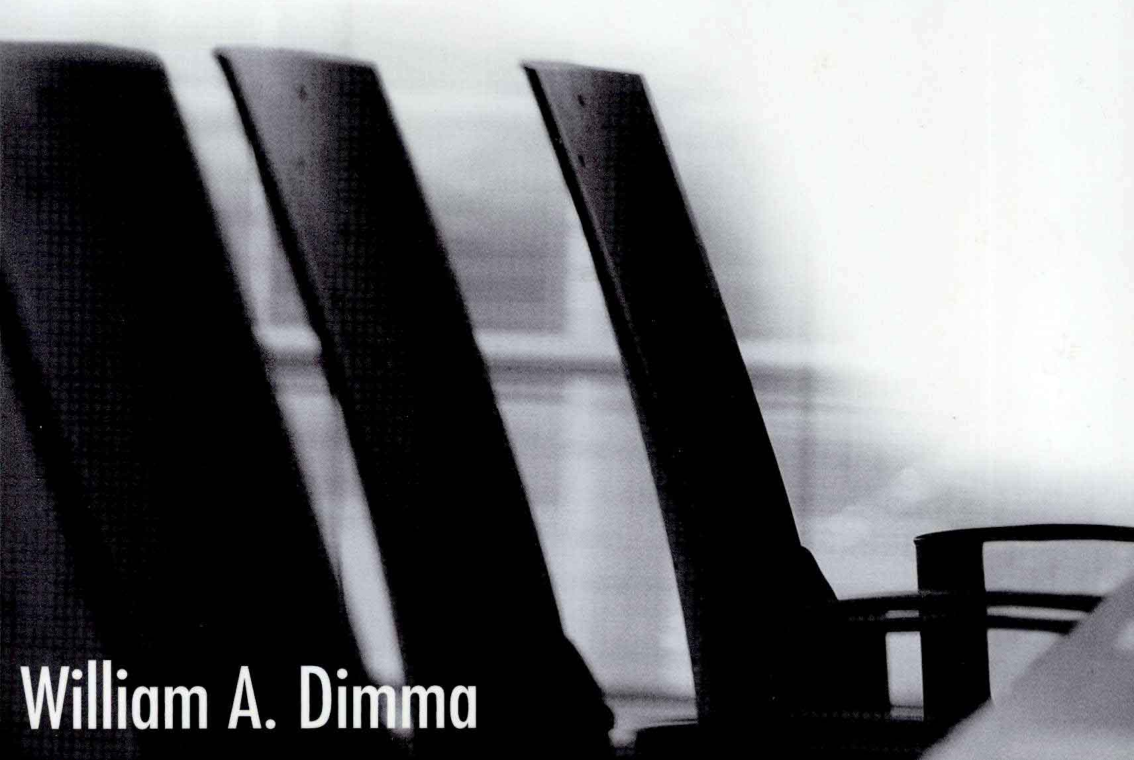
TOUGHER BOARDS for TOUGHER TIMES

Corporate Governance in the Post-Enron Era



William A. Dimma

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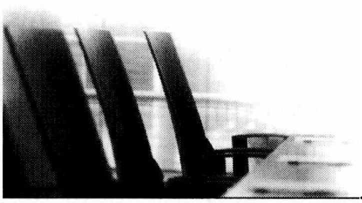


Foreword

— *Bernard R. Wilson, FCA, ICD.D*
Corporate Director and Chairman of the
Institute of Corporate Directors

LIKE A FINELY tuned athlete, Bill Dimma has once again "hit the governance ball out of the ballpark" with his new book *Tougher Boards for Tougher Times*. Following on the success of *Excellence in the Boardroom*, which is a must-read for any aspiring or experienced director, Bill Dimma has effectively gauged the marketplace and business environment and written a book for today in which he aptly describes the new work of directors as "… demanding, time-consuming, risk-laden, largely thankless and, well, tough and tougher."

The author covers all the post-graduate issues critical to directors, including the new regulatory landscape, time demands, compensation, risk and even ethics; the book is notable for both breadth and depth. However, the publication is made worthwhile by the chapter on "The Director with Character" alone, which should be committed to memory by all, so that everyone can rally around his call to "Bring it on." The book is generously filled with the experience of a lifetime of directorships—a motherlode of wisdom that few can match. This is why so many people respectfully call Bill Dimma the "Dean of Directors in Canada." Bill never holds back and always puts his best counsel and advice on the page for all to benefit from, and I, for one, am truly grateful for another gem to be added to my library—and that of every director, I hope.

I am confident that in this latest book, members of the Institute of Corporate Directors, and also the directors of the future, now have another "must-read" by Bill Dimma, which I know they will come back to time and time again.

Foreword

by Richard F. Haskayne
Board Chair Emeritus, University of Calgary

Corporate governance has always been important to the success of our free enterprise system. One important book, *Excellence in the Boardroom,* on this subject was written by Dr. Dimma in 2002. The new book, *Tougher Boards for Tougher Times,* takes on new relevance as the world has become aware of the catastrophic results of ineffective corporate governance. The most familiar recent example of weak corporate governance is reflected in the Enron case, which has been so widely chronicled. As well, there have been numerous other cases of equal importance in the United States, Canada and Europe. All of these high profile cases have been covered in detail in the press and many of them have been the subjects of authoritative books. *Tougher Boards for Tougher Times* was written subsequent to Enron and does a masterful job of outlining the issues that caused the downfall of Enron and placing those issues in an historical perspective.

Bill Dimma is a very good writer with an exceptional understanding of corporate governance by virtue of his having served on more than fifty corporate boards over a period of more than forty years. I personally have had the good fortune of serving on two of those boards with him. Accordingly, that relationship allows me to comment on this new publication and I am honoured to do so. In fact, I can think of no other director who has the length and breadth of experience in corporate governance issues as Dr. Bill Dimma.

The book is highly readable and designed in such a fashion that, after the first reading, a person can easily identify important subjects which can be used for reference in the practical application of specific governance issues. Dr. Dimma has outlined virtually every situation that a corporate director could face. He explores each issue with a history and an update on current thought. Perhaps of greater import, he provides his own personal observations, based on his vast knowledge and experience in the corporate boardroom.

There are many governance issues still in the process of being resolved, and the information in this book will help readers formulate their own views on these topics. For example, Dr. Dimma does a superb job of discussing the role of the non-executive chairman and covers it in detail, including the time demands on the position and the differences in the philosophical approach between Canada and the United States. I know, having served as a non-executive chairman of several companies, that this subject alone is critical to governance and should be followed closely by directors, particularly those serving on U.S.–based boards.

The controversial issue of senior executive compensation is another difficult challenge for directors, and once again Dr.

Dimma covers the subject in a way that reflects the reasons for some senior executive awards becoming so inflated. His unique approach to the subject is based on many years of handling this delicate matter. He also deals with related subject such as stock options and other compensation mechanisms, including pension benefits. Also included is information on how human resources consultants can be useful, along with a clear explanation of their reporting relationship with the board and management.

Sitting on board committees has become much more demanding in recent years. For a more in-depth treatment of a specialized subject, Dr. Dimma has called upon the expertise of Ken Hugessen to explain the role of the human resource and compensation committee and provide valuable insights based on his own personal experiences.

The role of audit committees has taken on an unusually high profile and responsibility in recent times because of significant overstatements of financial results in cases such as Enron. As a result, the composition of the audit committee has been under scrutiny and significant changes are now being implemented to ensure a much more thorough examination of the corporation's finances. David Smith has contributed an expert chapter covering all aspects of this subject, including views of professionals from the world of finance and accounting.

A third expert contributor, Bob Harding, has contributed a chapter on governance and nominating committees, filled with valuable information and wisdom gleaned from his experience in that area. These three chapters on committees form a little reference section in themselves.

This book offers a wealth of practical advice, based on real world examples, on such important subjects as ethics, social responsibility, interpersonal relationships with directors and management, and the issue of directors' liability. The author even counsels the reader on matters to consider before accepting a board invitation, as well as the problems associated with leaving a board. In my experience, these matters are often overlooked, particularly when people are joining a board for the first time.

Not only will this book be useful for people interested in governance of corporations, it also includes an important section that covers the major differences and similarities between corporations and "not-for-profit" institutions. The analysis in this book will provide an excellent reference for the thousands of people who sit on not-for-profit boards but lack experience with respect to standard corporate procedures.

Because of the practical examples offered on every subject, it would be hard to find a matter facing directors that has not been covered in this book. Accordingly, the book should have wide appeal to existing directors for all types of institutions, as well as officers and employees of those organizations. In addition, it will appeal to the many other stakeholders of institutions that have an interest in governance—including shareholders, bondholders, customers, investors and, in the "not for profit" world, contributors to the organization, as well as those receiving the benefits. All these stakeholders will find Dr. Dimma's insights invaluable.

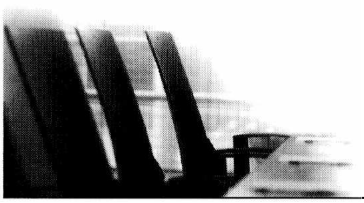
Another audience that could benefit from this book is that of business students, who at some point in their career are likely to be involved in the governance of various types of institutions. Here, the experience of the author on every governance subject will provide an excellent reference that will stand the test of time.

Having served on twenty public corporate boards over the past three decades, as well as on dozens of charitable and community boards, I can say that this book is a worthwhile read for even the most experienced director.

Richard F. Haskayne, O.C., FCA
Board Chair Emeritus, University of Calgary

Mr. Haskayne's past positions include:

Chairman, TransCanada Corporation
Chairman, NOVA Corporation
Chairman, TransAlta Corporation
Chairman, Fording Inc.
Chairman, MacMillan Bloedel
Chairman and CEO, InterHome Energy
President and CEO, Interprovincial Pipeline
President and CEO, Home Oil Limited
President, Hudson's Bay Oil and Gas Co.
Director of twenty public companies and numerous charitable boards



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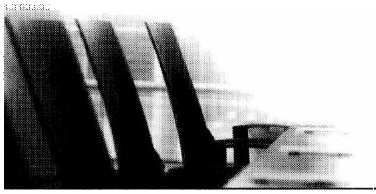

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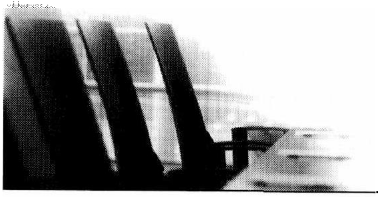

Introduction

There are excellent books out there in the market on the formal duties and legal liabilities of corporate directors. This is not such a book, although I touch on these themes from time to time.

In general, I want to focus less on what must and must not be done, much more on processes and behaviour that seek to promote the best interests of the corporation and its shareholders. It need hardly be added that such processes and behaviour must always be fully consistent with both the law and the legitimate interest of other stakeholders.

This book is named *Tougher Boards for Tougher Times* to underscore the obvious. As any director can wryly attest, sitting on a corporate board these days is not the sinecure (or piece of cake for those who prefer metaphor) that it was a generation ago. It's demanding, time-consuming, risk-laden, largely thankless, and, well, tough and tougher. And while director compensation is considerably better than ever before, there are some who feel that it is still insufficient to justify the combination of workload and risk that is part of a director's stock-in-trade these days.

Several years ago, Adam Zimmerman wrote a book with an apt and prescient title: *Who's In Charge Here, Anyway?* In a corporation, where does the buck finally stop? In law, boards hold all the top cards, all the power ... in theory. In practice, they continue to act far too often as if they didn't.

The reasons for this gap between theory and practice will be discussed in more depth throughout this book. But they can be encapsulated in this equation: Knowledge plus time plus resources equal power.

If I'm a CEO, my senior colleagues and I each work between sixty and ninety hours per week. Less doesn't cut it in today's extraordinarily complex and demanding environment. If I'm a director, I attend—let's be generous—eight board meetings and another eight board committee meetings per year at—again, let's be generous—four hours per meeting. This adds up to sixty-four hours per year, plus an equal amount of preparation time for a total of one hundred and twenty-eight hours per year devoted by a typical director to a typical board.

Some boards will, on occasion, demand more time: a company confronting a hostile takeover or initiating a major merger may meet a couple of dozen times a year. Some boards blessed with an environment of profitable stability (a utopian consummation devoutly to be wished!) may devote fewer hours than the average. But for most corporations most of the time, the numbers I've cited are typical.

The resulting comparison is startling. If the typical director devotes 128 hours per year to a corporate board, the typical CEO devotes between 3000 and 4500 hours per year to a corporation. And standing behind that CEO is a dedicated management team plus a rich range of capabilities and resources in terms of both staff and dollars.

This wide discrepancy in time, knowledge, and resources explains why, over the century and a half of the post-industrial revolution era, power migrated from ownership to management. Nevertheless what has evolved is no longer acceptable. And while it is important to remember the old lesson of the baby and the bath water, the lessons from the many corporate fiascos of the past several years cry out for adjustments to the balance of power between managements and directors who represent shareholders and ownership.

While imperial CEOs—at the moment, a breed out of favour but hardly extinct—will fight at every turn against any serious transfer of power from managements to boards, at last the tide has begun to turn. And the direction is as clear as any prediction about the future—capricious as always—can be.

Public outrage is high and is very likely to remain high as the long list of corporate disasters lengthens further. Too many influential segments of society are not amused by the incendiary mix of financial manipulation and outright fraud that has characterized too many corporations. Granted, they represent only a small fraction of the corporate population but still their numbers are far too high. And the sins of the few are visited on the many: distrust is widespread, even of the innocent.

However, there remains a dilemma. On the one hand, if knowledge plus time plus resources to command add up to corporate power, all the laws and all the corporate governance may not be enough to shift the locus of that power as far as it needs to be shifted. On the other hand, the great body of corporate law combines with best practice in corporate governance to make it clear that the balance of power must be shifted. Managements must cede power in critical areas to shareholders through directors acting on behalf of those shareholders.

I note in passing that both the kind and magnitude of shift needed will vary greatly between widely held corporations and those where one or more corporations or individuals are sole or controlling shareholders.

Only quite recently has the pressure to change some of the rules of the game intensified. In their ground-breaking book *The Modern Corporation and Private Property*, published in 1932, Adolf Berle and Gardiner Means identified clearly and early this major shift from owner-managers to hired professionals. But it took nearly seventy more years and the many corporate disasters and senior executive peccadilloes of the last two decades to move public opinion from tacit acceptance of that situation to a strident demand for change.[1]

Several constituencies have finally begun to flex their muscles and to demonstrate increasing clout. Why? Because—to repeat—there have been an unsettling number of outrageous examples of companies ruined or their reputations deeply sullied by power imbalances favouring managements.

The mass media's coverage of CEOs and CFOs doing that infamous perp walk is not reassuring to shareholders and their investor representatives: pension funds, mutual funds, and financial advisors of every stripe.

1. "An era can be said to end when its basic illusions are exhausted." (Arthur Miller) Has it been an illusion to believe that powerful CEOs will routinely put the interests of shareholders ahead of their own?