report useful. We will be building up the range and types of content included in the report over the coming months (for example regional updates from our correspondents around the world), so would like to hear from you to find out what you would most like to see included.

As you will appreciate, researching and producing these reports, not to mention the large amount of free content published on the website and the blog, takes time and we would like to ensure we are able to continue providing the best quality content to readers around the world. We have therefore decided to launch The ACG Report as a premium offering, albeit for a very modest cost and after offering you, our valued subscribers, free copies for you to evaluate.

If you would like to participate in our reader survey, please click on the link below - it should take you less than 2 minutes to complete:

https://survey.zohopublic.com/zs/y8B03L

As a thank you for for taking part, we would like to offer you 75% off the first year's subscription when we launch the paid version of this newsletter, following your feedback. If you are on our mailing list, we will send you details and your coupon codes by email.

Ongoing governance research

With our global reach, one of our goals is to be a source of unique first hand research and to include key findings in this report. To that end, we would like to invite you to participate in our Applied Corporate Governance Research Foundation. This initiative, along with other online projects, will be run as a Social Enterprise, with 100% of profits being redeployed to improve and increase the research and analysis of the data collected.

If you decide to participate in the programme, you will have free access to the data plus discounts on the reports analysing them. Please email us at the address below for more information.

* Updated from original January issue; the arrest of Samsung's Mr Lee took place on 17 February.

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