



One Planet Ventures

Overview: The US Governance Model

CFI Governance Working Group Presentation

by

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What drives the US corporate governance “model”?

- Sometimes referred to as “*Anglo-American*” governance model, since many elements are similar in UK and US.
- The separation of ownership from business control: the rise of equity financing via NY & London stock exchanges in 20th century (and the global importance of these markets) led to development of corporate governance principles focused on *shareholder* rights. Exchange-related regulations brought greater transparency and disclosure obligations for corporate issuers.
- At inception, corporate governance principles and market requirements focused on individual investors. In recent decades, institutional investors have become more prevalent, which has influenced the evolution of governance practices:
 - In UK, 62% of shares were owned by institutions in 1981, rising to 86% in 2004
 - In US, institutions owned 34% of shares in 1980, rising to 77% in 2006



Key features of the US Model

- Single tier governance: Each company has a single Board that includes “insiders” aka “executive” directors who are either employed by the company or have significant ties to corporate management, together with “outsiders” or “non-executive” directors who have no direct relationship with the company or its management.
- Leadership Duality: Company CEOs are empowered to serve as Chair of their corporate Board, which is prohibited in two-tier governance systems. Depending upon your viewpoint, this either increases Board responsiveness to corporate concerns or reduces Board independence.
- Standing Committees: US Boards typically create permanent committees such as Audit, Compensation and Nomination, ideally overseen by non-executive Board members and often required by law or exchange listing requirements.
- Minority Shareholder Rights: Special regulatory provisions ensure that minority shareholders are allowed to participate in governance structures, including voting rights.
- Disclosure and Communication: The US has comprehensive disclosure requirements across a wide range of information and a complex, well-regulated system for shareholder communications.



Advantages of the US Model

- Protection of Minority Shareholders
- Board functions permit the separation of decision-management from decision-control. In other words, management frames the strategy debate, but Board approval is needed to finalize strategic decisions.
- Both executive and non-executive directors participate in setting strategy and managing risk, theoretically ensuring a balance between knowledge of the company's strengths, weaknesses and competitors with broader insight on the economy and operating environment overall.
- A single tier Board is more cost-effective than maintaining separate management and supervisory Boards and able to respond more rapidly to changing market conditions.
- Significant disclosure requirements provide transparency with regard to corporate operations and performance.



Weaknesses of the US Model

- Concentration of Power: Where the company CEO serves as Board chairman, a great deal of power is vested in that individual. The excessive levels and growth rates of CEO pay are viewed as highly correlated to this phenomenon.
- Loss of Independence: Although notionally the presence of independent (non-executive) directors serves as a control on management ambition, in practice, they are subject to the influence of the CEO/Chairman and the knowledge that their actions are transparent vis-à-vis executive directors. It is harder to vote against an increase in executive compensation when the potential beneficiaries of that vote will continue to sit next to you at Board meetings.
- Fiduciary Responsibility viewed with a Profit Maximizing Lens: In contrast to stakeholder governance models, the US model spares little thought for the role of the corporation in modern society and thereby places little emphasis on the social or environmental impact of corporate decisions.



Implications for Microfinance?

- How do we ensure that our governance practices reflect the values and principles inherent in our mission statements and theories of change, i.e., the role of a corporation / social corporation in modern society?
- What elements of the US model are most appropriate for microfinance governance? Would our recommendations for the governance of microfinance equity funds be substantively different than the governance of microfinance institutions in this regard, due to regulation or otherwise?
- As global financial markets grow more integrated, the “good practices” dialogue has come to include talk of hybrid models and convergence across developed market governance frameworks. Do we in microfinance need to be consciously engaged (somehow) in this broader dialogue?
- Are there aspects of governance practice that we believe SHOULD be different for microfinance than for general corporate governance? For example, should we advocate for the use of a standing Social Impact Committee alongside Audit?
- Should we follow global corporate governance trends (i.e., maintaining separation of the CEO and Chair roles, the Norwegian attributed ownership approach) or advocate for a hybrid of our own invention, or both? If we think there’s a need for a global microfinance hybrid, how would we envisage the collaboration taking shape?
- Are we talking about integrating shareholder and stakeholder-focused governance models or do we need a broader multiple bottom-line framework of some kind?

A Stakeholder Approach Towards Governance (Focus on Shareholders, Employees and Clients)

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Two-Tier vs. One-Tier Governance Systems

Two-Tier Structure

Management Board

The management board refers to the executive committee of an organization that manages the day-to-day affairs of an organization and represents the organization.

Supervisory Board

The supervisory board is not involved in the day-to-day running of an organization. It oversees the management team, helps to shape the strategy, and safeguards the interests of an organization.

One-Tier Structure

Board of Directors

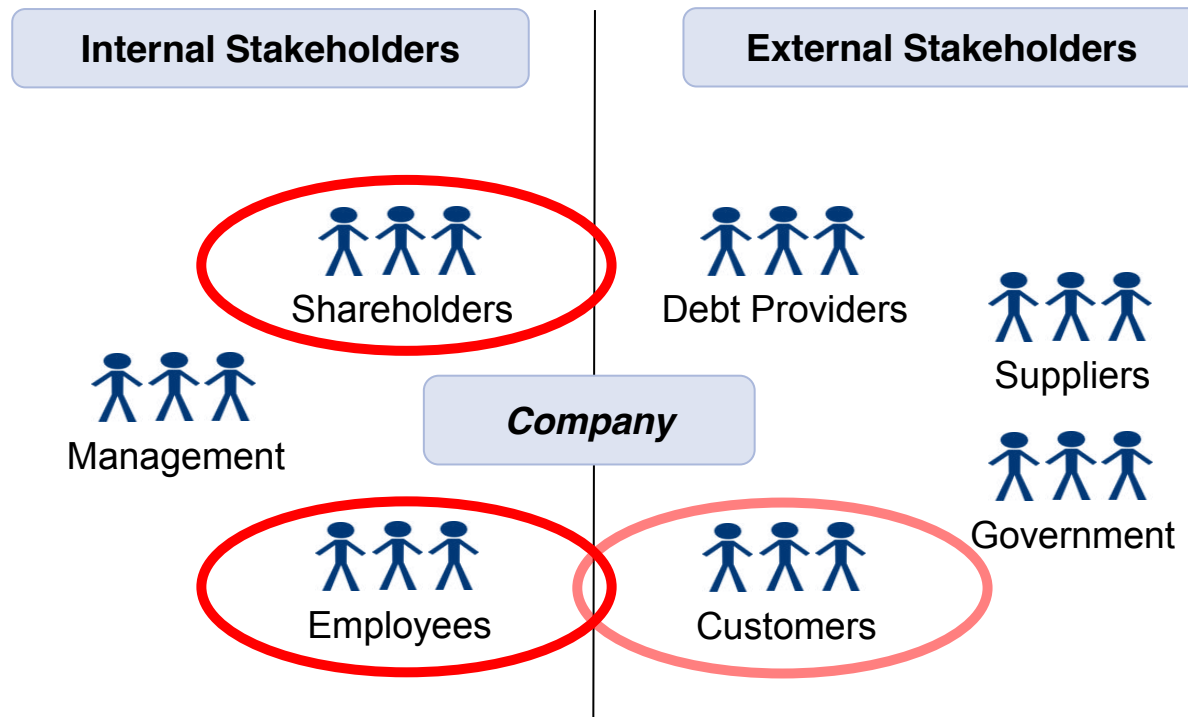
Executive Board Members

The executive members of the board of directors have the same tasks, duties and rights as members of the management board.

Non-Executive Board Members

Non-executive board members have the same duties and rights as supervisory board members. Their tasks usually pertain to oversight and consulting of the executive members.

Companies as Parts of a Broader Community



Those who have a stake in the functioning of the firm are made up of large and diverse groups.

Shareholders and Employees as Major Stakeholders

SHAREHOLDER

Financial Capital

- Duty of management to protect interests of shareholders.
 - Shareholders stake uniquely tied to the success of the firm; no residual value should firm fail.
 - Liquid market.
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- Fiduciary duty

EMPLOYEE

Human Capital

- management should make decisions for the benefit of all stakeholders
 - “illiquid” market
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- Moral duty



Most **shareholders** can sell their stocks far more easily than most **employees** can find another job.

Example: Employee Representation – Germany

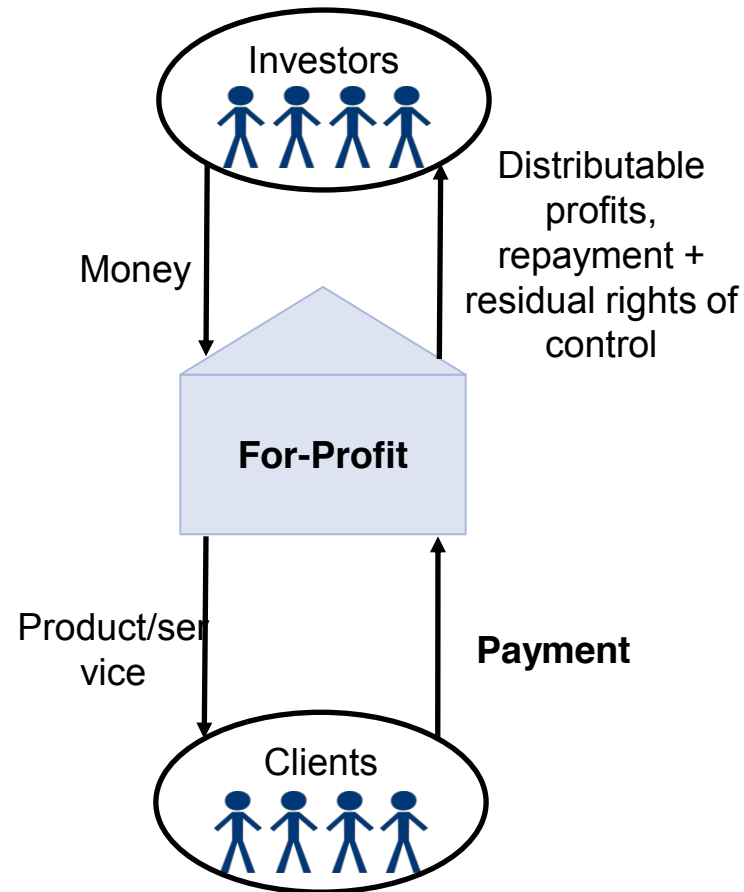
Companies with more than 500 employees:

- Law pertaining the one-third participation of employees in supervisory boards ("Drittelbeteiligungsgesetz")
- One-third of the supervisory board members must be employee representatives
- Number of board members must always be divisible by three (maximum: 21)

Companies with more than 2000 employees:

- Co-determination act
- Half of the supervisory board members must be employee representatives
- Board has either 12, 16 or 20 members
- Supervisory board with 12 or 16 members: Two of them have to be representatives of the workers' union (20 members: three representatives of the workers' union)
- Chairman (usually shareholders representative) has the casting vote in case of equal votes

Upward vs. Downward in the For-Profit World



Upward vs. Downward in the Non-Profit World

