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BOOKS AND OVERVIEWS

Martin Hilb: New corporate governance

Successful board management tools, Third edition, Springer, Berlin, 2008

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Corporate governance literature includes a very diverse and multidisciplinary set of studies, encompassing accounting, economics, finance, law, management, and sociology. Corporate governance is indeed a multi-faceted domain. As noted by Judge (2008), the 'dependent variable' in corporate governance studies is far to be clear and generally accepted. The third edition of the book *New Corporate Governance* written by Martin Hilb adopted a management approach and selected a very interesting 'variable' to study: board effectiveness.

The book focused on the board of directors. Among corporate governance issues, the board of directors is considered to be pivotal, as it is the organizational body at the apex of companies (Fama and Jensen 1983). Hilb shared the view of the Cadbury report (1992) about the role of the board of directors, which is expected to both 'direct and control a firm' (page 9). In his book Martin Hilb interestingly aimed at developing a 'holistic framework', which tries to address the major weaknesses in the theory and practice of corporate governance, by integrating formerly isolated elements of corporate governance in research and practice (see page 7). Indeed, the book provides a good balance between practice and research. This goal is consistently pursued in all the book's sections, and often accomplished. To achieve his aim, Professor Hilb took profit of his long experience in corporate governance and boards of directors from different perspectives: researching, teaching, and consulting. Indeed, sound scholarship is often combined with practical board management tools derived from the author's professional practice as consultant and the executive education workshops held at the University of St. Gallen (Switzerland), where he is Director of the IFPM Centre for Corporate Governance.

The proposed framework is based on four major principles (named 'dimensions'). The whole framework has been labelled as the 'reversed KISS principle' (situation, strategy, integration, and 'keep it controlled', page 7). All four 'dimensions' of the

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'reversed KISS principle' should be considered as equally important in order to develop a balanced view of corporate governance: no single dimension should be sacrificed to any other dimension. The book is structured according to the proposed framework. Each dimension is illustrated in a section of the book. The first part of the book discusses the situational dimensions of corporate governance. The second part focuses on the strategic issues, with special attention paid to how role and stewardship theories may influence corporate governance when dealing with corporate strategy. The third part of the book elaborates how much effort board management should invest in integrating different characters within the board of directors. The issues of control are considered in the fourth part of the framework. The main arguments in each section are supported by conceptual models, practical board management tools and/or short case studies. Although the cases presented in the book cannot be considered as research case studies (Yin 1984), they are usefully adopted to exemplify an analytical process, making the book ideally suited to corporate directors and M.B.A. students.

In the 'situational dimension' of corporate governance Professor Hilb deals with the normative, legal and ethical contexts that influence corporate governance. He eschews agency theory, by using a conceptual framework developed by institutional and situational theory (see Aoki 2001, Fiedler 1962). The analysis of the situational dimension goes beyond the analysis of board composition in terms of independence (proportion of executive vs. non-executive directors, presence of independent directors, etc.) and avoids a one-size-fits-all board approach. According to Professor Hilb, any analysis about board effectiveness should take into account national, industry, and corporate cultures (the so named 'external business context', see page 18) as well as the factors that characterise the 'internal business context' (ownership, board configuration, organizational complexity, board role players, the degree of internationalization, and the mix of board functions, see pages 35 ff). Martin Hilb was able to keep his analysis 'situational': he avoids the 'easy solution' to consider the Anglo-American corporate governance model as the global standard. The choice to consider two corporate governance systems (the Anglo-American and German-Japanese models) is valuable. The analysis is, however, far from being exhaustive, as the Latin and Asian (specially ASEAN countries) corporate governance models are very different (e.g. Weimer and Pape 1999; Li and Nair 2009). The book provides adequate attention to family-controlled firms (see pages 36–44), which, despite their pervasiveness around the world (e.g. Faccio and Lang 2002; La Porta et al. 1999), are often neglected in corporate governance literature. However, the analysis does not consider—if not marginally—how the presence of a dominant blockholder may exercise a significant influence on board effectiveness and corporate governance. Although corporate governance deals with the exercise of power over corporate entities (e.g. Tricker 2000), the role of power is hardly considered in the analysis developed in the book (see page 49). For example, there is little consideration for the role of minority shareholders in the board, despite the fact that the presence of directors appointed by minority shareholders has been one of the key corporate governance innovations in some countries (e.g. Italy, see Enriques and Volpin 2007), and that there is evidence that those directors play an important role to foster board effectiveness, by balancing the large blockholder's power (see Melis et al. 2008).

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Professor Hilb takes a very promising stakeholder orientation: his framework is expected to be able to integrate 'the interests of the shareholders, customers, employees and public' (page 11). Despite some valuable efforts to do so, some questions are left open to shareholder value advocates' criticism (e.g. Sternberg 1996; Jensen 2002). What is the company's objective function? Hilb supports a 'both-and' approach (in contrast with a 'either-or' approach), which might provide an answer to such question: for example the board of directors should pursue both shareholder value and value for customers, employees and the public at the same time (see page 210). This kind of answer is intriguing, as it seems to recall a 'balanced' view of performance (as explained by Kaplan and Norton 1992), an 'enlightened shareholder value' approach (Jensen 2002), or the theory of 'simultaneous maxima' developed in the *Economia aziendale* framework (Onida 1968). If a 'both-and' approach could potentially help a board of directors to take into account the diverse stakeholders' interests, another question is yet to be answered: why should a board of directors appointed by (controlling) shareholders should pursue stakeholders' value? Professor Hilb seems to take an 'idealistic' perspective, which assumes the absence of opportunism. However, assuming the absence of opportunism conflicts with the prevailing board practice as well as with theory: if directors (and senior managers) were not opportunistic, there would be no important corporate governance problem that could not be solved with a contract (Williamson 1985).

The second section of the book addresses the strategic direction responsibilities of corporate boards. The analysis of the strategic dimension of corporate governance opens the 'black box of board demography' (Zattoni and Zona 2007) to discuss the underlying processes that foster, inside the boardroom, board effectiveness (and performance). Although board demography conditions board effectiveness, it is the real behaviour and engagement of board members that determinates actual board performance (Roberts et al. 2005). By discussing issues such as board teams, culture, structure and strategic success measures, Hilb proposes four main 'preconditions' that a board of directors should meet to be able to develop, implement, and control corporate strategy: diversity, trust, network, and vision. In this part of the book Martin Hilb addresses issues about cooperation within the board, board composition, and stakeholder-oriented strategic board success measures. In particular, his ideas on board diversity (in terms of gender, age, cultures, knowledge, and expertise) are fascinating and thought-provoking. A good emphasis has also been given to the role of the Chairperson (illustrated in the pages 56–57, 88–90, and 113–115), as in such a diverse board coordination and conflict solution are pivotal issues that may hurdle board effectiveness. Professor Hilb strongly advocated board diversity, although the empirical evidence on the subject is still contradictory (e.g. Adams and Ferreira 2008; Minichilli et al. 2009; Rose 2007). The effects of board diversity are not necessarily always positive, as the composition of the board of directors depends on the complexity of the firm's internal and external environments (Brammer et al. 2007; Markarian and Parbonetti 2007). Therefore, more research seems needed before being able to make compelling prescriptions on board diversity.

Part three of the book deals with the integrated board management function through its responsibilities concerning selection, feedback, remuneration and development of board teams. Board composition that achieves diversity involves

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alternative director selection processes, which should be based on know-how, commitment and team role (see page 11), rather than on the 'old-boys' network. Board selection is a topical issue, and the only reason for appointing any directors to the board should be the value which they will add to their board (e.g. Cadbury 2002).

The chapter also provides a good selection of examples of self- and external evaluation board tools, for single directors, CEOs as well as for the entire board. These management tools are designed to enhance board feedback, which is expected to support the motivation of directors to act in the interest of the firm as well as foster their professional and role competence. This section of the book also contains a good analysis of director remuneration, which interestingly aims to answer the following question: how should the board members (including the CEO) be compensated? Professor Hilb believes that their remuneration should be designed in accord to both 'internal fairness' (i.e. based on 'competence' and 'conformance' with the requirements of a board member) and 'external fairness'(i.e. determined through relevant market comparisons). Performance-related fairness concludes the so named 'magic triangle' of remuneration fairness: the variable portion of pay should be linked to firm performance (see page 133). An adequate emphasis is given to performance-related long-term oriented remuneration (with the long-term orientation stressed, and defined as three years), that should be performance-indexed by taking into account competitors and the company's competitive position (i.e. benefits to shareholders and other stakeholders, such as customers and employees). Board remuneration is part of the integrated board management dimension. Indeed, a well-designed director remuneration is able to provide correct incentives and avoid rent-extraction and myopic behaviour. 'The devil is in the details', as stated by Bebchuk et al. (2002). Design matters to understand whether director remuneration is likely to be effective in aligning potentially diverging interests of directors and shareholders and fostering medium-long term value. Considered that Professor Hilb wrote his book before the global financial crisis, this part of the analysis deserves great merit, although his opinion against the use of stock options for executive directors (see pages 138 ff) is not entirely compelling. Again, it is the design that matters.

To enhance board development Professor Hilb advocates the institution of an integrated board management committee. According to the author's proposal, this committee should be composed of three independent directors. Its tasks would include four key areas: nomination, review, remuneration and development (see pages 152–153). This committee would combine the tasks of the nomination and the remuneration committees. Martin Hilb himself stated that an integrated board management committee is one of the differences between 'traditional' and 'new corporate governance' (see page 10). The idea is thought-provoking. Members of nomination committees are usually expected to have different competences and expertise from directors that sit in the remuneration committee. What kind of knowledge and expertise should each of the three members of an integrated board management committee have? Besides, many codes of best practices (e.g. the French, Italian and Spanish codes, to name just a few) recommend that nomination committees should be composed of a majority of independent directors. This recommendation often leaves a seat to a non-executive director who belongs (or is close to) the family (or another major blockholder) that controls the firm. Would a family (or another major

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blockholder) with an important financial stake into the company leave all the seats in such a pivotal committee to truly independent directors?

The fourth and last part of the book aims to address the monitoring function of the board of directors, which encompasses the auditing and risk management functions of the board (and the need for a committee that deals with both issues), the communication, and the evaluation functions of the board of directors. The most noteworthy contribution of this section is the proposal to institute an integrated audit and risk management committee in the boards of non financial firms. According to Professor Hilb, this committee would basically include the risk management function in the audit committee. It should be composed of three independent directors, two of whom with an accounting and finance experience, and one—at least—with auditing and risk management expertises (see pages 157 ff). Hilb's proposal finds his rationale on the assumption that, although risk management review is a task that belongs to the entire board, the average expertises of directors—with the exception of audit committee members—may be inadequate to fulfil this task in a professional way.

Eventually, a book entitled 'New corporate governance' begs the following ultimate question: does it contain new wine or is it just old wine in a new bottle? Professor Hilb aimed to pursue an integrated approach, and this is claimed to be one of the key differences between 'new corporate governance' and 'traditional corporate governance' (see pages 9–10). Despite this challenging aim the analysis is not fully integrated, as the author himself honestly admitted. The model paid lip service to interdependence, and then investigated its elements in isolation (see page 14). However, Hilb states that his model does meet the Brown (1965)'s criteria for the assessment of an effective model in that it is simple, has clarity and logic in its formal structure, is close to corporate reality, thus adequate for relevant prediction. Indeed, the book contents aim to represent a good balance between practice and research. The book tends to be normative and prescriptive in nature: ideas are presented as 'best practices' that are useful for directors to enhance board effectiveness. Taking a normative approach would not be a limitation, however, the 'prescriptions' contained in the book are sometimes too idealistic: normative arguments need to find their roots in the knowledge about how the world behaves, or they are likely to be unfeasible (e.g. Zappa 1927; Jensen 1983). But this need not detract from the value of the book as a thoughtful account of board effectiveness issues. Although many issues are still open (and I wonder whether they will ever be 'closed') and more research is still needed on such a fascinating subject, overall the book written by Martin Hilb does make a valuable contribution as a teaching and resource tool for advanced students and corporate directors. It does contain some new nice wine, and its reading can improve the understanding about corporate governance, and particularly board effectiveness.

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