

Eighth edition of Eurosif/“Le Monde”, “El Pais” and “La Stampa” indicators for environmental and social performance of international companies

## Governance: director’s pay at the top of the list

Annual reports that are now being published by listed American companies weigh a bit more than they have in the past: in a decision made on August 29<sup>th</sup>, 2006 the Securities and Exchange Commission (SEC), the American stock exchange regulation authority, has required that for all fiscal years that end on or after December 15<sup>th</sup>, 2006, listed companies in the United States must provide “*clearer and more complete disclosure of compensation of the principal executive officer, principal financial officer, the three other highest paid executive officers, and the directors. In addition, they must provide better information concerning the financial relationships between the companies, their managing directors, their directors, their main shareholders and close family. [for each one of these categories]*”. For the SEC, this will allow investors and stakeholders to measure the proportionality (or absence of) between directors’ remuneration and company performance. And most of all to react to scandals set off by revelations of retirement packages for CEOs of Home Depot or Exxon.

This new obligation shows how the theme of directors’ remunerations has gone from scandal – where socially unbearable practices are singled out – to the regulation of a number of practices thanks in part to public pressure. Before regulation however, in order to limit damages and try to employ “best practices”, there is normally an attempt at “auto-regulation”, which is generally unsuccessful. This was the strategy adopted by large French companies following the Crédit lyonnais and Vivendi scandals through the publication of the Viénot (1995) and Bouton (2002) reports.

This mechanism has placed questions about corporate governance at the top of agendas alongside “social and environmental responsibility”. In any case, it is about making risk management and the potential loss of value for companies more transparent. Recent events have shown that strategy errors, “blind” and isolated directors, a conflict of interest or simple greed can cause losses as much as industrial accidents or social conflicts can. Beyond the immediate

financial loss, they can cause more long-term damage to reputations.

### Across the Atlantic

If you believe the 8<sup>th</sup> edition of the Eurosif/Le Monde indicators, published with the support of the European Commission, and similar publications by *La Stampa* (Turin) and *El Pais* (Madrid), certain American companies anticipated, as early as 2006, requirements from the SEC and published more detailed reports on their director remuneration policies than their European counterparts (with the exception of Axa). But these methods could very well cross the Atlantic and become general practice for all listed European companies, as was the case for other areas of governance.

The annual study by Heidrick and Struggles on corporate governance in 300 European companies (a statistics survey which is not nominative) shows that the appointment of independent administrators in boards of directors, which is spreading to Europe little by little, has increased from 43% in 2001 to 54% in 2007 (36% to 51% in France).

At the same time, the proportion of companies which created audit committees has gone from 66% to 98%, 62% to 95% for remuneration committees, and 47% to 80% for nomination committees. Two-thirds of members of these committees are “independent”, which is true for 100% of the audit committees in British companies.

However, Eric Duvaud, partner in charge of the environment and sustainable development departments at Ernst & Young, explains that the problem is that “*the definition of independence used by companies is unfortunately rarely specified in their annual reports*”. Similarly, Heidrick & Struggles noticed that annual reports almost never indicate the situation of independent administrators in terms of shares they have in companies whose boards they are on, which is however a very important piece of information to be able to judge the real degree of independence. There is still a lot of work to do before corporate governance “best practices” are truly established.

A. R.

### American companies on the cutting edge of “best practices”

Companies	Proportion of independent members on the board of directors, in %	Part of employee stock ownership, in % of capital held by employees	Information on directors' remuneration, grade/5 <sup>(2)</sup>
Exxon Mobil (USA)	83	0	5
Wal-Mart Stores (USA)	83	0	4
Royal Dutch Shell (Netherlands)	67	0.3	4
BP (UK)	65	0.8	4
General Motors (USA)	92	0	5
Chevron (USA)	85	0	4
DaimerChrysler (Germany)	67	0.7	1
Ford Motor (USA)	73	0	4
ConocoPhillips (USA)	94	0	5
General Electric (USA)	73	0	5
Total (France)	81	4.0	2
ING Group (Netherlands)	61	0	4
Citigroup (USA)	81	0	4
AXA (France)	69	5.6	5
Allianz (Germany)	64	0.7	3
Volkswagen (Germany)	80	2.3	3
Fortis (Belgium)/(Netherlands)	91	0	1
Crédit agricole (France)	14 <sup>(1)</sup>	5.8	3
American Intl. Group (USA)	76	0	5
Assicurazioni Generali (Italy)	67	0	0
Siemens (Germany)	59	1.6	4

(1) 62 % of administrator positions on the board are given to representatives from regional agencies

(2) Each point is given based on the publication of the following data:

1 Break-down of remunerations (fixed, variable, stock-options, etc.)

2 Nominative data

3 Justification of remunerations given

4 Evolution of remunerations over several fiscal years

5 Non-executive members of board included

Source : Ernst & Young, based on information published by companies

#### **PUBLIC DATA**

Information published in this table was collected and processed by the consulting firm Ernst & Young based on documents published by companies. The companies listed are the biggest in their sector in terms of sales figures for 2006 according to *Fortune's* Global 500. Information on the percentage of independent administrators in the boards of directors is taken from documents published by companies. The definition of “independence” can vary according to the company, but most of the texts do not specify criteria used to define independent administrators as such. As a reminder, the Viénot and Bouton reports state that “*an administrator is independent when he does not have any relationship whatsoever with the company, the group or its management, which could compromise his freedom of judgement.*”

Aldo Cardoso: “shareholders and stakeholders have to be able to appreciate how well the decision making system works”

**Why has the “governance” of large listed companies become such a hot topic?**

Well before the Enron (2001) or Parmalat (2003) scandals the financial community was alerted by cases like the British media group Maxwell (1992), the banks BCCI (1991) and Barings (1995) or, in France, Crédit lyonnais (1994). We have to know how we got to this point, and how we can improve corporate governance and auditing systems in order to prevent such abuses.



In addition, in the 1990s the amount of savings placed in shares of listed companies experienced a dramatic increase, in particular via pension funds and investment companies: companies, wanting to tap into these savings, had to restore investors’ confidence by providing improved supervision, better risk prevention, and more transparency concerning their management policies. Even if these failures only concerned, in total, a small part of listed companies in the world – a dozen out of 20 000! Over the years, companies knew how to select best practices: independent administrators (but all have to be independent, the term “free of interest” would be better), remuneration and audit committees, writing annual reports based on specific rules, etc. These practices were diffused and adopted by almost all the listed companies, including under legislative pressure, as was the case for the financial security law in France.

**So has corporate governance become generally satisfactory?**

That doesn’t mean that failures are no longer possible – zero risk does not exist. Companies grow, exercise new trades, set up operations in new countries: corporate governance is more and more complex. You don’t run a multi-national company with 200 000 people the same way you would run a national firm with 2 000. The difficulty is in adapting the governance to this growing complexity in real time, or even to anticipate it.

**Should companies make more efforts to be transparent, in particular regarding director’s pay?**

The problem concerns, on the one hand the remuneration level considered to be outrageous, and on the other hand, its proportion to company performance. For the first point, the level of social acceptability varies based on the country- it is twenty times less in France than in the US! For the second point, proportionality rules have to be clearly stated. I don’t think it’s necessary to publish all the details, with the risk of going from providing

examples to voyeurism: it is simply important to show that the remuneration follows the rules that were created.

**What information is necessary to evaluate “good corporate governance”?**

Other than the description of the management board, the company has to inform the stakeholders about the frequency and length of meetings for the different committees, about the subjects that were discussed, and finally about the participation and commitment of their members. I don’t think that it’s necessary to go into detail about votes or resolutions that were passed or rejected, because that could reveal a company’s strategic secrets. The objective is not to place shareholders or stakeholders in a situation where they make the decisions, or even validate them, but to allow them to appreciate how well the decision making system works.

*Interview conducted by Antoine Reverchon*

**CV**

- 2007** Aldo Cardoso is administrator for Gaz de France, Accor, Rhodia, Imerys and Orange.
- 2003** He publishes *L’Anarchie libérale* with Fayard.
- 2000** He is named president of the board of directors of Andersen Worldwide until 2003.
- 1994** He becomes president of Andersen France and remains so until 2002.