6

Lessons from Private Sector Governance Practices

DALBERG GLOBAL DEVELOPMENT ADVISORS

Though the IMF differs from private for-profit organizations in its constitution, purposes, and accountability, the underlying rationale for corporate governance is the same in both private and inter-governmental organizations, as reflected in the similar functions of their boards. For an evaluation of IMF corporate governance, therefore, much insight can be gleaned from a review of principles and good practices used in the private sector to address some of the same fundamental issues as those faced by the Fund. This paper examines corporate governance principles and practices that have become widely accepted in the private sector. It identifies 14 principles seen to be of greatest relevance for the governance of the IMF and, for each principle, identifies relevant questions for the IMF. It also outlines processes and indicators used by the private sector for evaluating governance systems, and draws out potentially relevant processes and indicators for the Fund.

Relevance of Lessons from the Private Sector

This study reviews governance practices and lessons from the private sector with implications for IMF governance reform. It identifies the good

This paper was edited by Leonardo Martinez-Diaz and Alisa Abrams.

corporate governance principles and practices in the private sector that are most relevant to the IMF and suggests a set of indicators for measuring the performance of the Fund's Executive Board. The study does not provide a gap analysis between current IMF governance practices and the good practices in common use in other organizations. It therefore does not provide specific recommendations to address governance gaps.

Highly publicized corporate scandals—of which the most infamous include Enron, WorldCom, Arthur Andersen, and Tyco—have made governance a priority issue in the private sector. Governance in the private sector has moved away from norms of practice and towards a body of widely discussed, codified, and tested practices. In particular, governance codes are increasingly converging on a number of key principles and good practices.

While the Fund may look to corporations in the private sector for lessons in governance, some fundamental institutional differences call for a careful and customized approach to this comparison:

- The IMF's governance system is determined by its own Articles of Agreement, whereas private sector governance requirements are laid out by national laws, regulations, and court systems;
- The Fund's main functions—which can be summarized as surveillance, financial assistance, and technical assistance—as well as its mission to "ensure the stability of the international monetary system"[1] do not lend themselves to performance-based measurement as do activities in the private sector;
- The Fund's ownership structure renders it accountable to the governments of its 185 member countries, as opposed to private owners. As a result, executive directors' responsibilities and appointment processes at the Fund are quite different from those typical of the private sector:

    Responsibilities: Directors at the IMF have dual responsibilities, to the countries they represent and to the Fund. This creates challenges, as the various interests of the countries they represent are not always aligned, and sometimes they may run counter to the interests of the IMF as an institution. The misalignment of interests has grown as the Fund has moved away from function as a revolving credit union and toward an institution composed of perennial debtors and creditors.

[1]From IMF (2006), which summarizes the purposes of the International Monetary Fund as laid out in Article I of the Articles of Agreement of the International Monetary Fund (Purposes).

Appointment process: Board members are nominated or elected by the countries they represent, while in listed companies, they are elected democratically by shareholders based on competencies or relationships. While the directors of the Fund are representatives of the countries that elected or appointed them, directors in the private sector are personally liable to shareholders.

- The fourth major difference is in the IMF's weighted voting system, which is based on a quota formula measuring the relative size of each country in the world economy. In the private sector, voting rights are derived directly from share ownership (and in some instances, from the characteristics of the shares owned).

All of these special characteristics must be kept in mind when considering the relevance of lessons from the private sector to the Fund's current governance structures. That said, the underlying objectives for corporate governance—promoting transparency, accountability, sound management, and providing strategic steering—are similar in both the private sector and inter-governmental organizations. Therefore, important insights can be gleaned from a review of good practices that have emerged in the private sector to deal with some of the same fundamental issues.

One distinction is worth clarifying at the outset. By *principles* of good corporate governance we refer to fundamental rules: rules that have garnered broad consensus and recognition in governance codes across the world. By *good practices,* we refer to structures and processes that private sector corporations have adopted to improve their governance structures. These practices are often mandated by law in rules-based governance frameworks, such as that of the United States, but are not mandatory in the "comply or explain"[2] principles-based frameworks that are more prevalent in Europe.

This paper is structured as follows. The second section presents our approach to identifying the relevant governance areas as well as the 14 relevant principles that are associated with those areas. The third section explores each of these 14 principles in more detail, clarifies their application in practice, and identifies the questions raised for the IMF by each principle. The final section outlines private sector processes and indicators for evaluating governance systems, and draws out potentially relevant processes and indicators for the Fund.

[2]The principle of "comply or explain" is clarified in European Corporate Governance Forum (2006).

Methodology

Methodologically, this study followed four steps. First, we conducted a comprehensive survey of widely recognized corporate governance codes (Annex 1) that were carefully chosen to provide a representative sample of various corporate cultures. Governance codes were considered from countries with unitary vs. two-tiered board structures, rules-based vs. principles-based legal frameworks, and shareholder-driven vs. society-driven corporate cultures. Through this work, we were able to identify the main developments and emerging consensus around what constitutes good governance practices.

Through this survey, we identified four fundamental areas of good governance:

- Honest endeavor to set and fulfill overall *strategy and mission.* This addresses the organization's duty to achieve its purpose and manage risk through planning, evaluation, and overall direction setting;
- Governance structures and processes that ensure *accountability to stakeholders*;
- Independent *oversight* of management;
- *Stakeholder rights* ensured through disclosure, transparency, and voice.

Considering the four areas identified above, we used two filters to identify the private sector principles most relevant for this study. The first filter limits the principles to areas that represent the most critical concerns at the IMF, and the second looks at some of the most innovative thinking in the private sector. Through this approach, we were able to identify eight principles that directly address each of the four areas of strategy and mission, accountability, oversight, and stakeholder rights. We also identified six principles that simultaneously address all of these areas; these are illustrated in Figure 1.

For each of these principles, we also explored trends in practice, drawing from press searches, academic papers, and research by executive search consulting firms. The latter, which included Spencer Stuart and Egon Zehnder International, provided particularly rich sources of data on trends in governance structures and practices. Through desk research and interviews with private sector board members, we also identified trends in measuring good governance in the private sector. We gathered the types of indicators—qualitative and quantitative—used in the private sector, and from that inventory created a shortlist of potentially relevant metrics for the IMF.

Figure 1. Fourteen Governance Principles in the Private Sector

A. Strategy and mission	1. Boards should be involved in the process for setting strategy
B. Accountability	2. Directors are responsible for representing the interests of shareholders 3. Directors should be selected in a transparent fashion and based on objective criteria 4. The board should engage in CEO succession planning
C. Oversight	5. The board should have an adequate mix of independent and executive directors 6. The board should exert sufficient control over management
D. Stakeholder interests	7. Corporations should adhere to disclosure and transparency requirements 8. Minority shareholders' and stakeholders' interests should be respected

Principles that cut across governance areas
9. The board should have a leader who is not the CEO
10. Boards and their members should be evaluated on an annual basis
11. There should be a process for managing conflicts of interest
12. Board structures need to ensure the separation of management and control
13. Board operations should be effective and efficient
14. Committees should be used to further board effectiveness and efficiency as well as provide independence

Governance Principles and Practices in the Private Sector

All of the 14 principles identified above are based on the emerging consensus in corporate governance codes. This section describes and explains each of the 14 principles, provides examples of how they have been applied in practice in the corporate world, and identifies the questions these principles and practices raise for the governance of the IMF.

Strategy and Mission

Principle 1. Boards should be involved in the process for setting strategy. Boards are expected to fulfill strategic thinking and decision-making functions, taking into account the interests of shareholders. Boards' involvement is considered beneficial to their organizations because board members bring a wealth of experience and expertise that can help management in developing their strategy.

Governance Codes

The board's role in strategy setting is explicitly referenced across governance codes. For example, the OECD Principles of Corporate Governance (OECD, 2004) highlight reviewing and guiding corporate strategy, major plans of action, and business plans as a key function to be performed by a board. In France, the Viénot Report (AFEP/CNPF, 1995) stipulates that the board of directors has a four-fold function, which includes determining the company's strategy. Likewise, in Italy, the Preda Code (Italian Stock Exchange, 1999) charges boards with providing strategic and organizational guidance to their organizations.

While governance codes call for the board having a role in setting strategy, they do not specify *how* the board should play such a role. Therefore, boards have a large degree of flexibility in defining their involvement, as well as in determining how much of this role to delegate to management.

Private Sector Practices

In practice, private sector boards are constrained by their level of expertise and knowledge of the organization, as well as time—particularly since they are non-resident boards, generally meeting only a few times per year. As a result, it is generally management's role to define strategy, while the board is in charge of approving that strategy and/or providing advice, as well as monitoring management's performance. In practice, only a minority of boards contribute proactively to strategy-setting, rather than simply approving management's strategy. Business academics suggest that boards' over-involvement in strategy can lead to tensions with management, and that strategy committees can take away from the desired board-level focus on strategic decisions (Carter and Lorsch, 2004).

Boards that play an active role in setting strategy can and should be appropriately equipped to do so. One can look to Banco Santander as an example of a board that proactively contributes to strategy-setting, and has set up structures and processes to help it perform this role (Box 1).

Questions for the IMF

The IMF should ask itself whether its own Executive Board's role in the strategy-setting process is clearly delineated in its mission statement, so that there is a clear owner of the strategy. Second, the IMF should consider whether the Board has the skills and is appropriately equipped to play an approval role—taking account of whether Board members have the political capital to do so (in their role as representatives of governments) and whether they have the appropriate information and capabilities to do so.

The Board might also reconsider its current role in strategy setting. Is there benefit in the Board becoming more involved? If so, should it be involved through a strategy committee and an advisory board such as Banco Santander's? Or, following the practice of most private sector boards, is the bulk of strategy setting best left to management while the Board provides direction and approves or disapproves the proposed strategy?

Box 1. Case Study: Banco Santander's Board Involvement in Strategy-Setting

Santander's board of directors is involved in formulating and approving the bank's strategy and clearly lays this out in its mission statement. The board is supported in that role by two structures. First, an International Committee, made up of four executive and four non-executive members, meets twice a year and is responsible for monitoring the development of the bank's strategy, analyzing business opportunities, and reviewing the performance of the Bank's investments. Like all committees at Santander, the International Committee does not have decision-making rights; its role is to provide information, advice, and proposals. Second, an International Advisory Board, made up of members with distinguished business and political backgrounds, provides input and advice to the board.

In the case of Banco Santander, this level of involvement is consistent with an approach to governance whereby management constantly leverages the expertise of an experienced set of board members who are very knowledgeable about, and heavily engaged with, the organization. While the board of directors as a whole meets about nine times per year, the executive committee meets weekly, and the risk committee biweekly.[1]

[1]According to Banco Santander's "*Informe anual de gobierno corporativo correspondiente al ejercicio 2005*," the executive committee met 53 times and the risk committee met 100 times in 2005.

Source: Information on Banco Santander's governance structure and board involvement in strategy setting comes from the company's website, which quotes the Deminor Rating/ISS "Corporate Governance Rating & Investor Report" for 2006.

Accountability

Principle 2. Directors are responsible for representing the interests of shareholders. Directors in listed entities are responsible for increasing their companies' value to shareholders. Making directors responsible ensures that there is a visible focal point within each organization that is primarily concerned with, and accountable to, shareholders.

Governance Codes

Many codes allude directly to directors' responsibility to represent the interest of shareholders—which is generally taken to mean maximizing shareholder value. Among such codes are those of the OECD, Japan, and the U.K. In continental Europe, governance codes tend to couch this responsibility within a broader responsibility towards stakeholders in general, on the assumption that meeting this responsibility will raise the value of the company. The French and German codes are examples of this interpretation of director responsibility.

Governance codes recommend practices in selection, evaluation, reappointment, and orientation/training to ensure that the best directors are selected and that their talent is appropriately leveraged on the board. The present discussion focuses only on reappointment and orientation/training processes (we explore the topics of director selection and evaluation below under principles 3 and 10, because those principles address a broader set of issues than director responsibility).

Some governance codes address both reappointment and orientation/training processes. In the U.K., the Cadbury Report (London Stock Exchange, 1992), for example, mandates that "non-executive directors should be appointed for specified terms and reappointment should not be automatic," thus ensuring the need for shareholders' consent at regular intervals. As regards orientation/training, the OECD and New York Stock Exchange codes (OECD, 2004; NYSE, 2003) in particular refer to such processes as ways to help board members quickly and fully understand their responsibilities and duties as well as to obtain relevant information to help them better perform their duties.

Private Sector Practices

Selection, orientation, training, evaluation, and reappointment practices are in place in the private sector to ensure that directors fulfill their responsibilities to shareholders. Good practice requires that companies to allow shareholders to give their opinions at regular intervals about directors' permanence on the board, and requires companies to invest in induction and training to ensure that directors have a full and consistent understanding of their responsibilities.

Reappointment processes require a formal review of each director's continuation on the board at regular intervals. In practice, nomination committees are responsible for leading this process. For example, the charter of Nokia's nomination committee lays out the responsibility to prepare the proposal to the shareholders for the election or re-election of the members of the Board.

While corporate governance codes refer to director education programs, they intentionally leave flexibility for boards to define appropriate induction and training processes. Some boards, like BP's, make this a priority in their governance processes (Box 2).

Box 2. British Petroleum: Director Induction and Training

British Petroleum's (BP) induction and training are disclosed on the company's website as a matter of good governance.[1] The Chairman, with the support of the office of BP's Board Secretary, is accountable for the induction of new directors. The induction process is tailored to directors' needs and includes training on (1) the operations and activities of BP and (2) the role of the board, its decision-making powers, and its structures and processes (including the tasks and membership of the committees and the powers delegated to them). Beyond training on BP operations and governance structures, new Board members are also educated on their legal and other duties and obligations. Training is provided on an ongoing basis, and is customized depending on which committees directors are involved in and what skills and information can help enhance their effectiveness in the tasks that they perform.

[1]BP website, "Serving as a director: induction, training and evaluation," www.bp.com/sectiongenericarticle.do?categoryId=9014835&contentId=7014802.

Questions for the IMF

At the Fund, there exists an inherent conflict in the dual role of directors as representatives of the governments that elected or appointed them and as officers of the Fund. With the understanding that this conflict will continue to exist, what can the board do to emphasize the latter role of executive directors? Could the directors benefit from induction processes that help them manage better their dual role and to make choices when interests conflict?

Induction processes alone cannot guarantee that board members have the requisite integrity and competence to perform their dual roles. The Fund could consider what types of backgrounds and degrees of independence have allowed directors to play the most effective role in intermediating between their countries' interests and the Fund's interests. For example, are more senior and politically connected directors better able to communicate the Fund's interests back to their countries? Should and can these profiles be encouraged on the Board?

Finally, the Fund's directors currently are evaluated only by the countries that they represent. Can directors be made more accountable to the Fund while remaining accountable to their countries through a dual evaluation process?

Transparency of Selection

Principle 3. Directors should be selected in a transparent fashion and based on objective criteria. Private sector trends increasingly involve formal, rigorous, and transparent procedures for the appointment of new directors to the board. These procedures are intended to ensure the fairness of the process and to maximize the competence and integrity of directors elected to the board.

Governance Codes

The OECD governance code calls for a formal and transparent board nomination process as one of the board's key functions. Most codes, including the Viénot Report (France), the Japanese Corporate Governance Forum Principles (Corporate Governance Forum of Japan, 2001), the U.K.'s Combined Code (Financial Services Authority, 2003) and the NYSE's Listed Company Manual (NYSE, 2003) also recommend that a nomination committee be set up to effectively and independently design and implement the selection process. The nomination committee is required to make its terms of reference available, and to make explicit its role and the authority delegated to it by the board. Per NYSE requirements, at a minimum, this committee needs to "identify individuals qualified to become board members, consistent with criteria approved by the board, and to select, or to recommend that the board select, the director nominees for the next annual meeting of shareholders."

Private Sector Practices

The selection of directors is becoming more transparent in the private sector, with nomination committees increasingly leading the process based on a set of criteria (independence, age, and skill sets) to guarantee an adequate mix on the board. In practice, companies across the world have instituted nomination committees; all top 150 largest U.K. companies have nomination committees (Spencer Stuart, 2006a), as do all listed U.S. companies, per mandatory requirements. In two-tiered board structures as well, a growing number of companies are adopting equivalents to the nomination committee. In the Netherlands, 61 percent of companies had a selection and appointment committee in 2006, versus fewer than 20 percent in 1996 (Spencer Stuart, 2006b).

Nomination committees have laid out guidelines for evaluating candidacies to their boards. These commonly include management and leadership experience in business, education, or public service; skilled and diverse backgrounds, so as to bring the desired range of skills and diverse perspectives to the Board; and integrity and professionalism, which includes a desire to serve the interests of all stockholders (see Annex 2 for a specific example).

Questions for the IMF

The IMF Executive Board is composed of 24 executive directors, some of whom represent only one country and others of whom represent multi-country constituencies. Some Executive Directors are appointed, while others are elected.

With the understanding that ED appointments to the Board ultimately lie with member countries, to what extent can the Board play a role in defining the requisite skill sets and criteria for Board membership? Can and should the Board go as far as recommending individuals for member countries to consider? Or approving nominees for director positions, based on objective criteria defined by the Board? Could a Board-led nomination committee play a constructive role in designing and facilitating a selection process?

An additional point to consider is whether the resident status of the Board impedes access to the best candidates. As private sector boards are non-resident, and only meet an average of eight times a year, this allows them to tap into a skilled and high-caliber talent-pool that may not otherwise be available on a full-time basis.

Succession Planning

Principle 4. The board should engage in succession planning. Oversight of CEO succession planning is seen as an important responsibility of the board. The CEO selection process, however, does not require the same degree of transparency as that for director succession planning.

Governance Codes

The OECD Corporate Governance Code, the NYSE Listed Company Manual, and the Viénot Report (France) include the oversight of CEO succession planning as a key function of the board. Many corporate codes, however, do not address CEO succession explicitly; this group includes the Preda Report (Italy), the Corporate Governance Forum Principles (Japan), the Combined Code (U.K.), and the Peters code (Netherlands) (Committee on Corporate Governance, 2003).

Codes that require boards to have selection processes in place do not require boards to be transparent about these processes. The New York Stock Exchange specifically stipulates that “succession planning should include policies and principles for CEO selection and performance review, as well as policies regarding succession in the event of an emergency or the retirement of the CEO" (Rule 303A.09). The Viénot Report (France) recommends that the selection committee be involved in examining the chairman's proposals but specifically notes that there is a need for confidentiality in the CEO succession process: "it should be the permanent responsibility of the selection committee to be in a position to propose successors at short notice, although clearly this would require confidentiality" (AFEP/CNPF, 1995).

Private Sector Practices

According to Spencer Stuart data, CEO succession planning increasingly occupies the attention of boards in the US, where 94 percent of S&P500 firm discussed CEO succession on an annual basis in 2006, versus only 87 percent in 2005. Furthermore, 69 percent of the boards that were surveyed in 2006 had an emergency succession plan. In 38 percent of cases, the CEO led his or her succession planning, while in the majority of cases, both CEO and board were involved at intermediate steps, for instance in the management and evaluation of internal candidates.

Business academics recommend a four-step selection process: (1) establish criteria, setting goals and objectives of the search; (2) structure the process, establishing a committee to run a clearly-defined search process; (3) identify candidates, defining the candidate pool broadly and assessing thoroughly; and (4) execute selection, choosing candidates on the basis of goals and objectives. These steps are detailed in Annex 3.

Questions for the IMF

According to an unwritten convention, the Managing Director at the IMF is has always been a Western European citizen, nominated by European governments, with some input from the United States and other major Fund shareholders (for details, see Peretz, Chapter 11 in this volume). Private sector practices raise a number of questions for the IMF: Can executive directors be more involved in setting and implementing the MD selection process? Should a nomination committee be involved in drawing up shortlists? Does it make sense for the Board to be involved in succession planning on an annual basis? Does it make sense to develop an emergency succession planning process?

The last two questions underlie the likelihood of change of leadership in the private sector. That is, if governance codes pay relatively little attention to the matter of CEO selection, it is because constant performance evaluation, coupled with the power to compensate and dismiss, are the preferred private sector practices to ensure CEO competence. If serious and consequential MD evaluation were to be instituted at the Fund, the questions of annual succession planning and emergency succession plans would become much more relevant.

Oversight

Principle 5. Corporate boards should have an adequate mix of independent and executive directors. Boards across the world are expected to have a majority of independent directors, due to the belief that these directors can bring external expertise to the organization as well as allow enough independence to effectively and objectively oversee management activities. An independent director is defined as an individual who has no relationship that may compromise his or her objectivity and loyalty to shareholders. These are individuals who have no material relationship with the company, whether as a partner, employee of the organization or as an affiliate, paid advisor, or consultant to the firm, or immediate family member of a partner or employee of the company. The definition of independence itself has become stricter and limited to individuals who have no recent relationship to the company.

Governance Codes

Most codes do not mandate a majority of independent directors, but rather recommend a mix of executive and independent directors such that the board may operate independently of management. Codes that encourage companies to determine the adequate mix of directors include the OECD Principles, Viénot Report (France), Preda Report (Italy), Peters Code (The Netherlands), and the Combined Code (U.K.). More stringent codes such as those of the Australian Stock Exchange (2003) and NYSE require a majority of independent directors and demand that these directors hold regular meetings without the presence of management.

Even the less stringent Japanese Corporate Governance Forum Principles recommend that the board of directors include independent, non-executive directors but allow for a transitional measure whereby companies may appoint a "management advisory committee" (Corporate Governance Forum of Japan, 2001). The latter is in place to allow companies to transition from Japanese governance structures, which traditionally had no independent directors on the board.

Private Sector Practices

U.S. boards are complying with regulations and ensuring that independent directors make up a majority of board members. Of the average S&P500 board of eleven directors, 81 percent of directors were independent

Box 3. Toyota: Separating Oversight from Management, Without Independent Directors

Toyota, which is seen as one of Japan's corporate gemstones and has surpassed General Motors to become the world's largest carmaker, did not go the same route as its national rival, Mazda. Instead of adopting the U.S.-type of model, Toyota, along with 5 percent of other Japanese companies, has adapted the traditional Japanese model, separating the task of oversight from that of management, while introducing no independent directors. Toyota created an independent board of corporate auditors and reduced its board size to clearly separate monitoring and management functions—keeping executive directors focused on a monitoring role and meeting on a monthly basis, while creating a set of senior managing directors clearly accountable for management.

in 2006, versus only 77 percent in 2001. The same applied in countries with two-tiered board structures. In the Netherlands, more than 50 percent of directors are independent (Spencer Stuart, 2006b: 9). In Japan, where companies have freedom to decide, 4 percent of companies, including Sony, Hitachi, and Mazda, have adopted a U.S.-type model with outside directors to ensure the separation of board and management interests (Egon Zehnder International). Toyota has taken a different approach (see Box 3).

Questions for the IMF

While bringing "independent" directors to the institution may prove impracticable, the Fund could consider ways to effectively separate the oversight and management functions on the Board. Today, the Executive Board is heavily involved in management activities while the International Monetary and Finance Committee (IMFC) plays a very "light-touch" role in oversight. Would a clear split of oversight and management activities, such as Toyota's, make sense? Alternatively, could certain functions of the Board be handled by independent board members? In the case of internal audit functions, could the Fund consider creating an independent internal audit committee to monitor both the Executive Board and management, and report directly to the Board of Governors? The UN has such an independent Audit Advisory Committee that reports directly to the General Assembly.

Control over Management

Principle 6. The board should exercise sufficient control over management. Boards need to exert an adequate degree of control to effectively perform their oversight of management.

Governance Codes

Governance codes unanimously emphasize the board's responsibility to monitor management effectively and to ensure that the strategic objectives of their organizations are being achieved. This role is reiterated in the OECD Principles, the Viénot Report (France), the Preda Report (Italy), the Corporate Governance Forum Principles (Japan), the Peters Code (the Netherlands), and the Cadbury Report (U.K.).

Private Sector Practices

In practice, private sector boards exert influence over management primarily through their ability to motivate (including through compensation) and, if necessary, to replace the top layer of management. The power to determine management compensation is used on an ongoing basis to exert influence over management. Based on the recommendations of compensation committees, private sector boards determine top executives' compensation and incentive plans at regular intervals.

Situations where private sector boards generally step in more visibly arise when the company runs into difficulties, or if the board loses confidence in management's ability to set strategy or to execute its plans. In those instances, the board can choose to challenge the CEO and go as far as replacing him or her. More and more boards are using these powers; the past years in particular have seen a flurry of CEO replacements. The 2006/2007 list includes those at Ford, Viacom, Home Depot, McAfee, Disney, Sovereign Bancorp, and CNET Networks.

Business academics suggest that, during a normal state of affairs, a constructive board will perform its oversight of management without over-interfering or micromanaging—that is, there should always be substantial delegation by the board. This is for two reasons: first, boards have limited time and should focus on the most strategic decisions and oversight functions and second, over-interfering boards run the risk of undermining management and making it difficult to hold the latter accountable for results that it did not fully own.

A best-practice board will maintain its independence and strive to achieve a balance between control and micromanagement. Within those parameters, Carter and Lorsch (2004) suggest that there is significant room for variation in the oversight activities performed by private sector boards depending on company specificities, including the complexity of the business and particular circumstances such as when a new CEO has yet to earn the trust of the board.

Questions for the IMF

As mentioned previously, the Fund's Executive Board is very heavily involved in management activities while the IMFC plays a very "light-touch" role in oversight. This raises some challenges as to whether the Board has sufficient independence and is sufficiently distant from management to be able to hold management accountable.

Furthermore, the Executive Board today is not involved in evaluating management, and only discusses management compensation in general, not in reference to specific individuals occupying the office. One can also ask whether the Board should be involved in selecting, evaluating, compensating, and potentially replacing the MD and Deputy Managing Directors.

Stakeholder Interests

Principle 7. Corporations should adhere to disclosure and transparency requirements. There is widespread acceptance of the need for financial and non-financial disclosure, and the various governance codes are increasingly converging towards similar requirements. Disclosure of corporate governance practices in particular is seen as a way to build trust with shareholders by allowing better transparency around how boards ensure the performance of their duties to shareholders.

Governance Codes

Corporate governance codes are aligned in calling for timely disclosure of financial and operating results, with the emphasis no longer simply on providing the data, but on making it digestible and user friendly for shareholders and stakeholders. On the non-financial disclosure front, governance codes are nearly unanimous in calling for disclosure of board member and key executive compensation, as well as disclosure of corporate governance practices.

Disclosure of corporate governance practices is most relevant for the IMF. The OECD Principles, Australian Stock Exchange listing requirements, Viénot Report (France), and the Peters Code (Netherlands) all require such disclosure in general terms. For example, the Peters Code requires that "the main principles of corporate governance" be disclosed. Some other codes do not require disclosure in these general terms, but rather mandate the disclosure of specific practices. For example, the NYSE requires disclosure of practices relating to the selection of directors.

Beyond the strict legal financial disclosure requirements, boards are often expected to follow the "comply or explain" principle if they do not meet their local code requirements. The UN's Guidance on Good Practices in Corporate Governance Disclosure (UNCTAD, 2006) states that "where there is no local code on corporate governance, companies should follow recognized international good practices."

Private Sector Practices

Even in legal environments that do not explicitly require companies to disclose their main principles of corporate governance, companies have opted to provide information on their governance practices. For example, since 1992, the Campbell Soup Company has published its corporate governance standards in a Proxy Statement, the 2007 version of which can be accessed on the company's website.[3]

Questions for the IMF

The Fund should consider whether it should or can become more transparent about its structures and processes. Also, is it effectively prioritizing substance over form, and effectively using web updates, newsletters, annual reports, and other means of communication with shareholders and stakeholders?

Shareholder Rights

Principle 8. Minority shareholders' and stakeholders' rights should be respected. Minority shareholder rights have been emphasized in the movement for "one-share-one-vote," whose goal is to ensure that minority shareholders are protected from majority shareholder decisions that could be harmful to them. Protecting the rights of stakeholders (such as employees, suppliers, customers, and communities) is also recognized as part of good governance.

Governance Codes

Corporate governance codes encourage corporate democracy. The issue of "one-share-one-vote" (1S1V) is explicitly addressed by most European governance codes. A major German code, for example, states that "in principle each share carries one vote. There are no shares with multiple

[3]www.campbellsoupcompany.com/governance_standards.asp.

voting rights, [. . .] golden shares or maximum voting rights" (German Government Commission, 2006). While the NYSE agrees to list companies with dual-class shares (i.e., those that do not respect the 1S1V principle), the Listed Company Manual states that it is concerned with arrangements that grant special rights to a shareholder or group of shareholders.

Private Sector Practices

In practice, the majority of European companies apply the 1S1V principle, but there are wide variations among countries. While in Belgium, Germany, and the U.K. almost all companies adhere to 1S1V, in the Netherlands, Sweden, and France only 14 percent, 25 percent, and 31 percent of companies do so, respectively (Deminor Rating, 2005).[4]

Questions for the IMF

The ongoing debate on corporate democracy has a strong parallel in the world of inter-governmental organizations. The Fund's ownership structure is not within the scope of the IEO governance evaluation or the current study. However, the issue of 1S1V raises an interesting question for the IMF: what is the Fund's equivalent to "one share"? Has that definition changed with the shift of the IMF's focus away from lending activities and towards a more diverse mix of surveillance, crisis prevention, crisis management, monitoring, and lending activities? Does the Fund adequately represent and give sufficient voice to smaller shareholders?

Principles That Cut Across Governance Areas

Principle 9. The board should have a leader who is not the CEO. Good practice requires a leader for the board who is not the CEO, in order to increase the CEO's accountability to the board and strengthen the board's independence. In a combined chairman/CEO model with no CEO-independent leadership for the board, the CEO would have control over the board's agenda, the information provided to directors, and the conduct of board meetings, thus dominating decision making. This would render it difficult for the board to exercise independent judgment or to meet without the presence of the CEO to objectively evaluate his or her performance or identify and discuss potential CEO conflicts of interests.

Overcoming the combined chairman/CEO impediment to board independence can take place either through a split between chairman and CEO positions or through the designation of a "lead director" or "presid-

[4]"Application of the one share—one vote principle in Europe." Commissioned by the Association of British Insurers.

ing director." In the latter models, a director is designated from among independent board members and charged with convening and leading independent directors' meetings as well as reviewing the board meeting agenda with the CEO.

Governance Codes

Two-tiered boards by definition require a split between chairman and CEO, whereas unitary boards offer the option of split or combined positions. As laid out in the OECD Principles (OECD, 2004), in unitary boards, governance codes usually propose the separation of roles. The Combined Code (U.K.) is particularly clear on the issue, stating that "There are two key tasks at the top of every listed company—the running of the board and the executive responsibility for the running of the company's business" and that these two roles should be split between two individuals. The Japanese Corporate Governance Forum Principles also require separation and mandate an explanation to shareholders when a combination is unavoidable. U.S., French, and Italian corporate governance codes do not explicitly require splitting the positions.

Whether the chairman and CEO positions should be split or combined has been subject to endless debate with no clear winner. One can see advantages and disadvantages to both models. Combined roles offer a centralized leadership and more agile structure but can put management interests above those of shareholders. Split roles allow the CEO to focus on running the company and permit further board independence, but can result in power struggles and confusion about company leadership.

Private Sector Practices

While two-tier board structures—common in continental European countries such as Germany, the Netherlands, and Austria—by nature require a split between the leaders of the supervisory and management boards, unitary boards allow for either model. In the world of one-tiered boards, almost all British companies have split the roles, versus only 33 percent of U.S. companies. The "lead director" model—whereby a director is designated among independent board members and charged with convening and leading independent directors' meetings and as reviewing the board meeting agenda with the CEO) has been on the rise in the U.S., where 96 percent of companies had a lead or presiding director in 2006 (Spencer Stuart, 2006c: 12).

A relevant trend in two-tiered structures is the increase in companies with non-executive chairmen. Having a non-executive chairman reinforces the latter's independence from the CEO and thus ability to effectively disagree with the CEO. In the Netherlands, for example, 95 percent of companies had a non-executive chairman in 2006 versus 86 percent the previous year (Spencer Stuart, 2006b: 9).

Questions for the IMF

The consensus around having a leader on the board who is not the CEO, as well as the rise of the "lead director" model, in practice begs the question of how the Fund can succeed in both alleviating the MD's workload and putting checks and balances on his or her power. Is it possible or desirable to extend the responsibilities of the current DMDs or Dean of the Executive Board? Under what circumstances is it desirable for the Board to meet without the MD's presence? Such sessions may be beneficial for the purpose of discussing the CEO's or management's performance, for example.

Finally, the IMF MD is currently responsible for two distinct aspects: the political and the technical. Can and should the Fund consider a clearer split of those responsibilities between individuals?

Evaluation

Principle 10. Boards and their members should be evaluated annually. Boards are urged to conduct annual self-evaluations (at the board and committee levels) and CEO evaluation. Board evaluations, in particular, are used as a tool to raise issues, increase the board's ownership and accountability, and identify and track improvements. Individual director evaluations are less common but are on the rise as a way to promote positive behavior and continued learning by board members.

Governance Codes

Many corporate codes recommend annual evaluations to gauge whether the board and its committees are functioning effectively. The NYSE requires that boards and their committees conduct self-assessments at least annually but makes no such demands for director self-evaluation. The U.K. Combined Code recommends that the board should undertake annual evaluations of the its own performance, as well as its committees and individual directors. Other codes make vaguer recommendations. In Germany, the Supervisory Board is expected to "examine the efficiency of its activities on a regular basis" (German Government Commission, 2006: 20). The TSE simply mandates the "development and improvement of a mutual monitoring system by directors" (Tokyo Stock Exchange, 2004).

Private Sector Practices

Practically all (96 percent) of U.S. S&P500 boards have institutionalized an annual process to evaluate the CEO's performance, and this process is increasingly becoming the responsibility of the entire board rather than of a specific committee. A large majority (81 percent) also conduct full board evaluations (see Annex 4 for a sample questionnaire), while around 73 percent conduct committee evaluations and only around 40 percent perform individual director evaluations (Spencer Stuart, 2004).

Individual evaluations can be conducted in a variety of ways; self- and peer-evaluations are the most common, and use of committees less so. In the Netherlands, supervisory boards are increasingly performing assessments of their own boards and management boards; around 92 percent of the supervisory boards assessed their own performance and around 85 percent assessed that of the management board (Spencer Stuart, 2006b).

Questions for the IMF

Currently, the IMF Executive Board is very different from private sector boards in that it conducts no evaluations. Given that evaluating the Board's performance as a whole is less politically sensitive than evaluating the MD or individual directors, can the Fund easily implement Board evaluations as a tool to promote positive change? Such evaluations need to be well planned and be blessed with the commitment of the Board to address the issues raised. Would the Fund be better off with an internal evaluation process? Or would an external consultant be a better option to ensure a transparent process and voicing of sensitive issues? For MD or individual director evaluations, the Fund could also choose among self-evaluation, peer-evaluation, or evaluation by a committee.

Conflicts of Interest

Principle 11. There should be a process for managing conflicts of interest. The issue of conflicts of interests is minimized by the trend towards more independent directors who are able to provide independent oversight of management activities. Good practice requires that board members disclose any personal interests in a transaction conducted by the company in order to protect the organization's interests.

Governance Codes

Governance codes require board members to act with integrity and disclose to other members if they have any personal financial interests in a transaction conducted by the company or the possibility of personally exploiting an opportunity that rightfully belongs to the company. This requirement is laid out clearly in various codes including the German and U.K. codes. The Dutch Corporate Governance Code (*Tabaksblat* Code) specifically defines conflicts of interest and how to deal with them. It mandates that "a management board member shall immediately report any conflict of interest or potential conflict of interest [. . .] and shall provide all relevant information, including information concerning his wife, registered partner, or other life companion, foster child and relatives by blood or marriage up to the second degree" (Committee on Corporate Governance, 2003). The same code specifies that the supervisory board should decide whether there is a conflict of interest without the concerned board member's presence.

Codes generally identify the areas of nomination, remuneration, and audit as those where potential conflicts of interest are high, and so prescribe committees staffed by independent directors to monitor and regulate these areas.

Private Sector Practices

Good practice involves the elaboration of codes of ethics that clearly define conflicts of interest as well as the process for dealing with them. Nokia makes such information available to the public in the form of a three-page document, the Nokia Code of Conduct (revised 2005), available on the company's website in 31 different languages.[5]

Business academics recommend that directors be explicit with the CEO/chairman as well as board members about any conflicts of interest they may have, as well as recusing themselves from discussions where such conflicts of interest may arise. Carter and Lorsch (2004) identify CEO evaluation and management compensation and succession as the most obvious areas where private-sector board members may have conflicts of interest.

Questions for the IMF

The Fund may want to consider whether it has sufficiently clear policies and procedures in place for dealing with personal conflicts of interest when they arise. Do all Board members understand what constitutes a conflict of interest? Is there a procedure in place for reviewing and managing conflicts?

[5]www.nokia.com/link?cid=EDITORIAL_64678.

Separation

Principle 12. Board structures need to ensure the separation of management and control. One- and two-tiered structures are the two main models, each based on underlying cultural dimensions. The unitary or one-tiered board structure has a single board that is both the supreme executive body and the supervisory organ. This model emphasizes the role of non-executive and independent directors to ensure control over management. The two-tiered model, on the other hand, assigns the executive and supervisory functions to two separate boards: the supervisory board, which is generally made up of shareholder and employee representatives, and the management board, which manages the company. The most common belief is that both unitary and two-tiered structures can work, provided there is a commitment to establishing clear distinctions between management and control such that there can be control over management.

Governance Codes

Codes vary in their recommendations on board structures, but they share the common goal of ensuring the separation of management and control. Corporate laws in countries such as Germany and the Netherlands mandate two-tiered board structures that allow employees and shareholders to directly oversee management's actions. Conversely, unitary board structures in countries such as the U.K., U.S., and Spain require a balancing of executive, non-executive, and independent directors to ensure that no one group can dominate the board's decision making. Both Japan and Italy have been rethinking traditional structures, with one alternative model emphasizing the need for independent internal audit. In Italy, the 2004 reform of governance law requires that the main board be supplemented by a board of auditors elected by shareholders, or by a German-style two-tiered structure, or by a U.S.-style independent unitary board structure.

Private Sector Practices

Whether companies have unitary or two-tiered boards depends largely on the local cultural environment, and has not evolved significantly over time. What has evolved more is board size. Unitary board structures, on average, seem to be converging around 10–12 board members, down from about 16 in 1980. There are some significant variations by industry, however. U.S. banks have an average of 17 board members; some factors that explain this bigger board size include larger firm size, complex organizational structures (subsidiaries, etc.), and predominantly friendly versus hostile acquisitions (Adams and Mehran, 2003). German law mandates that 20 members should sit on the supervisory board of companies with 2,000+ workers; these larger boards stay efficient by delegating to committees and ensuring that the concerned members meet with management separately before board meetings. Deutsche Bank's supervisory board, for example, has its employee representatives and shareholder representatives meet separately with management, to consider issues relevant to each before the full board meeting.

Questions for the IMF

The Fund's structure, when compared with structures in the private sector, raises questions about the separation between management and control. With the Executive Board so involved in management and the IMFC exerting no official power over the Executive Board, there is a clear gap in oversight. How can the Fund overcome this gap? Should it consider strengthening the IMFC, giving it more power over the Executive Board? Would it help to simply convene the IMFC more often than bi-annually? Could an independent audit committee bring some (albeit partial) improvements in oversight?

The size of the Executive Board raises questions about effectiveness and efficiency (including effective use of committees) which are both addressed in the two principles discussed below.

Effectiveness and Efficiency

Principle 13. Board operations should be effective and efficient. Regular and sufficient board meetings, appropriate board size, effective use of committees, and adequate and timely supply of material to the board are some private-sector tools used to promote effective and efficient board operations. Efficiency is a particular concern in the private sector, given that boards are non-resident and need to effectively fulfill an extensive set of responsibilities.

Governance Codes

In all matters related to effectiveness and efficiency, governance codes leave a large degree of flexibility to boards, but they do explicitly refer to these practices. For example, the issue of regular and sufficient meetings is frequently brought up in governance codes, even though no specific recommendations on frequency are made. The Viénot Report specifically explains why: "the frequency and duration of meetings are not amenable to the definition of general rules and should be left up to each board to decide" (AFEP/CNPF, 1995: 11).

Many codes also comment on the issue of adequate supply of material to the board. The U.K.'s Combined Code notes that the "board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties (Financial Services Authority, 2003: 22). French, German, and Italian codes likewise emphasize this matter.

Private Sector Practices

The trend towards smaller boards is seen as a major source of greater board effectiveness and efficiency. Other measures include shorter meetings and increased delegation to committees.

The frequency of board meetings varies between three and 30+ meetings a year across the S&P500 (Carter and Lorsch, 2004). However, there is a general convergence around an average of about eight board meetings of about half a day each. Annual averages in Europe are lower in some countries (five in Germany, six in Switzerland and France) and slightly higher in others (ten in Italy and twelve in the U.K.) (Carter and Lorsch, 2004).

Board practices vary widely, but good practice suggests that directors must be both supportive and challenging of management, and reach consensus while encouraging dissent. As regards the material they receive, most directors say they are overwhelmed with volume and unimpressed by content. Carter and Lorsch (2004) recommend that directors carefully define the information that the board really needs in order to ensure that the board is receiving the appropriate information.

Questions for the IMF

Unlike in the private sector, the Fund's Executive Board is a resident board and is extremely involved in management activities. As such, the norms for the frequency of private-sector board meetings are more applicable to a body such as the IMFC that is not involved in management. Should the IMFC meet more often than twice a year to exercise its functions properly? If the Executive Board has not done so already, can it consider defining what information it really needs from management?

Use of Committees

Principle 14. Committees should be used to further board effectiveness and efficiency as well as provide independence. There is a strong trend towards having three main committees staffed by members of the board to ensure efficient use of time and expertise as well as sufficient independence—particularly in functions such as audit and compensation.

Governance Codes

Governance codes increasingly advocate the use of a set of three standard committees: on audit, compensation, and nomination/governance. The NYSE (2003) clearly defines the composition and responsibilities of these three committees:

- *Nominating/corporate governance committee*: made up entirely of independent directors and responsible for (1) identifying qualified individuals to serve on the board; (2) recommending corporate governance guidelines; (3) overseeing board and management evaluation.
- *Compensation committee*: made up entirely of independent directors, and responsible for evaluating the CEO and recommending non-CEO executive compensation to the board.
- *Audit committee*: made up of at least three financially literate members, and responsible for assisting board oversight of (1) the company's financial statements; (2) compliance with legal and regulatory requirements; (3) independent auditor's qualifications and independence; (4) performance of internal and independent auditors.

The U.K. Combined Code suggests having three similar committees. The German code leaves more flexibility, requiring only the audit committee. The Tokyo Stock Exchange code allows a choice between having a separate board of corporate auditors or the three committees.

Private Sector Practices

Most companies have the three standard committees. In Europe, almost all companies had committees in 2005, with the average number trending towards three (Heidrick and Struggles, 2005, and Annex 5 below). The most common committees were much like the ones defined by the NYSE, with around 94 percent of companies having audit and remuneration committees, and around 71 percent having a nomination committee. It is common practice for each committee to have well defined terms of reference as to its responsibilities and authorities as delegated to it by the board. Committees generally meet in closed session and are led by a small number of board members (good practice advocates four or five) who are selected by the nomination committee. In the German two-tiered model, where the supervisory board is made up of employee and shareholder representatives, committees maintain that same 50/50 ratio to ensure fair representation.[6]

[6]Interview with German Bank board member.

Beyond the three standard committees, some organizations create additional committees to address company-specific topics. Resources and chemical companies may have environment committees for example, while financial services companies are likely to have risk committees. Indeed, 70 percent of the top ten Fortune 100 universal banks have risk committees monitoring issues such as credit, market, interest rate, liquidity, and reputational risk.

Questions for the IMF

Today, the Fund's Board committees differ from private-sector committees in that they are several are staffed by management rather than board members and are conducted in open session rather than only with the presence of committee members. Looking at the private sector use of committees raises many questions for the Fund's use of committees today. Should the Fund continue to have Board committees staffed by Management? Or should its Board committees be run entirely by board members? The size of IMF Board committees also raises effectiveness concerns: Are they too large to be effective? Should they be run in closed session? How can the Fund ensure that the right people are selected to sit on each committee, while ensuring that they are representative of the board as a whole?

Further, the private sector stresses the need for clear mandates and clarity on the degree of delegation granted to committees. Has the Fund's Executive Board defined clear terms of reference for its committees? Is there a distinction between information received at the Board level versus at committee level? Do committees have the appropriate degree of decision-making ability? Is there any business now handled by the Board that can be delegated to a committee? Or vice versa? Do committee reports give the right information to the Board?

Having explored the 14 private sector principles, we now turn our attention to how the private sector thinks about measuring governance.

Measuring Governance in the Private Sector

Internal company practices do not generally include rigorous governance tracking but rather rely on board evaluations as a thermometer for the health of their governance structures. External ratings agencies have filled the information gap for shareholders and investors using a plethora of qualitative and quantitative metrics.

Internal Company Practices

Most companies do not conduct rigorous internal tracking of governance practices. They use evaluations and self-reporting metrics instead of indicators, mainly in order to learn and permit continuous improvement rather than for the purpose of evaluation per se. In evaluating board performance and individual performance, companies do collect relevant information for understanding and improving upon their governance structures and policies. From talking to board members we found that these evaluations, done annually or biennially, can provide strong baselines for evaluating improvements over time. At each evaluation, the board automatically goes back to the previous evaluation and is able to see whether there have been improvements.

Of course, these evaluations have the dual role of allowing the board to track improvements as well as galvanizing the board into action; each evaluation is followed by a distillation of feedback and delegation of the responsibility to change governance structures and processes based on that feedback. The types of issues that are uncovered during these evaluations range from operational complaints about meeting length, number of executive sessions, or types of documents received, to more complex issues around the role of the board in strategic decision making and gaps in the skill sets of the members of the board. Qualitative and quantitative metrics can be developed around any one of these issues to measure performance over time.

The private sector performs these evaluations either internally or with the help of outside consultants. Deutsche Bank's supervisory board chose to recruit the help of external consultants to help it get started on its first evaluation, and then repeated the same type of evaluation internally, through the Chairman's Committee, in 2006. Whether internal or external, successful evaluations require a lead director to champion the process.

Best practice also requires a combination of well thought out questionnaires and one-on-one discussions to fully bring out each director's concerns as well as candid board-wide discussions to increase the ownership and commitment of the entire board. The types of questions addressed in the course of board evaluations must probe into directors' perceptions around a full checklist of the board's responsibilities. Annex 4 and Annex 6 provide examples of questions asked in the private sector.

External Rating Agencies

While there are no internationally recognized standards and benchmarks as far as private-sector corporate governance metrics are concerned, a number of companies assisting shareholders and investors have taken the lead in developing corporate governance ratings. The most recognized rating agencies include Institutional Shareholder Services (ISS), Governance Metrics International (GMI), Deminor Rating (sold to ISS in 2005), Standard & Poor's, Audit Integrity, and a handful of others. These companies use different methodologies but generally develop hundreds of qualitative and quantitative criteria to evaluate companies based on securities regulations, listing requirements, and corporate governance codes, as well as perceptions of governance experts.

These criteria generally have a number of governance components. For example, Standard & Poor's Corporate Governance Score has four: (1) ownership structure; (2) financial stakeholder relations; (3) financial transparency and information disclosure; and (4) board structure and process. Governance Metrics International has a slightly broader scope; it looks at six governance components that include the four above plus remuneration and interactions with non-financial stakeholders, including employees and suppliers.

Figure 2 illustrates some of the qualitative and quantitative criteria tracked by ratings agencies, including GMI, Deminor/ISS, and Audit Integrity. Most of these criteria consider whether or not the company adheres to selected practices, as opposed to tracking performance indicators using a particular metric.

Suggestions for the IMF in Creating a Governance Scorecard

To develop a scorecard for good governance, the Fund could draw on two sources of information: comprehensive annual Board evaluations and internal organization metrics similar to those tracked by external ratings agencies in the private sector. While such a process should be run in close coordination with the Board and ensure executive directors' understanding and commitment to the Board evaluation process, it would also benefit from the independence of a Fund office such as the IEO.

Figure 3 is an example of a potential scorecard, with the understanding that this is neither a comprehensive list of metrics that could be tracked, nor one that necessarily reflects the priorities of the Fund,

Figure 2. Governance Criteria Tracked by Rating Agencies

Areas	Metric	Rationale
Strategy and mission	Caliber of board members based on ensuring mix of relevant academic and professional expertise that reflects the needs of the organization (criteria include gender, nationality, functional experience) as well as mix of senior experts and younger more action-oriented members.	High caliber and appropriate diversity of board members are considered strong asset for providing valuable direction and advice to management.
Accountability	Percent change in number of company shares held by the senior management.	Shares held by board members are seen as a proxy for commitment to the company.
	Board attendance e.g. whether or not all directors attended at least 75 percent of meetings.	Directors' attendance is seen as a critical component of accountability.
	Whether or not training and orientation are required for new board members.	Training and orientation are seen as a way to ensure that directors are fully cognizant of their responsibilities.
Oversight	Whether or not the remuneration committee seeks professional advice from external consultants.	Performance-based remuneration of management is seen as a key component of effective oversight.
	Number of directors serving on the board for more than 15 years.	Belief that directors who have served on board for too long get too friendly with management at the expense of shareholders.
	Whether or not there is a policy for non-executive directors to meet before or after every board meeting.	Board independence from management is facilitated by non-executive sessions.
	Percent of independent directors on the board.	Board independence is considered a critical element enabling independent oversight of management.
Stakeholder interests	Whether or not training is required for audit committee members.	Ensuring that audit committee members have the requisite skill-sets.
	Whether or not the company has a policy for selection of auditors that includes either periodic rotation of the outside audit firm or competitive procurement.	This metric stresses the importance of continually evaluating and refreshing auditors.
	Number of restated earnings within the past years.	Seen as indicator of poor auditing processes.

Figure 2 ***(concluded)***

Areas	Metric	Rationale
	Disclosure of criteria used by the board or a board committee to formally evaluate CEO.	Disclosure of non-financial criteria signals transparency to stakeholders.
	Whether or not all shares are one-share-one-vote.	Ensuring that there are no special privileges granted to any shareholders, or restrictions imposed on minority shareholders.
	Whether or not minority shareholders (e.g., 10 percent of shareowners) can convene an extraordinary general meeting.	This metric is seen as a proxy for minority shareholder voice.
	Whether or not the company complies with established workplace codes.	Seen as an indicator for employee relations.
	Whether or not the company discloses its environmental performance in its annual report, on its website, or in a special environmental report.	Metric to assess environmental risk management.
Structures and processes	Size of the board (e.g., around 12 seen as good practice).	Smaller boards seen as more efficient.
	Adequate size of committees (e.g., around 5 members seen as good practice) as well as composition.	Smaller committees seen as more effective. Independence of committee is seen as critical for certain committees such as audit and nomination.
	Whether or not executives take part in committee deliberations.	Independence of committee's decision making as key element of good governance.

which have not been systematically evaluated. Given the uniqueness of the Fund, many of the benchmarks would need to be focused on continuous improvement and thus on comparative historical metrics rather than on external benchmarks.

Many of the benchmarks shown in Figure 3 imply changes to current IMF Board structures and process, and should be taken for what they are: potential examples of what a scorecard might look like. As mentioned previously, any final list of indicators should ultimately be driven by the recommended actions resulting from a comprehensive gap analysis, and should be based on an in-depth review of the Fund's realities.

Figure 3. A Potential Scorecard for the IMF

<table>
<tr><th>Principle</th><th>Indicator</th><th>Description/ Observation</th><th>Objective</th><th>Source</th></tr>
<tr><td>Strategy and mission</td><td>Average years of experience of EDs (and distribution across EDs)</td><td>Years should be defined as total "relevant" professional experience</td><td>Assesses caliber of board members and is proxy for relevance of IMF</td><td rowspan="6">Visible/ traceable metrics</td></tr>
<tr><td rowspan="2">Accountability</td><td>Percent of board meeting time attended by all EDs</td><td>Percent of hours out of total official board time during which all EDs present</td><td>Measure engagement and accountability of board members</td></tr>
<tr><td>Percent of new directors receiving training and orientation</td><td>This metric implies training and induction are formalized</td><td>Assesses effort of the board in promoting accountability</td></tr>
<tr><td>Oversight</td><td>Number of board sessions where MD and DMDs not present</td><td>Executive board sessions where management does not take part</td><td>Tracks ability of board to independently deliberate on management</td></tr>
<tr><td>Stakeholder interests</td><td>Disclosure of criteria used by board or committee to evaluate MD</td><td>This metric implies evaluation of MD's performance is formalized</td><td>Assesses degree of accountability of the MD to the board and the Fund</td></tr>
<tr><td rowspan="6">Structures and processes</td><td>Whether or not executives take part in committee deliberations</td><td>This metric implies switch to board-member led and run committees</td><td>Assesses degree of independence between management and board</td></tr>
<tr><td>Ability of board members to speak up in board meetings</td><td rowspan="5">Aggregate of director satisfaction scores when answering these questions in annual board evaluation survey (e.g., on a scale of 1–5 from very dissatisfied to very satisfied)</td><td>Gauge whether MD is encouraging contributions on the board</td><td rowspan="5">Board self-evaluation</td></tr>
<tr><td>Transparency of procedures for contact between management and directors outside board meetings</td><td>Measure to what extent information flowing to the board takes place in a symmetrical/ transparent way</td></tr>
<tr><td>Involvement in determination of Fund's long-term strategy</td><td>Assess whether the board is focused on the right mix of activities</td></tr>
<tr><td>Level of detail and quality of committee reports to the board</td><td>Gauge whether directors feel that committees are providing appropriate information</td></tr>
</table>

Conclusion

This initial phase of work provides a solid fact base that raises some important questions for the Fund to consider as it seeks to improve its governance structures and the performance of its Executive Board. To assist the IMF in starting the transformation that would be necessary to adopt and adapt these good practices and indicators, subsequent phases of work might include: (1) conducting a gap analysis of current IMF governance practices with good practice; (2) outlining a transition/ implementation plan with recommendations to close the gaps—ranging from "light touch" improvements to fundamental structural changes; and (3) establishing a final set of indicators to track improvements in governance structure over time.

Annex 1. Sources of Research for Private Sector Governance Principles

Sources were identified across a diverse set of countries and organizations:

Country/ Organization	Document
Australia	Australian Stock Exchange (2003), "Corporate Governance in Australia."
Canada	Canadian Coalition of Good Governance (2005), "Corporate Governance Guidelines for Building High Performance Boards."
France	Association Française des entreprises Privées et Conseil National du Patronat Français (1995), "Le conseil d'administration des sociétés cotées" (or Viénot I Report), Rapport du groupe de travail.
Germany	German Government Commission (2006), "German Corporate Governance Code."
Italy	Italian Parliament (2001), "Riforma organiza della disciplina delle societa' di capitali e societa' cooperative, in attualizione della legge 3 ottobre 2001, n. 366." Committee for the Corporate Governance of Listed Companies, Borsa Italiana (1999), "Report & Code of Conduct" (or the Preda Code).
Japan	Corporate Governance Forum of Japan (1997), "Corporate Governance Principles—A Japanese View (Interim Report)." Ministry of Justice (2002), "Commercial Code Revisions in Japan." Tokyo Stock Exchange (2004), "Principles for Corporate Governance for Listed Companies."
Netherlands	Committee on Corporate Governance (1997), "Peters Report & Recommendations, Corporate Governance in the Netherlands." Corporate Governance Committee Chaired by Morris Tabaksblat (2003), "The Dutch Corporate Governance Code" (or the Tabaksblat Code).
OECD	OECD (2004), "OECD Principles of Corporate Governance."

Country/ Organization	Document
United Kingdom	Financial Services Authority (2003), "The Combined Code on Corporate Governance."
United States	New York Stock Exchange (2003), "Listed Company Manual." United States Senate and House of Representatives (2002), "Sarbanes-Oxley Act of 2002."
Other	Goldman Sachs (2006), "The Goldman Sachs Energy ESG Index—Integrating Environmental, Social and Governance Factors into Energy Industry Analysis." Heidrick & Struggles (2005), "Corporate Governance in Europe: What's the Outlook?"

Annex 2. Merrill Lynch & Co., Inc., Board Candidate Guidelines

The Board of Directors should be composed of individuals who have demonstrated notable or significant achievements in business, education, or public service. In addition, the director candidate should possess the requisite intelligence, education and experience to make a significant contribution to the membership of the Board of Directors and bring a range of skills, diverse perspectives and backgrounds to the deliberations of the Board of Directors. Importantly, the director candidate must have the highest ethical standards, strong sense of professionalism and dedication to serving the interests of all the shareholders and be able to make himself or herself available to the Board of Directors in the fulfillment of his or her duties. For those director candidates who are also employees of the Corporation, he or she should be members of the executive management of the Corporation who have or are in the position to have a broad base of information about the Corporation and its business.

The overall ability and experience of the individual should determine his or her suitability. However, the following attributes and qualifications should be considered in evaluating the candidacy of an individual as a director for the Board of Directors:

> *Management and leadership experience—The Board candidate must have extensive experience in business, education, or public service.*

The experience of candidates from the different fields of business, education, or public service should be measured as follows:

Candidates from the field of business: The Board candidate is or has been the Chief Executive Officer, Chief Operating Officer or Chief Financial

Officer of, or holds or has held a senior managerial position in, a major public corporation, recognized privately held entity or recognized money or investment management firm.

Candidates from the field of education: The Board candidate holds or has held either a significant position at a prominent educational institution comparable to the position of university or college president and/or dean of a school within the university or college or a senior faculty position in an area of study important or relevant to the Corporation.

Candidates from the field of public service: The Board candidate has held one or more elected or appointed senior positions in the U.S. federal government or agency, any U.S. state government or agency or any non-U.S. governmental entity or holds or has held one or more elected or appointed senior positions in a highly visible nonprofit organization.

Skilled and diverse background—The Board candidate must bring a desired range of skills, diverse perspectives and experience to the Board.

The following attributes should be considered in assessing the contribution that the Board candidate would make as a member of the Board of Directors:

Financial literacy: Board candidates having a sufficient understanding of financial reporting and internal control principles or financial management experience bring desirable knowledge and skills to the Board.

International experience: International experience is a significant positive characteristic in a Board candidate's profile. Having an understanding of the language and culture of non-English speaking countries will also be considered beneficial.

Knowledge of the duties of director: The Board candidate's aptitude and/or experience to understand fully the legal responsibilities of a director and governance processes of a public company is an essential factor.

No interlocking directorships: The Board candidate should not have any prohibitive interlocking relationships.

Integrity and professionalism—The Board candidate must have the highest ethical standards, a strong sense of professionalism, and be prepared to serve the interests of all the stockholders.

Personal experience: The Board candidate should be of the highest moral and ethical character. The candidate must exhibit independence, objectivity and willingness to serve as a representative of the Corporation's stockholders. He or she should have a personal commitment to the Corporation's Principles of Client Focus, Respect for the Individual, Teamwork, Responsible Citizenship and Integrity.

Individual characteristics: The Board candidate should have the personal qualities to be able to make a substantial active contribution to Board deliberations. These qualities include intelligence, self-assuredness, high ethical standards, inter-personal skills, independence, courage, a willingness to ask difficult questions, communication skills and commitment. In considering candidates for Board membership, the diversity of the communities in which the Corporation conducts its business should be considered in looking at the composition of the Board.

Annex 3. Typical CEO Selection Process

Establish Criteria: Set Goals and Objectives of the Search

- Examine the strategic and market challenges facing the organization
- Identify the leadership skills and attributes necessary to meet those challenges: character/emotional, technical competence in industry and as CEO, administrative and interpersonal skills
    - Include consideration of "soft skills," e.g., emotional intelligence as well as skills like demonstrates integrity, provides meaning, generates trust, and communicates values
    - Consider valued skills sets (in appropriate moderation), e.g., being a team player, hands-on coaching, operational proficiency, dynamic public speaking, raw ambition, and similarity and familiarity (fit)

Structure Process: Establish Committee to Run a Clearly Defined Search Process

- Establish a search committee that contains:
    - Individuals who have deep knowledge of the organization and its challenges
    - Individuals who are diverse in their functional backgrounds or cognizant of their potential biases
- Enlist the entire board in gathering detailed information about candidates through trusted contacts
- Set a clearly defined, transparent process and timetable that includes candidate identification, short listing, and formal and informal assessments of candidates

Identify Candidates: Define Candidate Pool Broadly and Assess Thoroughly

- Utilize selection criteria to identify broad pool of prospective candidates
- Encourage less obvious candidates to be considered seriously
- Focus on candidates who can best meet the long-term objectives of the organization, not the short-term reaction of Wall Street and the business media
- Use thorough formal and informal assessments/discussions with candidates and colleagues to narrow candidate pool to the short list

Candidate Selection: Choose Candidates on Basis of Goals and Objectives

- Analyze candidates in context to better understand the trade-offs choosing each candidate involves
    - Realize the CEO is an important element of organization performance, but not the only one
    - Recognize the trade-offs involved with any candidate, e.g., insider vs. outside candidate
- Guide selection using the position requirements rather than evaluate candidates against one another
- Avoid political compromises – compromise solutions are often the mediocre candidate in the middle
- Allow search consultant (if one is used) to mediate the sensitive compensation discussions

Source: Dalberg analysis and research of sources including: "Find the Right CEO: Why Boards Often Make Poor Choices," MIT Sloan Management Review; "Hire the Right CEO" collection of articles in HBR OnPoint.

Annex 4. Sample Board Evaluation Questionnaire

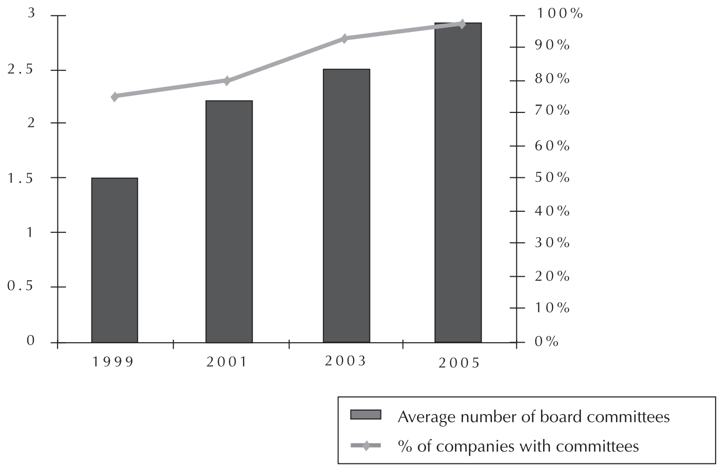
From Bryan Cave, LLP:

Board Structure			Comments
Does the Board as a whole possess the right skills and background to help guide management and the company through the current issues facing the company?	Y	N	
Does the Board have the right number of directors? Are there enough directors to fulfill the Board's responsibility without burdening the directors?	Y	N	
The Board has _____ inside and _____ outside directors. Should there be more outside directors?	Y	N	
Is the process for selecting new directors and re-nominating current directors appropriate?	Y	N	
Should significant investors in the company or other outsiders have an ability to nominate directors?	Y	N	
The Board does not have a mandatory retirement/resignation age for directors. Is this policy appropriate?	Y	N	
The company does not limit the length of service of directors. Is this appropriate?	Y	N	
Does the Board have the right Committee structure. At present, it has the following committees: [list committees]	Y	N	
Is the annual review of committee memberships and chairmanships appropriate and adequate?	Y	N	
Should the Board appoint a lead outside director?	Y	N	

Board Meetings			**Comments**
Does the Board have the appropriate number of meetings per year?	Y	N	
Does the Board receive adequate materials in advance of the meetings of the Board? If delivery of materials can be improved, please provide input.	Y	N	
Are you satisfied with the content of Board meetings? Does the agenda include what is important (rather than mere formalities)?	Y	N	
Do you feel that you are able to easily place items on the agenda or to raise issues that are not on the agenda?	Y	N	
Are you satisfied with the allocation of time for the different agenda items and feel that all important issues are discussed and analyzed?	Y	N	
Are you satisfied with presentations to the Board?	Y	N	
Is there sufficient time at Board meetings for presentation and full discussion of the subjects covered? And to address all of your questions?	Y	N	
Is the time at Board meetings utilized effectively?	Y	N	
Does the Board have open and constructive deliberations?	Y	N	
Are the directors well prepared for Board meetings?	Y	N	
Is there any business that is handled by the full Board that should be delegated to a committee?	Y	N	
Is there any business now handled by a committee that should be handled by the full Board?	Y	N	
Do committee reports give the appropriate amount of information to the Board? Do you feel like you know what each committee is working on?	Y	N	
Is there sufficient time/opportunity for outside directors to meet independently, either in a formal "executive session" or otherwise?	Y	N	
Is the frequency in which the Board meets with members of senior management alone sufficient?	Y	N	

Key Board Responsibilities			**Comments**
Is the Board adequately and properly involved in determination of the company's long-term strategy?	Y	N	
Is the Board effective in monitoring the implementation of the company's long-term strategy?	Y	N	

Annex 5. Average Number of Board Committees in Europe, 1999–2005



Source: Heidrick & Struggles 2005 Study, "Corporate Governance in Europe: What's the Outlook?" Dalberg Research & Analysis.

Note: Heidrick & Struggles study based on 300 of Europe's top companies from the following countries: U.K., the Netherlands, France, Sweden, Spain, Belgium, Portugal, Germany, and Italy.

Annex 6. Ten Questions for Assessing Board Behavior

From *Back to the Drawing Board*, by Colin B. Carter and Jay W. Lorsch (Harvard Business School Press, 2004)

1. Is the chairman's leadership style effective?
2. Do the chairman (or lead director) and CEO have a good working relationship?
3. Do the chairman (or lead director) and CEO understand their respective roles?
4. Does the CEO encourage contributions from the board?
5. Is the relationship between directors and management a constructive one?
6. Are there agreed procedures for contact between management and directors outside board meetings?
7. Can individual directors raise issues for discussion without difficulty – is dissent OK?

8. Do directors express their views to each other and to management in ways that are constructive?
9. Having reached decisions, are directors cohesive in supporting the board's decision?
10. Is bad news communicated quickly and openly by management to the board?

References

Adams, Renée, and Hamid Mehran, 2003, "Is Corporate Governance Different for Bank Holding Companies?" *FRBNY Economic Policy Review* (April), pp. 123–42.

Association Française des entreprises Privées et Conseil National du Patronat Français (AFEP/CNPF), 1995, *Le conseil d'administration des sociétés cotées* (or Viénot I Report), Rapport du groupe de travail. Available via the Internet: www.ecgi.org/codes/code.php?code_id=42.

Association of Chartered Certified Accountants, 2001, "Corporate Governance: The Stakeholder Challenge." Available via the Internet: www.ifac.org/Credibility/ViewPoints_PubDL.php?PubID=00020.

Audit Integrity, 2005, *Measuring Accounting and Governance Risk in Public Corporations.*

Australian Stock Exchange, 2003, *Corporate Governance in Australia: Principles of Good Corporate Governance and Best Practice Recommendations.* Available via the Internet: www.shareholder.com/visitors/dynamicdoc/document.cfm?documentid=364.

BusinessWeek, 2004, "One Share, Many Votes," March 29.

Carter, Colin B., and Jay W. Lorsch, 2004, *Back to the Drawing Board* (Cambridge, Massachusetts: Harvard Business School Press).

CNN Money, 2007, "Companies Splitting CEO, Chairman Roles," January 31.

Colley, John L. Jr., Jacqueline L. Doyle, George W. Logan, and Wallace Stettinius, 2003, *Corporate Governance* (New York: McGraw-Hill Executive MBA Series).

Committee on Corporate Governance, 1997, *Peters Report & Recommendations, Corporate Governance in the Netherlands* (Peters Code). Available via the Internet: www.commissiecorporategovernance.nl/Information%20in%20English.

Committee on Corporate Governance, 2003, *The Dutch Corporate Governance Code: Principles of Good Corporate Governance and Best Practice Provisions* (Tabaksblat Code). Available via the Internet: corpgov.nl/page/downloads/CODE%20DEF%20ENGELS%20COMPLEET%20III.pdf.

Corporate Governance Forum of Japan, 1997, "Corporate Governance Principles: A Japanese View (Interim Report)."

———, Corporate Governance Committee, 2001, *Revised Corporate Governance Principles*. Available via the Internet: www.ifac.org/Credibility/ViewPoints_PubDL.php?PubID=00046.

Deminor Rating, 2003, Research and Rating Service Methodology.

———, 2005, "Application of the One Share—One Vote Principle in Europe," Commissioned by the Association of British Insurers.

———, 2006. "Corporate Governance Rating and Investor Report—Banco Santander Central Hispano SA."

Egon Zehnder International [n.d.], "The Changing Face of Japanese Corporate Governance—A Farewell to Tradition."

European Corporate Governance Institute, 2004, B*oard Models in Europe: Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy*, Law Working Paper No. 18.

European Corporate Governance Forum, 2006, "Statement of the European Corporate Governance Forum on the Comply-or-Explain Principle." Available via the Internet: ec.europa.eu/internal_market/company/docs/ecgforum/ecgf-comply-explain_en.pdf.

Financial Services Authority, 2003, *The Combined Code on Corporate Governance*. Available via the Internet: www.fsa.gov.uk/pubs/ukla/lr_comcode2003.pdf .

German Government Commission, 2006, *German Corporate Governance Code*, as amended on June 12, 2006. Available via the Internet: www.corporate-governance-code.de/eng/kodex/index.html.

Goldman Sachs, 2006, *The Goldman Sachs Energy ESG Index—Integrating Environmental, Social and Governance Factors into Energy Industry Analysis*, Greenleaf Publishing. Available via the Internet: www.greenleaf-publishing.com/greenleaf/abstractpopup.kmod?productid=654.

Governance Metrics International, 2007, GMI Research Categories and Sample Metrics.

Heidrick and Struggles, 2005, *Corporate Governance in Europe: What's the Outlook?* Available via the Internet: www.heidrick.com/NR/rdonlyres/B1A816CD-0E51-4605-B22C-40CB1B50561D/0/HS_EuropeCorpGovOutlook.pdf.

International Monetary Fund (IMF), 2006, *What Is the International Monetary Fund?* Available via the Internet: www.imf.org/external/pubs/ft/exrp/what.htm.

Italian Parliament, 2001, "Riforma organica della disciplina delle societa' di capitali e societa' cooperative," *Attualazione della legge 366* (October 3).

Italian Stock Exchange, Committee for the Corporate Governance of Listed Companies, 1999, *Report & Code of Conduct* (Preda Code). Available via the Internet: www.ecgi.org/codes/code.php?code_id=67.

Japan Ministry of Justice, 2002, *Commercial Code Revisions in Japan*.

Knowledge@Warton, 2004, "Splitting Up the Roles of CEO and Chairman: Reform or Red Herring?" June 2.

London Stock Exchange, Committee on the Financial Aspects of Corporate Governance, 1992, *The Financial Aspects of Corporate Governance* (Cadbury Report) (London: Gee and Co.). Available via the Internet: www.ecgi.org/codes/code.php?code_id=132.

Lorsch, Jay W., and Andy Zelleke, 2005, "Should the CEO Be the Chairman?" *MIT Sloan Management Review*, Vol. 46, No. 2.

McKinsey & Co., 2004a, "A New Era in Corporate Governance?" *McKinsey Quarterly*. Available via the Internet: www.mckinseyquarterly.com/Governance/Boards/A_new_era_in_corporate_governance_1414_abstract.

———, 2004b, "How to Separate the Roles of Chairman and CEO," *McKinsey Quarterly*. Available via the Internet: www.mckinseyquarterly.com/Governance/Boards/How_to_separate_the_roles_of_chairman_and_CEO_1512_abstract.

Mercer Delta, 2003, "Board Assessment—Laying the Foundation for Better Governance."

New York Stock Exchange, 2003, *Listed Company Manual*. Available via the Internet: www.nyse.com/regulation/listed/1182508124422.html.

New York Times, 2007, "Move Over G.M., Toyota Is No. 1," April 25.

Organization for Economic Cooperation and Development (OECD), 2004, *OECD Principles of Corporate Governance* (Paris).

Sonnenfeld, Jeffrey, 2004, "Good Governance and the Misleading Myths of Bad Metrics," *Academy of Management Executives*, Vol. 18, No. 1.

Spencer Stuart, 2004, "Taking a Closer Look: The Board Evaluation."

———, 2006a, "2006 UK Board Index—Current Board Trends and Practices at Major UK Companies."

———, 2006b, "The Netherlands Board Index—Board Trends and Practices at 100 Leading Companies," Ninth Edition.

———, 2006c, "The Changing Profile of Directors."

———, 2006d, "Five-Year Trends Reveal a Changing Boardroom and Greater Independence."

———, 2006e, "Spencer Stuart Board Index—Osservatorio del Consiglio di Amministrazione delle Società Italiane."

Tokyo Stock Exchange, 2004, *Principles of Corporate Governance for Listed Companies*. Available via the Internet: www.ethosfund.ch/pdf/Code_Japan_principles.pdf.

Toyota, 2006, *Annual Report*.

United Nations, 2006, *Comprehensive Review of Governance and Oversight Within the United Nations, Funds, Programs, and Specialized Agencies*. Available via the Internet: www.un.org/reform/governance/report.html.

United Nations Conference on Trade and Development, 2006, *Guidance on Good Practices in Corporate Governance Disclosure* (New York: United Nations).

United States Senate and House of Representatives, 2002, Sarbanes-Oxley Act of 2002.

Van Houtven, L., 2002, *Governance of the IMF: Decision Making, Institutional Oversight, Transparency, and Accountability*. IMF Pamphlet Series No. 53 (Washington: International Monetary Fund).