

Corporate Governance: A View from the Top
Brazilian CEOs Share their Views on Key Governance Issues

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The focus of corporate governance should be on creating a set of efficient mechanisms to both motivate and monitor executives' actions with the purpose of ensuring that their behavior and the results they deliver are aligned with the shareholders' interests.

Today's credit crisis, volatile capital markets and increasing pressure on the bottom line are leading to rising demands for enhanced corporate governance, corporate accountability, and transparency.

In Brazil, the lack of professional board members and specific training presents its own specific challenges. However, this situation is beginning to improve with the advent of support groups, such as the *Instituto Brasileiro de Governança Corporativa* (IBGC) and a growing cadre of professionals with multinational experience.

Succession planning, executive compensation, as well as board and management's roles and responsibilities are key elements of corporate governance that are top of mind among C-level executives.

A group of top executives in Brazil met to discuss these issues in early September, 2009, during an executive roundtable. The group included CEOs from major multinational and Brazilian companies and represented a broad cross-section of industries.

Leading the roundtable was David Nosal, Founder, Chairman and CEO of Nosal Partners LLC. What follows is a summary of the discussion.

Succession Planning - Putting in Place the Right Strategy

Succession planning is not only essential to good corporate governance, but also has profound implications for an organization's near- and long-term viability.

The short-term implications of poor succession planning are many. Lack of succession planning can put companies in a reactive position when replacing key executives; it can also prompt a board to inflate existing compensation packages – with little correlation to executive performance – as a retention strategy. In the long-term, the lack of succession planning can have a profound impact on the sustainability of the business.

Despite its importance, companies appear to be slow to adopt succession planning policies—perhaps in part because the topic is a delicate one to raise with existing leadership, and since it can seem far-removed from

more immediate critical issues and concerns. A 2008 survey by the National Association of Corporate Directors (NACD) found that 42% of major corporations have no CEO succession plan. Further, only 16% of directors surveyed felt their board is effective at CEO succession planning.¹

Poor succession planning is also an issue in Brazil. By and large, most executives view succession planning as an “HR problem” versus a team/leadership opportunity. With a few notable exceptions, efforts tend to be disorganized and not seen as priority.

In the group of Brazilian CEOs, less than half of the companies represented had formal succession planning policies and processes in place. In all of these cases, the companies were affiliates of multinational companies.

Reasons cited during the roundtable for not having a succession plan or for having less-than-ideal implementation:

- *“Our focus is on the day-to-day operations and on short-term deliverables. Succession planning needs a conscientious effort.”* (multinational company executive)
- *“In multinationals, corporate governance is being driven down. In local companies, this is a recent issue... and is not part of the corporate culture. This starts changing as multinational managers start coming into the local companies and are driving the Boards to address the issue”* (Brazilian company executive)

Those that do have succession planning are committed to the program:

- *“The most important asset in a company is its people.”* (multinational company executive)
- *“Succession planning needs to be tied to the vision, not only the process. It has to do with what we want for the business. It has to be tied-in to the plans for the future.”* (multinational company executive)

The roundtable participants discussed the need to treat succession planning with a sense of urgency, tying it into compensation plans as a key objective. The executives also highlighted the importance of attracting new people and cultures, as well as those who are focused on innovation and execution.

Boards and managers need to understand their own roles and competencies when it comes to succession planning. Making succession planning a top priority is critical to attracting and retaining people who can lead an organization into the future and thereby ensure an organization’s success and sustainability.

Executive Compensation - The Need for Greater Alignment with Performance

The financial crisis has brought increased attention to executive pay. The U.S. government, media and the general public are questioning the executive incentives and accountability for performance. Consequently, the government included specific provisions in the U.S. Emergency Economic Stabilization Act (EESA) that limit executive compensation at participating companies.²

In addition, many shareholders believe there is an insufficient link between pay and performance. Some are especially skeptical about whether directors are setting compensation levels properly. PriceWaterhouse

Coopers notes that the depth of shareholder concern is evident in their ongoing push for an advisory role on executive compensation.³

The situation is no different in Brazil, where top executive compensation packages are increasingly subject to regulatory oversight. When it comes to variable compensation, Brazil also faces a very delicate legal issue since labor unions must take part in approving any plan design.

Watson Wyatt research showed that more than 95% of companies paid bonuses in Brazil in 2008 according to target/budget despite the economic crisis. While the research did not examine the merit of these bonuses relative to company and individual performances, the perception is that many companies may have paid targeted/budgeted bonuses regardless of results.⁴

The Nosal Partners Brazil roundtable participants reported unanimously that their companies not only paid bonuses in 2008, but did so based on results.

Nonetheless, executive compensation proved a sensitive issue:

- *“Seventy-five percent of the bonus is based on local results, and 25% on global performance.”* (multinational company executive)
- *“One-hundred percent is based on local results.”* (Brazilian company executive)
- *“The real issue are the KPIs (Key Performance Indicators). Boards need to define and determine the appropriate KPIs. What KPIs really create value? There appears to be a disconnect between KPIs and value. Boards don’t appear to know what really drives value.”* (multinational company executive)
- *“The boards need to determine what really contributes, and need to drive this notion down to all levels. They also need to define a general formula that will remain unchanged, but allow for specific changes to KPIs as needed.”* (same)
- *“You may not be able to be fair in the short term, but you need to look at the mid-term.”* (same)
- *“Many executives create a culture that is different than what was intended with the bonus package. The bonus becomes almost a part of the salary, not a performance incentive. Many executives already spend their bonuses. Then, if the bonus is not paid out, morale goes down and the company ends up paying for it. This defeats the purpose and intent of the bonus program.”* (multinational company executive)
- *“Bonus must include long-term incentives and corporate goals.”* (same)
- *“My bonus is keeping my job!”* (same)

There was consensus that boards need to be in tune with executive compensation as a key business issue. The controversy appears to center not on what is paid, but rather on the behaviors that need to be rewarded and the expected results. Boards need to clearly define metrics and hold leaders accountable.

Executive compensation is a key area of responsibility for boards. There is increasing pressure on boards to focus on and demand accountability at all levels.

Roles and Responsibilities of Board and Management -Working in Tandem to Ensure Sustainability, Compliance and Accountability

The economic meltdown of 2008 and 2009 also highlighted the need to understand roles and responsibilities of boards and management teams. Two key issues related to this are financial reporting/controls and risk management, and the consequent definition of who does what and how.

PriceWaterhouse Coopers notes that the SEC Advisory Committee on Improvements to Financial Reporting (CIFiR) doesn't preclude different accounting and financial reporting conclusions about similar transactions, but at least provides a basis of comparison for reaching and substantiating accounting conclusions.⁵

Additionally, PriceWaterhouse Coopers highlights the need for businesses to take risks to earn returns for owners. The point therefore is not to avoid all risk-taking, but to take risks that are manageable and which support the company's strategy.⁶

In Brazil, heightened sensitivity around risk has also affected the local operations of multinationals. Although the Brazilian economy escaped most of the recessionary problems that affected the U.S. and European markets, local executives within multinationals have still felt pressure, because many corporate boards slowed the pace of foreign investment in the wake of poor corporate results in countries harder hit by the recession. As a result, Brazil-based managers concerned about losing growth momentum in a growing market have encountered some understandable tension between local objectives and those of their multinational boards.

One end-result has been increased discussion regarding roles and responsibilities of board members and their managers.

Half of the roundtable participants worked directly with a board. Following are the issues that were at the top of the CEO wish list:

- *"...Better timing X market dynamics. The Board needs to understand the market, not only their (own) needs."* (multinational company executive)
- *"There is a real gap between the day-to-day reality and the vision; these are different drivers."* (multinational company executive)
- *"...Better understanding of the situation/market. Board needs to be careful not to give the wrong direction."* (Brazilian company executive)
- *"...Ask the right questions. Face up to the long-term decisions (i.e., funding). Give clear direction, esp. since it's a family board and a lot is left unsaid."* (Brazilian company executive)
- *"I spend too much time with the Board. A total of 25 days per year (10% of year) when I'm not generating value... The company needs to define what the executive's responsibility is and what the Board's responsibility is."* (multinational company executive)
- *"In many ways, the executive becomes a hostage."* (same)
- *"I spend 50% of my time in meetings/reporting. The Board needs to focus time and effort on the future of the business (and less on reporting)."* (multinational company executive)
- *"The executive needs to understand where to invest his time. The Board needs to define direction, key KPIs and what is non-negotiable. The rest should be left to the executive."* (multinational company executive)
- *"Everything is very connected. If not, the company will attract the wrong executive. All issues are important (compensation, ethics, etc.). It's all about establishing roles, the role of the executive, the role of the Board. It's all about a job description."* (same)
- *"The board should be used as a sounding board, not to define specific strategies. Also, the board needs to be careful with controls. If not, it may lead to mistrust. The relationship is important."* (Brazilian company executive)
- *"The keys are trust, relationship, conflict resolution tools and transparency."* (Brazilian company executive)

In essence, the roundtable participants felt that boards need to be responsible for succession planning, executive compensation, as well as high level financial controls, ethics and accountability. They felt that the mission of a board of directors was not centered on control per se, but on ensuring the organization's sustainability.

They felt that the executive team, on the other hand, needs to focus on the task at hand, deliver the expected results, recommend the strategic direction, and ensure compliance. Finally, they agreed that trust and transparency should form the pillars of an executive team's relationship with its board.

Unfortunately, many board members appear either unaware of their roles and responsibilities in fostering this sustainability, or inadequately prepared to act in this respect. The roundtable participants felt that nominating committees need to dig deeper to find the right board members and/or better prepare new directors for these board responsibilities. Similarly, boards need to ensure the right people are attracted and retained in their executive suites.

"In Brazil, we're still behind in corporate governance. The consciousness is growing, but there is still a gap. Executives need to be better prepared, and executive coaching is becoming more important to bridge that gap." (Brazilian company)

It is incumbent on board members to ensure a company's financial health and sustainability. It is the imperative of the executive team to drive compliance and accountability.

¹ Sandra Davis, Ph.D. & David Nosal, Smart Planning for CEO Succession, The Corporate Board, September/October 2009;

² 2009 Current developments for directors (PriceWaterhouse Coopers)

³ Ibid

⁴ Cyro Magalhães (Watson Wyatt consultant) speech at CONARH (Congresso Nacional sobre Gestão de Pessoas) 2009 congress (<http://abrnacional.org/category/remuneracao/>)

⁵ 2009 Current developments for directors (PriceWaterhouse Coopers)

⁶ Ibid

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