

The Incredible Adventures of Carla

Practical Guide for Nominee Directors

**IFC**

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Ulrich Steger and **Christoph Nedopil**

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Davit Karapetyan

IFC Corporate Governance Group

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How to Read this Novel with Pleasure— And Learn about Directorship Challenges

This is a book about directorship. More precisely, it's about *nominee directors*, who are nominated by IFC and other development finance institutions (DFIs) to the boards of investee companies to fulfill a dual mandate:

1. First, they are expected to perform all the duties and tasks of a board member.
2. Second, they are also charged with improving the corporate governance, sustainability, and ethical behavior of the investee company.

This need exists because the empirical evidence indicates that in many developing countries it is nearly impossible to create long-term shareholder value without marked improvements in these areas. This book, based on sound research and real-life examples, offers not only a useful learning platform but also, the authors hope, an entertaining read.

It focuses on directorship and leadership skills in the boardroom and does not attempt to cover the whole “waterfront” on corporate governance issues. Many other publications (including some found on the IFC website) deal extensively with the structures, processes, and legal frameworks of corporate governance.

As a novel, *The Incredible Adventures of Carla* describes the learning journey of a fictional nominee director, from the initial contact by the DFI to the final exit through a successful IPO. Although Carla, the main character, is fictional, the events and experiences are not: they are based on real-life examples, documented in the annual meeting records of the IFC's Network of Nominee Directors and other events over the last 10 years. The authors didn't make up any of the situations described; they just arranged them into a consistent storyline to develop an unfolding drama, rather than just presenting a series of unrelated case studies.

The book uses everyday language and, admittedly, some stereotypes as well as deliberately exaggerated or oversimplified elements in an effort to strike a good balance between the “human” side of the story and the professional learning purpose.

The setting is not an ideal world, in which all the processes and structures work efficiently and everyone is cooperative. Instead, it takes place amid the messiness and chaos that often accompanies a learning process. It is a journey with trials and errors, victories and defeats—clearly not just best practices and optimal behaviors. The objective is to describe good, ambivalent, and even bad practices—what real nominee directors typically encounter during the evolution of their directorship.

The story emphasizes the learning and adapting that must go on for a nominee director to be effective in encouraging change/improvement on the board and in the company. It draws on specific situations to illustrate that IFC rules and instructions cannot always be

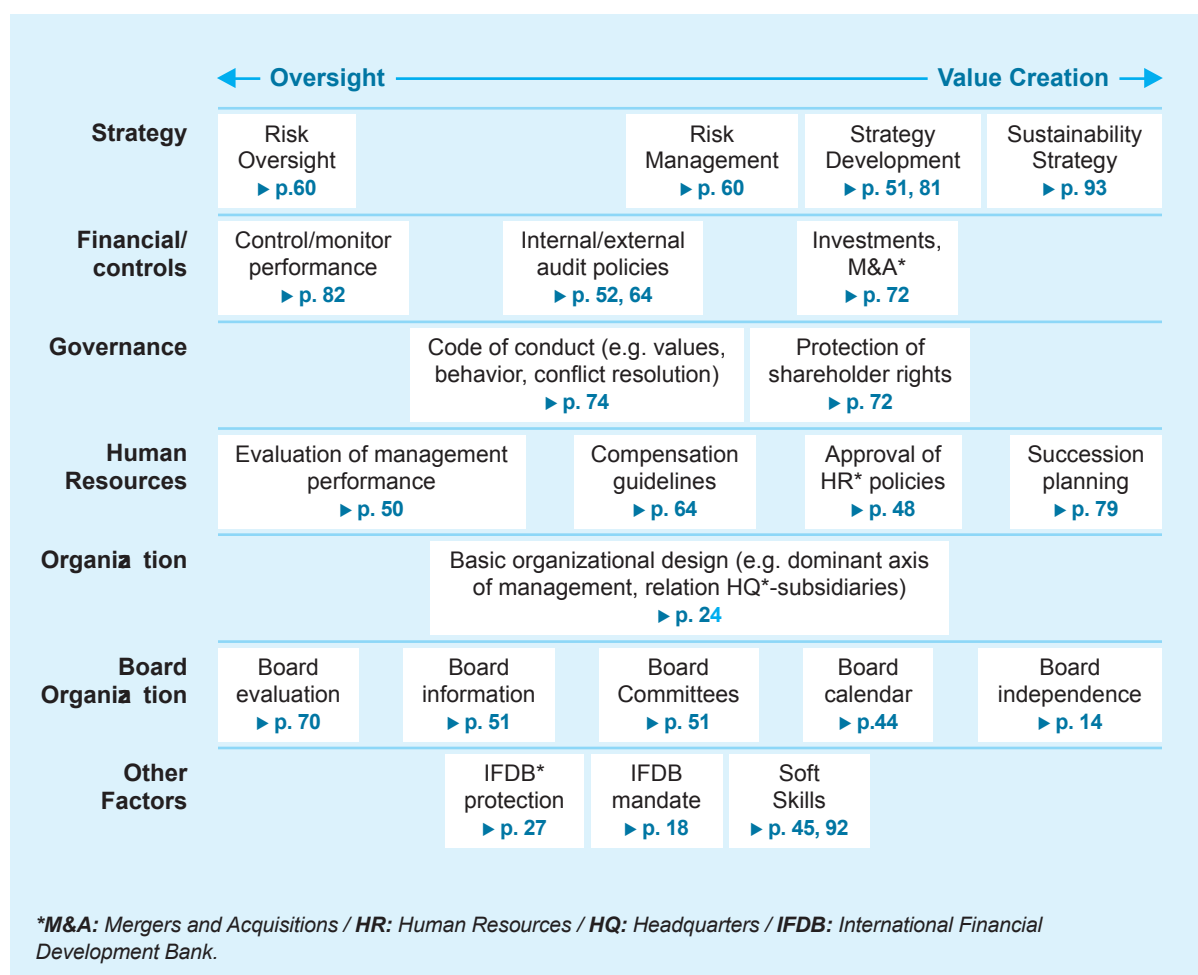
perfectly followed: the nominee director is in the “heat of the battle,” under time pressure, and confronted with dilemmas and uncertainty that only in hindsight can be structured and analyzed clearly. For example, Carla is constantly faced with the dilemma that a nominee director is the “slave of two masters”: her fiduciary duty to the company and the responsibility to protect the wealth of the public investor who nominated her. Another example is the uncertainty of how others are interpreting and reacting to her actions, which come from the best of intentions.

The target audience of *The Incredible Adventures of Carla* is nominee directors, especially those who are newly appointed or candidates who are considering taking on such a role. It aims to expose them to the challenges in the behavioral dimension of corporate governance and to help them learn, through Carla’s experience, the actions and communications that can help them—or not help them—achieve the goals they are committed to.

In her directorship journey, Carla encounters multiple aspects of corporate governance (see Figure 1). And an “interview” with her, at the end of the book, provides a summary of the key learnings. The authors hope you will enjoy traveling through this experience with Carla.

Bon voyage!

Figure 1: Map of Directorship Topics Covered in the Book



Setting the Stage

Bankistan

The story takes place mostly in Italy and Bankistan, a fictional country in Eastern Europe. Bankistan is an oil-rich country that has some typical and some less typical characteristics of countries in that region. Typical characteristics are, for example, the Slavic language and the excellent food. The constant fight for and against transparency and corruption could also be considered typical.

Bankistan, with its population of about 20 million, has been run by the same president for the past 20 years. Nevertheless, several improvements to its business climate have been achieved to attract international investors. The country is seen as a strategic partner in the region, combining a central location with good infrastructure and easy access to its five neighboring countries, plus some well-established and functioning public institutions. Because the stock market of Bankistan is little developed, about 20 companies have listed their shares abroad.

International Finance Development Bank— FDB

As an international financial institution, IFDB offers investment, advisory, and asset management services to encourage private sector development in developing countries. The bank was established in 1991, after the fall of the Berlin wall, to advance economic development to bring equality and fair opportunities to all political systems. It invests strictly in for-profit and commercial projects that reduce poverty and promote development.

IFDB's stated aim is to create opportunities for people to escape poverty and achieve better living standards by mobilizing financial resources for private enterprise, promoting accessible and competitive markets, supporting businesses and other private sector entities, and creating jobs for and delivering necessary services to those who are poverty-stricken or otherwise vulnerable.

IFDB's goals are to increase sustainable agriculture opportunities, improve health and education, increase access to financing for microfinance and business clients, advance infrastructure, help small businesses grow revenues, and invest in climate health.

On the following page, Table 1 introduces the characters, and Table 2 describes the investee company, SlavaBanca.

Table 1: The Characters

NAME (AGE)	ROLE	BACKGROUND
Carlotta (Carla) Feltrini (68)	Nominee Director	<ul style="list-style-type: none"> Retired IFDB risk manager Former employee of Credito Universale Experience in Central and Eastern Europe through previous investment work Married to Giacomo Feltrini
Giacomo Feltrini (66)	Husband of Nominee Director	<ul style="list-style-type: none"> Professor of history Married to Carlotta Feltrini
Alberto Montemarano (72)	Friend of Carlotta	<ul style="list-style-type: none"> Former colleague of Carla's from Credito Universale Economist Experienced director, but mostly in developed markets
Margaret (Maggie) O'Brian (51)	IFDB portfolio manager for Eastern Europe department	<ul style="list-style-type: none"> Responsible for IFDB investments in Eastern Europe Former colleague of Carlotta Feltrini
Hank Healey (46)	IFDB Portfolio Officer	<ul style="list-style-type: none"> Works on Margaret O'Brian's team Responsible for SlavaBanca investment
Gurkarn Singh (69)	Former employee in IFDB's Corporate Governance Department	<ul style="list-style-type: none"> Retired IFDB employee Sound experience in corporate governance Interested in the arts
General Aleksei Chomutowski (76)	Chairman and Founder of SlavaBanca	<ul style="list-style-type: none"> Retired general Founded SlavaBanca and owns 10% directly and controls 50% through a holding company Has stakes in different businesses Politically well-connected
Sergeii Ivanovich (44)	CEO of SlavaBanca	<ul style="list-style-type: none"> Married to General Chomutowski's daughter Former soldier under General Chomutowski Little experience in banking Employed by SlavaBanca since 2009 Owns 5% of shares of SlavaBanca
Boris Krohobor (49)	CFO of SlavaBanca	<ul style="list-style-type: none"> Employee of SlavaBanca since 1991 Former soldier under the General
Michael Flynt (42)	Non-executive director nominated by Global Equity Partner (GEP)	<ul style="list-style-type: none"> Partner at Global Equity Partner (GEP), an investor in SlavaBanca Interested in expanding business in Bankistan and the region
Kakha Kolas (39)	Independent director	<ul style="list-style-type: none"> Young lawyer in Bankistan
Oleg Jattschanka (69)	Independent director	<ul style="list-style-type: none"> Former soldier Knowledgeable in the history of Bankistan

Table 2: Executive Summary: The Company, SlavaBanca

Country of Operations	Bankistan and two neighboring countries
Business:	<p>SlavaBanca is a bank with its headquarters in Danubesk', Bankistan. It has 21 branches throughout Bankistan, 5 branches in the neighboring countries.</p> <p>The bank's main clients are public institutions, private customers, and SMEs throughout the three countries it operates in, with a focus on real estate and construction investments. It extended its client base through the merger with Bancia Polozk by 25% in January 2009.</p>
History:	The bank was founded in 1991 by General Aleksei Chomutowski (today, the chairman); it merged with another bank, Bancia Polozk, in January 2009.
Board structure:	One-tier board with two executive and four non-executive directors (two of which are independent)
Board committees:	Audit and risk committee
Executive board members:	<ul style="list-style-type: none"> • CEO: Sergeii Ivanovich (since January 2009) • CFO: Boris Krohobor (since 2004, but has been with the bank since 1991 in various positions)
Non-executive board members:	<ul style="list-style-type: none"> • Chairman: General Aleksei Chomutowski (non-independent) • Oleg Jattschanka (independent) • Kakha Kolas (independent) • Michael Flynt (non-independent)
Shareholder structure:	<ul style="list-style-type: none"> • Chomu-Holding (belonging to Aleksei Chomutowski and his family): 50% • Aleksei Chomutowski (chairman): 10% • Global Equity Partners: 15% • IFDB: 10% • Staff: 10% • Sergeii Ivanovich (CEO): 5%
Reason for IFDB's investment:	<ul style="list-style-type: none"> • Support SME development • Expand the business in Bankistan • Support development of the real estate and construction sectors • Developing corporate governance and sustainability standards in Bankistan
Key trends:	<ul style="list-style-type: none"> • Asset Growth: 2008 = 30%; 2009* = 70%; 3 months 2010 = minus 7% • Deposit Growth: 2008 = 30%; 2009* = 70%; 3 months 2010 = 12% • Branches in 2010: 39 (up from 31 from the time after the merger) • Headcount: 1,087 (up from over 950 from the time after the merger) • Loan/Deposit: 2008 = 200%; 2009* = 180%; 2010 = 140% • Net profits: 2008 = \$12 million; 2009 = \$1 million (would have been negative \$11 million if not for big securities trading net gain); 3 months 2010 = minus \$0.5 million • ROE: 2008 = 11.5%; 2009* = 3.1%; 3 months 2010 = minus 2.3% • Capital Adequacy (Basel): 2008 = 14.4%; 2009* = 19.2%; 2010 = 23.1% <p>NPLs/Losses: Impairment provisions on loan book up 60% in first 3 months 2010; estimated NPL levels in the range of 4–15% of loan assets, depending on borrowing sector, with overall bank average of ~7% in Q1 2010</p>
* 2009 was the year of the merger with Bancia Polozk.	

The Incredible Adventures of Carla

BECOMING A NOMINEE DIRECTOR

Rome | May 2010

Since retiring as head of risk management at the International Financial Development Bank nearly 15 months earlier, Carlotta Feltrini enjoyed sleeping in until 9:00 a.m., a luxury she couldn't afford before. She was enjoying her retirement and had plans to enjoy it even more. And none of those plans included IFDB.

1.1 The Wake-Up Call / Invitation to Serve

Shortly after 7:00 a.m.:

The ringing telephone woke Carlotta. Even though she found the early call annoying, she jumped out of bed and answered the phone.

“Hi, it’s Maggie from IFDB,” said the voice on the other end of the line. Carlotta recognized Maggie—Margaret O’Brian—as the bank’s portfolio manager for Eastern Europe.

“How are you, Carla?” Margaret continued. And Carla, still not fully awake, couldn’t resist telling her that the call had awakened her from a sound sleep, noting that it was only 7:00 a.m. Maggie apologized for getting the time zones mixed up. Then she said, now in a soft tone, “Please forgive me for calling so early.”

The soft tone put Carla on high alert! In the bank, Margaret O’Brian was known as “Iron Lady,” and not just because she shared her first name with the former British Prime Minister. Carla knew—from many battles between their departments—how tough Maggie could be. But when she used that soft voice, you could be sure she wanted something—and usually it was something difficult to achieve.

Carla decided to take the bull by the horns: “There must be a specific reason why you called me, whatever the timing,” she said. “So, what’s up, Maggie?”

Maggie immediately switched to her no-nonsense tone—the one Carla always thought sounded like bullet points. “It is about a difficult investment decision in Bankistan,” she began. “A relatively large bank. Privately owned. Merged with another bank twelve months ago through a full buy-out. Wants to expand nationally with a focus on small and medium enterprises in real estate and construction. Is thinking about an IPO, but needs better risk management before it can go forward. We decided to nominate a board member from our own ranks, and we thought of you, Carla, due to your experience. And since you have applied—”

“I didn’t apply for anything,” Carla interrupted. “I was asked to place my CV in a database of the Corporate Governance department,” she explained. And before Maggie could speak again, Carla added, “As a loyal former employee, I only did what I was asked to do.”—just to make sure she retained an option to say “no.”

“Well, in any case,” Maggie continued, in a voice even softer than usual, “you definitely know risk management. And before you joined IFDB, your former employer, Credito Unversale, had heavy investments in that region. It actually was the first to run subsidiaries there. As I am informed, you were very much involved in this. So we assume you have some country knowledge. With that in mind, we came to the conclusion that you are the ideal person to serve as our representative on that board.” She paused briefly, then added, “And as a retiree, you might also take this opportunity to spend your time in some interesting way and gain some additional income.”

“But what makes it a difficult investment decision?” Carla asked, ignoring Maggie’s obvious attempt to soften her up with compliments about her competence and lure her with extra money.

“Well,” said Maggie, pausing for a deep breath, “you know the situation in Bankistan. It has not become more politically transparent over the years. And although we did an earnest due diligence, we are not yet quite sure whether we discovered everything in that pretty complex bank.”

“Who else is onboard?” Carla wanted to know.

“Besides us, there is Global Equity Partner with fifteen percent. They are eager to expand their operations in that region. So you are not alone as foreign director.” Then Maggie tried to push the conversation toward getting Carla’s agreement. “So I think this is very interesting for you.”

But Carla was unmoved. She did not want to discuss with Maggie how busy the life of a retiree could be. “I just got out of bed,” she said politely. “I need to think about this. I have never been a nominee director. But I do know it’s heavy lifting. If I’m going to consider it, I need to have some more specific information about the bank.”

Maggie didn’t hesitate. “I can send you the Executive Summary we sent to our investment committee for approval,” she said, “confidentially of course.” Then she pushed to close the deal: “When can I hear your decision?”

Maggie can be really persistent, Carla thought. “When do you need it?”

“By tomorrow afternoon our time,” Maggie said. “But, honestly, I thought you would be more enthusiastic. What’s holding you back?”

“I just need more information,” said Carla. “And I need to think about the implications. When I take on such a responsibility, I want to be sure I can deliver. Isn’t that also in your interest?”

“Sure,” Maggie responded, now more coolly. “I’ll send you the promised information and will be waiting for your agreement. Have a nice day.” She hung up without waiting for a response.

Carla tried to go back to sleep, but her stirring thoughts wouldn’t let her. “There must be something brewing,” she said aloud to herself. “Normally things move much slower at IFDB. . .”

* * *

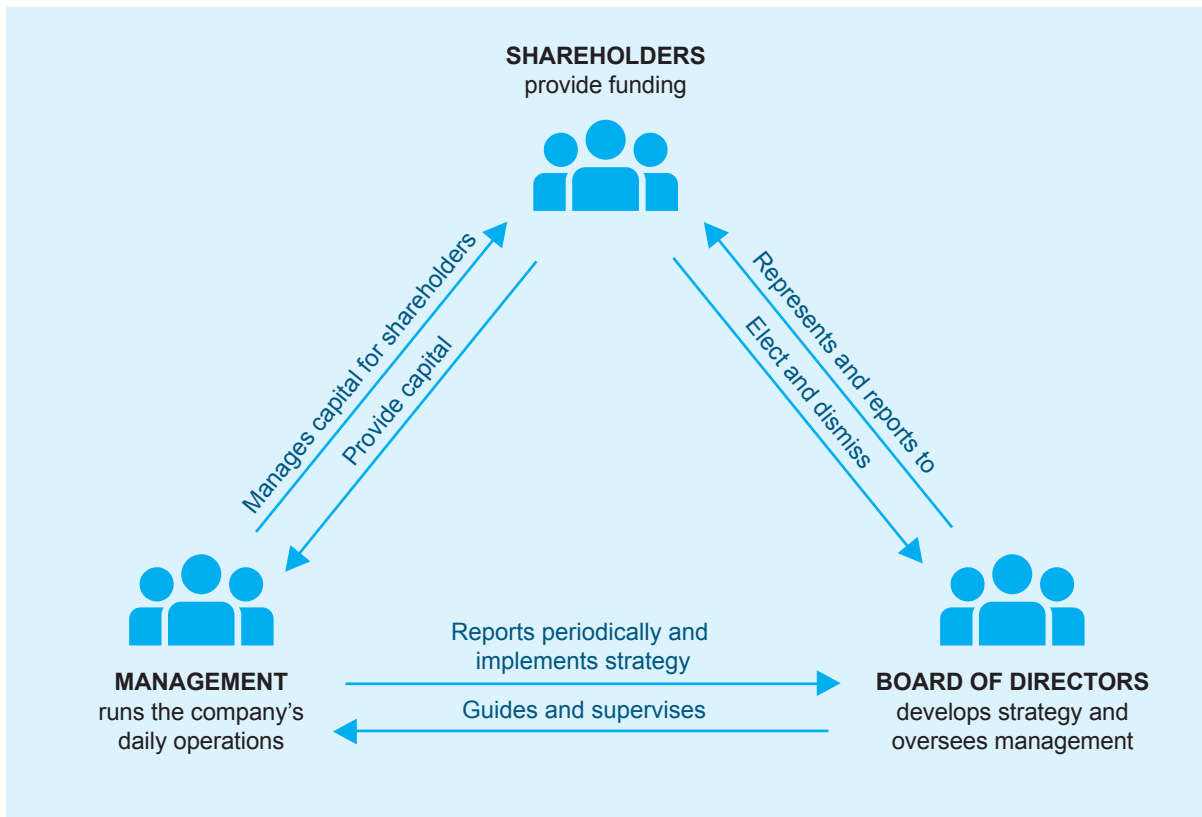
Carla had just started to prepare breakfast, when her husband came into the kitchen, fresh from his morning shower. Unlike Carla, Giacomo was an “early bird”—one reason they decided to have different bedrooms when they moved back to Rome. Cheerfully, he asked, “Why do people from IFDB call you so early? I assume that’s who it was, right?”

“Indeed,” Carla replied, knowing she couldn’t be anything other than forthcoming with her husband. “Maggie asked me to serve as a nominee director on a board.”

“Maggie?” Giacomo was surprised. “I always thought she didn’t like you.—A bean counter, always concerned and risk-averse. And now?” Giacomo shrugged. As a professor of history, he didn’t really have a business mind, but he was good at reading people. As an afterthought, he added, “And what is a nominee director?”

“Question One,” said Carla, “she needs me—obviously urgently. Question Two: someone who represents the interests of investors on a board by overseeing management and shaping the strategy of the company.” She made a quick drawing for her husband (see Figure 2). She knew that her answer was at best incomplete, but she wasn’t up for giving long explanations this early in the day. So she added softly, “Darling, you know that I am not good at difficult topics in the morning. Can we just enjoy breakfast first?”

Figure 2: The Three Players of Corporate Governance



There are three central players in corporate governance of larger corporations: First, the owners or **shareholders**, who provide funding and who own the company. The owners elect the second player, the **board of directors**. The board is responsible for tasks such as strategy, supervision, and selection of **management**, the third player. Management is responsible for running the company—and for fulfilling the goals of the shareholders.

“But you tell me later,” Giacomo insisted.

“Sure,” she promised. “But let me get clearer about a couple of things first myself.”

“As long as you do not sacrifice our cruise vacation, I can wait.” Then Giacomo smiled and changed the subject, asking about her impressions of the people they had met for dinner last night as part of their efforts to rebuild their social network in Rome.

* * *

After breakfast, Carla went to her laptop and found that Maggie’s information had already arrived—along with a confidentiality agreement for her to sign. (See Table 2, on page 5, for the Executive Summary on SlavaBanca.) As she read the material, knowing how investment officers “polish” their proposals, she began to see what made the proposal difficult.

The bank, founded by an entrepreneurial former general after the collapse of communism, apparently was quite successful with an opportunistic business strategy, but it lacked a consistent business model. The leadership structure—as far as she could discover—was based on the chairman’s power; risk-management functions probably played “second fiddle” at best; and corporate governance—at least from Carla’s perspective—existed only at a rudimentary level. *A board full of friends and family, she thought, probably legally compliant, but with no system of checks and balances. Plus the country risk. . .*

Carla wondered what to do. On the one hand, she did feel that her experience in risk management prepared her somewhat to tackle this challenge. Yet on the other hand, she wasn’t sure about her capabilities as a board member. Granted, she had read about the need for corporate governance and often enough took corporate governance into account when assessing risks of a company. But what does it actually mean to be a director? And besides all that, how would this new role affect her ability to enjoy her retirement?

As always in a situation like this, she knew that the best way to make such a decision was to get some sound advice. And she knew exactly where to turn: her old friend Alberto Montemarano. She had known him since their time at Credito Universale, where he had ascended in rank from consultant to chief economist. Alberto had served on many a board in Italy and Western Europe, so Carla was certain she could count on him for some good advice.

She called him right away and explained her situation—and her need to understand better the role of a nominee director. Alberto didn’t hesitate; he offered to meet for lunch and share his experience and observations.

1.2 The Lunch / Boardroom Basics

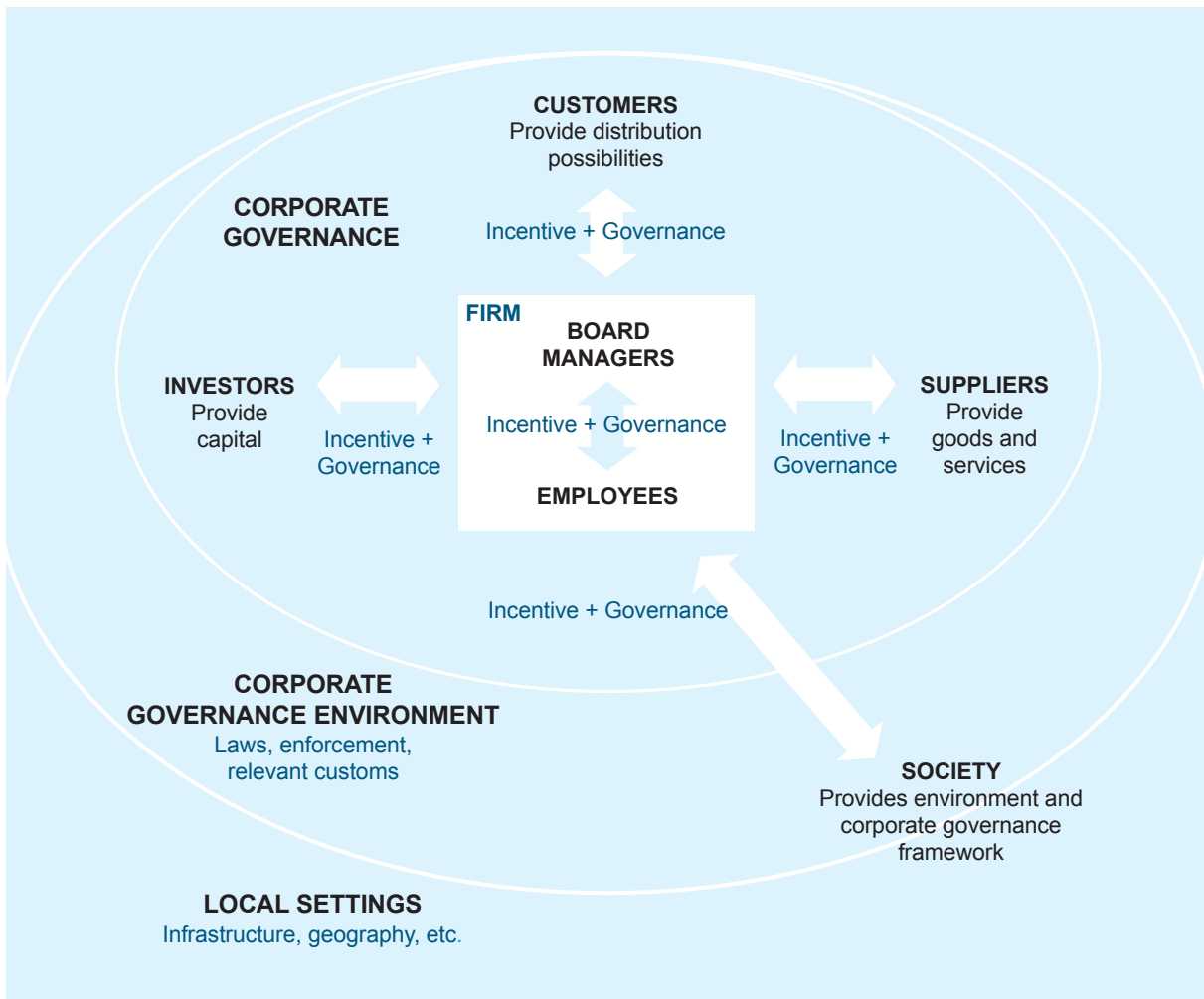
Alberto and Carla had a lively chat over the antipasti and the first course, talking about everything but business, until Carla told her friend, “I am sorry to stop our interesting discussion at this point, Alberto, but you know we met for a specific reason, and I urgently need to learn more about this job of a nominee director. What is it all about?”

“It all depends,” said Alberto, sounding like an economist, as usual. And Carla knew what would come next: a 2 x 2 matrix or a circle diagram—an old habit of Alberto’s since his days as an economist at a major consulting company. And indeed, here it came. . .

“The role of the nominee director,” he began, “—or for that matter of any director—depends on what the board does; which in turn depends on what the board *should* be doing; which should be defined in the company’s bylaws and of course the country’s laws. This means that the role of the board is shaped by **corporate governance**, which is the overall term used to sum up the role of the board, the legal duties to the shareholders, employees, et cetera.”

Alberto paused to be sure Carla was following him, then continued, “And obviously, this corporate governance is—similarly to the company—embedded in **an external and internal environment** that influences the corporate governance and consequently the board work. Parts of it are laws and regulations, but also the stakeholders of the firm. Internally for a company, there are the owners, the board, the management, and of course the

Figure 3: Internal and External Corporate Governance Environments



Corporate governance in a company (internal) is embedded in a wider environment that sets the laws and brings in law enforcement and social values. The internal corporate governance is shaped by the relationship between the firm’s major stakeholders (e.g., investors, customers, and suppliers) as well as the board and the employees.
Source: Christoph Nedopil, *The Influence of Foreign Direct Investment on the Corporate Governance Environment* (2009).

operations.”

He pulled a pen from his pocket and drew the inevitable figure (see Figure 3 on the previous page) on his napkin. He finished it just as the waiter arrived with the second course, Saltimbocca Roma, a favorite of both of theirs.

“Please continue orally,” Carla requested, assuring her friend, “I will understand the concepts.”

Alberto looked a bit disappointed but then went on with his explanation. “To understand your responsibilities as a board director in the framework of the corporate governance structure,” he said, “you first need to answer a question: What do you think is the benefit of corporate governance? And I’ll give you a hint from a fellow researcher, Bob Tricker. He said that if management is about running the business, corporate governance is about seeing that it is run properly. All companies need governing as well as managing.” Then he repeated his question: “What do you think is the benefit of corporate governance?”

As much as Carla disliked Alberto’s practice of talking in questions, she went along with it. “If management is running the company,” she said, “the board should make sure it’s running in the right direction.”

Alberto was not yet convinced. “Yes, but to what advantages, Carla?”

Carla contemplated the question. Then the light dawned, and she knew exactly what Alberto was aiming at—after all, she had worked in risk management long enough! “Well, if there are proper corporate governance structures, it is usually much easier and cheaper for a company to get external financing due to increased transparency. Also, it is said that with good corporate governance better strategic decisions can be made, as a good board brings in its external knowledge about market forces. Also, a good board sometimes manages external stakeholder relations.”

“Yes,” said Alberto. “These are exactly the benefits that good corporate governance can bring.” He paused, and Carla knew he was about to bring up one of his real-life anecdotes. And he didn’t disappoint. “I was on a board of a family company once. You cannot imagine how much infighting there was between the family members when the father wanted to retire. It was madness! Especially the mother was—”

Carla interrupted, impatient to continue with her issues. “So I’m sure you saved the company! But what about the role of a board director?”

Alberto smirked. “Indeed, the company is still around, and the external members of the board certainly helped resolve the family issues.” Having wrapped up his story, however briefly, he returned to Carla’s question. “Well, let’s continue then,” he said. “Another question you must ask yourself in order to better understand the role of the director is this: Are the shareholders equally represented on the board?” He paused, waiting for her to answer.

But Carla was a bit lost. *What does he mean by “all shareholders equally represented”?* she wondered. Then she answered aloud, “If all are equally represented, they enjoy the same risks and spoils and have all the same incentive to participate. If there are dominant shareholders, there might be a difference in voting power, and minority shareholders could feel that their information cost is proportionally higher for the returns than that of the

Advantages of Good Corporate Governance

- Improving access to capital markets
- Reducing cost of capital
- Improving decision making
- Balancing (sometimes) diverging shareholder interests
- Resolving governance issues in family-owned companies
- Ensuring sustainability
- Achieving better operational results

majority shareholders.”

Alberto was smiling. “You’re on the right track. This is why majority shareholders fear free-riding (where small shareholders profit from the supervision performed by the bigger shareholders, who have more incentive to control their investment), and minority shareholders fear being expropriated by the majority shareholders and often get special protection. And indeed, information is one of the most important aspects of board work and one of the most valuable assets for shareholders. But when you think about the information on the board, what does the shareholder structure tell you about how much information the board gets, compared to the shareholders?”

The question startled Carla. She thought for a minute and felt awkward, because she couldn’t see the answer. Finally, Alberto broke the silence. “As a board, it is your responsibility to work in the interest of the company, and the company alone, which is called **fiduciary duty**. If you are voted in by the general assembly, you don’t represent a specific shareholder. So you have to see that every investor gets the same information and no shareholder gets preferential treatment, meaning that the results and information of board meetings are confidential. This is to protect minority shareholders from being discriminated against. However, if you have all shareholders represented on the board through directors, this problem of discrimination is obviously different, and you can make certain arrangements, for example, to agree that directors can report to their shareholders.”

“Got it!” Carla replied. After thinking about it for a second, she added, “So it is paramount that no discrimination of minority shareholders takes place through the board and all shareholders are treated equally. But what about size?”

“Well,” Alberto paused to sample his new glass of red wine. “If you mean the size of the business, this can give you an indication of the complexity of your board work: Do you have different business models or strategies in one organization, say investment and commercial banking plus insurance? Do you have subsidiaries, maybe with minority shareholders, et cetera? Size influences board information systems, committees, and so on.”

“Got it,” Carla interrupted again. “Basically your message is that there is no ‘one size fits all.’”

“Yes! Corporate governance and board work are highly dependent on circumstances such as ownership structure, strategies, et cetera,” said Alberto.

“And of course personalities,” Carla added. “And you need to comply with regulation.”

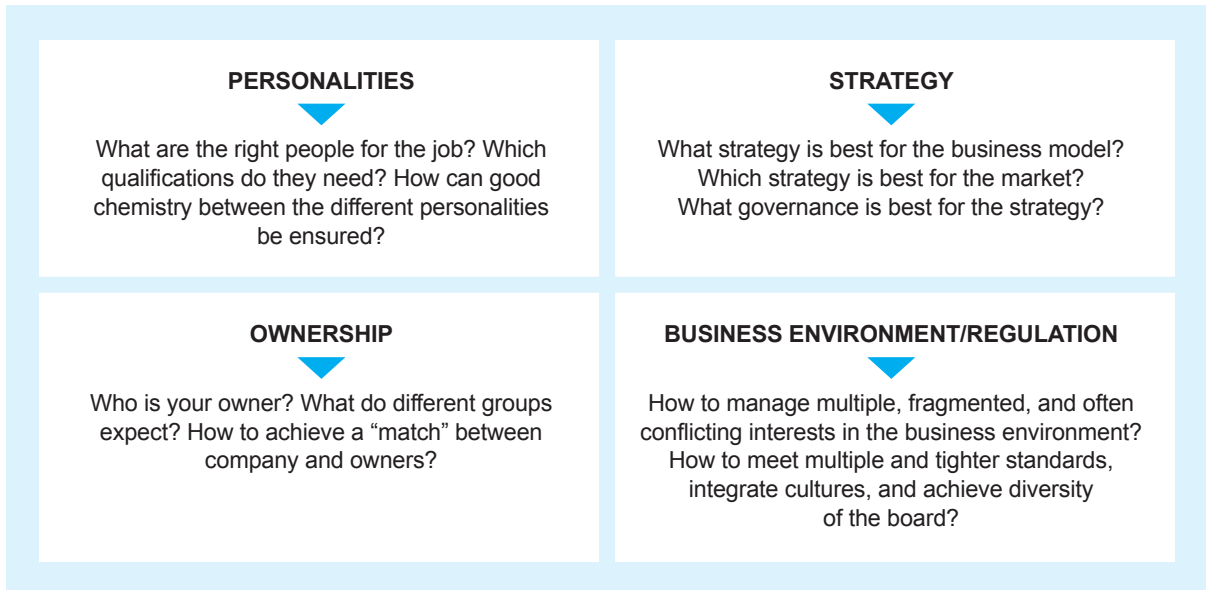
“You catch on very fast, Carla!” said Alberto. And he couldn’t resist taking Carla’s napkin and drawing on it the four factors influencing corporate governance. (See Figure 4 on page 13.)

“Does all that also relate to the one-tier and two-tier boards?” Carla wanted to know.

Alberto shook his head vigorously. “Not at all, Carla! The one-tier and two-tier board systems are something very legalistic and often have little influence on the work of the board in reality. So in some jurisdictions the top team of the company is legally divided into a supervisory board and a management board, which is called the two-tier system. In this system, the supervisory board elects the management board. In other jurisdictions the management and supervision are in one board and are distinguished as executive and non-executive directors. In most cases the two types of directors have their meetings together, be they one-tier or two-tier boards.” (See Figure 5.)

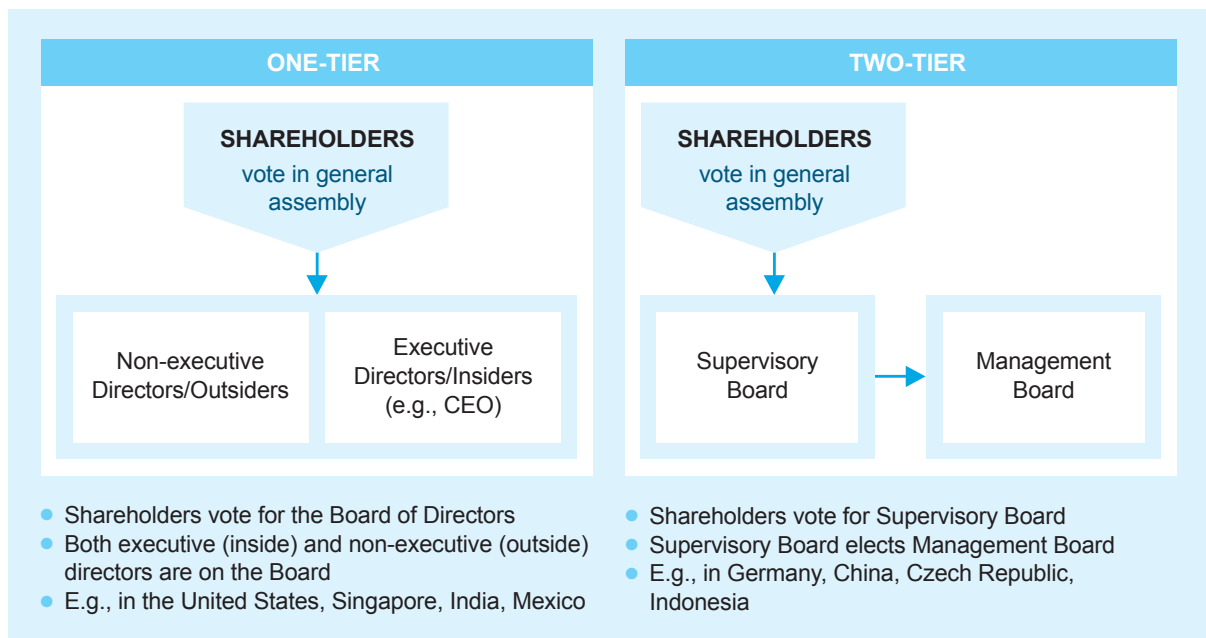
“Ah, I see,” said Carla. “Then what do you think the difference is between a regular non-executive director and a nominee director?”

Figure 4: Four Influencing Factors of Corporate Governance



Four factors influence how corporate governance is practiced: personalities (e.g., the personalities of the chairman or the CEO matter), the strategy (e.g., a company in a fast-moving consumer-goods industry requires different corporate governance than a bank), the ownership (e.g., a family-owned company needs different governance than a listed company), and the business environment (e.g., laws and law enforcement matter for corporate governance).

Figure 5: One-Tier versus Two-Tier Boards



One-tier and two-tier boards differ in structure in that two-tier boards make a legal distinction between the executive and non-executive bodies of the board, whereas one-tier boards make no such legal distinction. In practice, both board types share most of the same responsibilities and duties.

Alberto laughed. “I know you will ridicule me if I say it again, but it all depends! As far as my experience goes, different investors expect very different things from their directors. Some keep them at arm’s length, nearly completely independent; others hold them on a short leash. So you must clarify with IFDB in detail what they expect from you: What are your contractual obligations? What is the policy? How do they support you? And how does this really work out in practice?”

Carla smiled and said, with a touch of irony, “I was with IFDB for twelve years, but I must admit that I never gave much thought to this aspect of the work. The assessments of the corporate governance experts were important for us in the risk assessment, but how a nominee director fits into it after the investment decision was made—that was beyond my horizon.”

Alberto took a sip of his wine, considering what he would say next. “I can tell you, though, Carla,” he said at last, “what I see as the four pillars of board work: accountability, fairness, transparency, and responsibility.”

Carla almost choked on her wine—such a vague response coming from Alberto! But rather than press him to go into more detail, she changed the subject. “Tell me, Alberto, how do you think the nominee directors are treated on the boards they serve on?”

“You need to find out,” said Alberto, smiling. “And again—sorry—it all depends. Sometimes the rest of the board members are eager to learn from you and your experience, and to enjoy the support provided by the investor. Other times, they become hostile when you try to push management and governance best practice, because you violate vested interests or family bonds.”

He paused for another sip of wine, then continued, “Of course, legally you have all the same rights as the rest of the board. But often enough, there is a practical difference

Nominee Directors and Independence

Directors nominated by IFC are considered non-executive directors irrespective of whether they are current staff members. At the same time, although IFC does not direct or mandate how its nominee directors are to vote on board decisions, it does not consider these non-executive directors as to be “independent directors” in the legal sense of the term.

As a rule, an independent director is a member of the board of directors who does not have links to the controlling (or significant) shareholders and management of the company who may influence the decision making and behavior of the director. Typically, corporate/securities laws and/or corporate governance voluntary codes of best practice specify the technical, legal definition of an independent director. While in some jurisdictions IFC nominee directors may meet the local standard of independence, the following circumstances prevent IFC from naming the nominees as independent directors:

1. IFC typically nominates a director by exercising its contractual right as negotiated with other shareholders of the company. This means that other shareholders are obliged to vote for an IFC nominee. This gives IFC the power to nominate any candidate and, at the same time, the right to replace the nominee at any moment for any reason or without such reason.
2. IFC typically engages with the nominee director through a short-term consulting (STC) contract that obliges the nominee to follow all World Bank Group relevant policies.
3. Often, IFC remunerates the nominee directors directly, based on the World Bank Group’s compensation policies.
4. IFC also provides indemnification to nominee directors, which is supplemental to the company’s indemnification and directors and officers liability insurance.

between nominee directors and others. It is just like in the book, *Animal Farm*: some directors are more equal than others. You have to earn your position in the board. Sometimes you even have to fight for your rights—probably even more as a beautiful woman like you. But that’s what makes the work of a director so interesting: it is a perpetual learning process and keeps your brain whirling!”

Then Alberto tilted his head to one side and asked carefully: “Carla, what I am wondering: Why do they want to do an IPO?”

Carla had thought about that question herself but hadn’t come to a conclusive answer yet: “Good question! And I can only speculate. Two possibilities have come to my mind. The first is that the General wants to get out and enjoy his retirement. The second is that the chairman or the CEO wants to expand and hence needs extra investors.”¹

* * *

When Carla returned home, Giacomo was already waiting for her with the afternoon tea, a habit they had become fond of from their time in Great Britain and had taken with them wherever they went. “Darling, you look so preoccupied,” he said to her, sounding a bit worried.

“Indeed,” Carla replied. “Alberto was a great help. He brought a lot of ideas about what corporate governance is—food for thought. Now I need to understand what he actually meant and how it works in practice. You know him: he has his special style and likes to talk in riddles. So, after tea, I need to mail my old friend Gürkarn. You remember him? He was the great storyteller, always claiming that it is because of his Sikh name and culture. He was in the corporate governance department of IFDB for a long time and has been an IFDB nominee director for a while in his retirement as well. Maybe he can help me figure out what the official policies are—and what is expected of me—before I ask Margaret too many stupid-sounding questions.”

Giacomo nodded. “That makes sense,” he said, “but don’t forget: tonight we are going to the opera in the Terme di Caracalla and need to leave at seven.”

1.3 The Fast Response / Special Role of a Nominee Director

Right after tea, Carla went to her desk to write an e-mail to Gürkarn Singh. They had been allies in many of the institutional controversies at IFDB, and Carla valued his sharp legal mind, combined with his Indian ancient wisdom. Also, Gürkarn had created a network for “Art in IFDB,” to which Carla—as an Italian, for sure—also belonged. They organized many art exhibitions and cultural outings together and became good friends. She sent him the following e-mail:

Dear Gürkarn,

I sincerely hope this e-mail finds you well and you are enjoying your time as a retiree. As you might know, I joined you in the “alumni” of IFDB, as I retired as well.

Now I have a very personal and informal question to ask: I have been asked to serve as a nominee director for SlavaBanca. Whereas I have some information

¹ For more information governance for banks, see Richard Westlake, *Guidance for the Directors of Banks*, <http://bit.ly/1iFUoLL>.

about the bank, I still struggle to understand what exactly IFDB is expecting from me. What are the legal and factual obligations, what exactly is my status, and how does a nominee director differ from a normal director? What are the targets for me in that role, who is setting them, and how are they measured? What kind of support will I get from IFDB, and how is it delivered? Are there reporting requirements, and to whom?

It would be helpful if we could discuss this tomorrow morning CET, as IFDB is expecting an answer from me soon.

Many thanks in advance, my old friend, and I look forward to hearing from you!

Carla

* * *

Almost as soon as Carla sent the e-mail, the phone rang. It was Gurrkarn. “Gurrkarn, my old friend, how are you?” she greeted her former colleague warmly. “It must be midnight where you are!”

“Well, you know the life of a retiree,” said Gurrkarn. “As you certainly will know, it is very busy! I had just finished a chapter of my new book on the history of the Sikh, when I saw your e-mail and thought I’d better discuss it with you instead of writing it all down.”

Carla laughed and replied, “You have my sympathy!” Then more seriously, “Listen, Gurrkarn, I am afraid that my questions may be a bit naïve. I received some information about SlavaBanca, but I have no idea why I was chosen and what is expected of me.”

Gurrkarn sighed. “Well, Carla, it is pretty simple. I know the case a bit, and I definitely know the situation in Bankistan. They are in the bottom quartile of Transparency International’s Corruption Perception Index and are not too great on the World Bank ranking on Ease of Doing Business. You know that type of country. And since IFDB wants to support further development in that region, it needs to invest and at the same time protect its investments. That is probably why they decided to place a nominee director on the board of SlavaBanca. Frankly, this is most likely the best safeguard in a country where the legal institutions are just not as sound.”

IFC’s corporate governance website offers many frameworks for corporate governance: www.ifc.org/corporategovernance.

“Sure, Gurrkarn—I understand that. But why me?” Carla asked calmly. “I have not been on a board before, and, honestly, I don’t know much about the specifics of corporate governance.”

“Well, indeed you are a bit of an exception, Carla. Normally, IFDB tries to find people with detailed industry experience.” Gurrkarn thought for a second. “I am sure it must have something to do with your extensive risk experience. You have always been someone who can smell the risks and take the heat—”

“Thanks, Gurrkarn.” Carla interrupted. “But today I got more compliments from my former colleagues than in a whole year. So please put the fish on the table.” *To put the fish on the table* was an old expression of fishermen from Southern Italy, and Gurrkarn recognized it as Carla’s signature signal that it was time to stop beating around the bush and confront the often harsh reality.

Gurrkarn paused for a few seconds, then said slowly, “I guess you have to work on the assumption that this is not an easy mandate.”

“Then why would they place a bloody corporate governance beginner on such a difficult board?” Carla wanted to know.

“Well. . .” Gürkarn was obviously searching for the right argument, which rarely happened. “Let me try to explain it to you this way, Carla: You can say that corporate governance rests on three foundational building blocks.”

Carla recalled Alberto’s example using pillars and dreaded being subjected to yet another vague answer. But she didn’t want to interrupt Gürkarn again.

“The **first is the legal framework**,” Gürkarn continued. “And actually, the legal framework and the processes and structures of corporate governance is the easiest part to learn. IFDB has tons of material on its website, or you can just ask any corporate governance officer. They can support you in a second, if you need for example a charter for an audit committee or the main corporate governance requirements in any country.”

He paused for a second, and Carla took advantage of the silence to ask, “What are the other two building blocks then?”

“This is where it becomes difficult,” Gürkarn continued. “One foundational block is the **soft skills of leadership**—in other words, a board director who has enough experience and stomach to dig into opaque situations, uncover shaky business dealings, understand the inner workings of the company, and deal with all that without alienating the other investors and directors. Nominee directors very often need to understand the long-term risks of a company, because the people in the company probably don’t know its risk status.”

“Do they even want to know it?” Carla interrupted.

“Probably they don’t want *IFDB* to know it,” said Gürkarn. “And furthermore, the board directors need to push relentlessly for improvements, both in the transparency of the business and in the governance procedures.”

“And what about your famous legal compliance, which you always explain is Job Number One?”

“Yes,” said Gürkarn, “this is the foundation. But you will see that on the surface everything is compliant—the board, the committees, et cetera. But if you dig deeper, you’ll probably find corruption, tunneling of assets, relatives in senior positions but with no responsibility and no work. I don’t need to tell you what you can easily find in these countries. The scope of corporate governance problems in emerging economies is definitely different from what is taught in the textbooks.” (See Table 3 on page 18.)²

“And I am supposed to be the Hercules cleaning up the Augean stables?” Carla asked, trying not to sound too sarcastic.

“Well, Carla, there are also forces for a positive change in SlavaBanca, as far as I know. The owners know that if they want to go for an IPO they need to attract foreign capital. This is the best incentive for change.”

Carla was skeptical. “Maybe on paper. But in practice?”

“Well, that’s where it starts,” Gürkarn confirmed. “But what we have seen is that, over time and with much effort, things are finally moving in the right direction.” Then he added, in his Indian-wisdom tone, “From the basics, you build performance.”

“Am I understanding you correctly?” Carla asked. “You not only expect me to be a board member, with all the duties and obligations to drive a better business and be legally compliant, but I’m also supposed to be a change agent for better corporate governance, no tolerance for corruption, and all the other things that IFDB stands for. Is that it?”

² For more information on corporate governance in emerging countries, see Melsa Ararat and George Dallas (2011) *Corporate Governance in Emerging Markets*. <http://bit.ly/1lBjVMQ>.

Gurkarn was as excited as an Indian lawyer could get. “Yeah, this is exactly it! And the third foundational building block of corporate governance is **the dual mandate of IFDB: commercial goals and development objectives!** And you need to reflect that on the board as well.”

Carla knew about that from her work at IFDB, so it was not too much of a surprise for her. But she wondered how to achieve it? What were her targets—from a commercial as well as a development perspective? She asked Gurkarn, “We naturally stayed at a very general level of my duties. But what about my precise targets? Who is setting them? How are they formulated in this *case*? Are there benchmarks, milestones, et cetera? And what is the time frame?”

“Those are questions for IFDB,” Gurkarn replied, and Carla felt that maybe this was also not the right time to continue this conversation. Gurkarn’s day had been very long already, and she wanted to let him off the hook. “What do you think, Gurkarn,” she asked, “shall we conclude this call before dawn?”

He laughed, then said, “Listen, Carla, don’t worry about this too much. I will send you a corporate governance progression matrix from IFDB, so you will understand better where to start at SlavaBanca. You can call me any time, if you want to continue this discussion or have any questions.”

Carla opened Gurkarn’s e-mail, clicked on the hyperlink to IFDB’s website, and started to read through the progression matrix. (See Table 4 on pages 20, 21, 22, and 23.) *There are some great ideas here about how to move a company forward*, she thought. *The question is, what is the starting point?* Then she had a startling thought: *Maybe the company has not even reached Level One yet; maybe I will find in SlavaBanca a Level Zero. . .*

While skimming through the other corporate governance materials on the IFDB website³

Table 3: Corporate Governance Focus in Developed and Emerging Economies

DEVELOPED MARKETS		EMERGING MARKETS
Executive compensation	vs.	Regulation of related-party transactions
Board compensation	vs.	Competence of directors
Investor activism	vs.	State activism
Market-driven incentives	vs.	Non-market mechanisms
Fiduciary duty to shareholders	vs.	Subpar disclosure and internal controls
Board-management relations	vs.	Independence from controlling shareholder
Regulating increasingly sophisticated issues	vs.	Capacity gaps for rigorous enforcement
Cycles of scandals, corruption, and collapse	vs.	More of the same (nepotism, self-dealing, market abuse)
Multinationals and listed companies	vs.	Family- or state-controlled companies
Preventive risk management	vs.	Crisis management/reactive risk management

The focus of corporate governance in emerging economies differs in practice from that in developed countries. For example, in developed economies, the market for corporate control (e.g., through incentives, through access to finance) is more advanced, whereas state activism plays a bigger role in many emerging economies.

³ See <http://bit.ly/1snpyrE>. More corporate governance progression matrices are available: <http://bit.ly/1snpurR>.

—from reporting to resolving disputes, from governing banks to best-practice codes—she wondered when she should read all of that and how it should be applied. *The tools and processes all look very professional*, she thought. *But how do I apply this in Bankistan and for SlavaBanca?* Would the other owners even be eager to create more transparency in such an environment, have serious accounting standards, and agree to power sharing between board and management—with external people sitting there? And then she had another sobering thought: *How can I understand the culture, if I don't even speak the language? Probably few speak English well, and the little Slavic I picked up there will not be sufficient.*

After reading for an hour, she stopped and went back into the living room. Giacomo gave her a quizzical look. “You look as if your thoughts will not be on the opera this evening, but that you will be distracted by reflections on unsolved work issues—just like in the good old days at IFDB.”

“Not really, darling,” she said, smiling. “If we have time for an aperitif, I will share my reflections with you, and you can help me clear my thoughts—just like in the good old days!”

1.4 The Clearer Perspective / Basics of a Nominee Director

Giacomo began preparing two distinctly different aperitifs: Carla preferred the light and sweet version of the prosecco Colfondo, from the pre-alpine hills of Veneto (the home region of prosecco). Giacomo was addicted to a very dry Mosel-Riesling, not least because he believed that this was the heritage from his ancestors 2,000 years ago. This was typical for the couple: they agreed on matters of great consequence—say, the importance of fulfilling work in life or how they raised their two children—but disagreed on nearly everything else. “Probably the most important competence you bring to your role as a board member, darling,” Giacomo mused, picking up the thread of the conversation, “is your expertise in conflict resolution—trained in over forty years of marriage.”

Carla smiled wryly. “Don’t you always tell me that as a historian you cannot simplify things like that?”

“True!” he said. “One should not overestimate the role of personalities in historical change, relative to the socioeconomic forces. People rarely create a revolutionary situation by themselves. But nevertheless, history is never independent from personalities—”

Before Giacomo could start on one of his favorite history lectures, Carla interrupted him. “My task is much more mundane,” she said. “There is a messy organization in a corrupt country, and IFDB doesn’t really know what’s going on. But they decided to invest anyway. And now they’re looking for someone—*me!*—to protect their investment and clean things up so the company can be listed on the stock market.”

“Well, the challenge is at the corporate level,” he noted. “But nevertheless, it sounds like you need to organize a revolution. And do they expect you to achieve this single-handedly?”

Carla laughed. “I hope not! So, I need to learn more about the key people, their perceptions—”

“. . . and their interest,” Giacomo said, completing his wife’s thought. “After all, you talk about money and power, but beyond that, what have you learned from Alberto and Gürkarn about your new role as a director—and especially as a nominee director? What

Table 4: IFC Corporate Governance Progression Matrix for Financial Institutions

ATTRIBUTES	LEVEL 1 STAR*	LEVEL 2 STARS **
A. Commitment to Corporate Governance	<ul style="list-style-type: none"> • The basic formalities of corporate governance are in place. • The institution has a written, articulated set of policies or corporate governance code addressing, at a minimum, the rights and treatment of shareholders, the role of the board of directors, transparency and disclosure, and business ethics. • The company has a written code of ethics, approved by the board and there is a designated officer responsible for compliance. 	<ul style="list-style-type: none"> • The institution has a designated officer responsible for ensuring compliance with the corporate governance code and policies, and for periodic review of the code and policies. • The institution periodically discloses to shareholders its corporate governance code and practices, as well as the extent to which such practices conform to the voluntary code of best practice in this country.
B. Structure and Functioning of the Board of Directors	<ul style="list-style-type: none"> • The board of directors meets regularly, and deliberates independently of executive management. • Board members are given sufficient time and information for analysis and deliberation so they can exercise their duties related to oversight and development of the institution's direction and strategy. • The board includes a majority of directors who are not executives of the institution or its affiliates. That is, they are not executives of the institution or its affiliates. • The board has an audit and compliance committee with a majority of independent directors. That committee recommends external auditors to the shareholders' meeting; reviews and approves the reports of the external and internal auditors; and oversees implementation of both the auditor's recommendations and the regulatory compliance program. • The board establishes, and periodically reviews, the institution's qualitative and quantitative thresholds. That is, policies regarding what types of credit transactions must be approved at the manager, credit committee, and full-board levels. 	<ul style="list-style-type: none"> • The board includes two or more directors that are independent of management and controlling shareholders. • The board has a risk management committee and the full board receives annual reviews, with input from outside sources of expertise, of the institution's risk management (credit, market, and operational risk) system. • Special procedures are in place for full-board review of all material credit transactions involving officers, directors and affiliates of the institution. • Board composition (competencies/skill mix) adequate to oversight duties. Annual evaluation conducted.

(Continued
next page)

ATTRIBUTES	LEVEL 3 STARS ***	LEVEL 4 STARS ****
A. Commitment to Corporate Governance	<ul style="list-style-type: none"> • The institution meets all applicable recommendations of the voluntary code of best practices of the country. • The board has a corporate governance committee. 	<ul style="list-style-type: none"> • The institution is publically recognized as a national leader and among the global leaders in corporate governance.
B. Structure and Functioning of the Board of Directors	<ul style="list-style-type: none"> • The board's audit and compliance and risk management committees are composed entirely of independent directors. • The institution's board is composed of a majority of independent directors. • A committee of the board composed <i>entirely</i> of independent directors is required to approve all material transactions with affiliates of the controllers, directors, or management. • Other specialized committees of the board exist to address special technical topics or potential conflicts of interest (e.g., nominations and compensation). • The board is fully elected on an annual basis. 	<ul style="list-style-type: none"> • The institution has a independent asset (or loan) review function reporting directly to the board (or a committee of the board) to ensure timely recognition and resolution of impaired assets.

Source: <http://bit.ly/1snpurR>

Table 4: IFC Corporate Governance Progression Matrix for Financial Institutions

ATTRIBUTES	LEVEL 1 STAR*	LEVEL 2 STARS **
C. Control Environment and Processes	<ul style="list-style-type: none"> The institution has an appropriate system of internal controls and internal auditing in place, accountable to the board of directors, and integrated with the activities of the compliance officer, the external auditors, and the regulator. The institution's policies and practices related to reporting regulatory capital, portfolio quality and performance, anti-money laundering, and all other matters of regulatory compliance meet all standards established by the corresponding national regulatory agency(ies). 	<ul style="list-style-type: none"> Financial and regulatory accounting, internal control, and internal audit policies and practices exceed national legal and regulatory requirements, incorporating significant elements of international best practices for financial institutions
D. Transparency and Disclosure	<ul style="list-style-type: none"> Financial statements are prepared in accordance with an internationally recognized system of accounting and audited by a recognized independent auditing firm. The institution complies with all disclosure requirements under applicable law, regulations, and listed rules (fair disclosure). Investors and financial analysts are treated equally regarding information disclosure. 	<ul style="list-style-type: none"> Financial and regulatory reporting and disclosure policies and practices exceed national legal and regulatory requirements, incorporating significant elements of international best practices for financial institutions The company discloses its code of ethics, the main provisions of its implementation program, and the degree of compliance in its annual report.
E. Treatment of Minority Shareholders	<ul style="list-style-type: none"> Minority shareholders are provided with adequate notice and agenda of all shareholders' meetings, and permitted to participate and vote at shareholders' meetings. The institution treats all shareholders of the same class equally regarding voting rights, subscription rights, and transfer rights. All holders of the same type of each security are treated equally regarding information disclosure (fair disclosure). Shareholders are provided with accurate and timely information regarding the number of shares of all classes held by controllers and affiliates (ownership concentration). 	<ul style="list-style-type: none"> Effective representation of minority shareholders is provided by cumulative voting or similar mechanisms. The institution has clearly articulated and enforceable policies on treatment of minority shareholders in changes of control. The institution has a well-understood policy and practice of full and timely disclosure to shareholders of all material transactions with affiliates of the controlling shareholders, directors, or management (conflicts of interest); and complete, timely, and accurate disclosure is made of all material shareholder agreements among controllers. The annual report discloses the principal risks to minority shareholders associated with the identity of the institution's controlling shareholders, the degree of ownership concentration, cross-holdings among institutional affiliates, and any imbalances between the controller's voting power and overall equity position in the institution.

ATTRIBUTES	LEVEL 3 STARS ***	LEVEL 4 STARS ****
C. Control Environment and Processes	<ul style="list-style-type: none"> Internal control, audit, risk management, and compliance practices are in accordance with highest international standards. 	
D. Transparency and Disclosure	<ul style="list-style-type: none"> Financial and nonfinancial reporting and disclosure practices are in accordance with highest international standards. All disclosures and communications with shareholders and the public are made available on the Internet in a timely fashion. 	
E. Treatment of Minority Shareholders	<ul style="list-style-type: none"> The institution has effective shareholder voting mechanisms in place to protect minority shareholders against unfairly prejudiced actions of controllers when ownership is especially concentrated or controlling shareholders may have strong conflicts of interest. These mechanisms may include supermajority requirements or “majority of minority” provisions. 	<ul style="list-style-type: none"> The institution's history of equitable treatment of shareholders demonstrates consistent conformance with international market expectations.

Source: <http://bit.ly/1snpurR>

would your responsibilities be as a board director?” He paused, then added, “And as a revolutionary, what leverage do you have to get things moving?”

Carla loved it when her husband brought the conversation straight to the point. Thinking for a moment, she responded by listing for him the board’s three main responsibilities:

- *Strategy*—set the strategic direction and supervise the implementation;
- *Compliance*—ensure the legal and ethical conduct of the business; and
- *Performance oversight*—hire and fire management and oversee their performance.

Carla went on to explain that the responsibility of the board stems from the directors’ election to the board by the shareholders—or, simply, the owners of the company. In some cases—such as SlavaBanca—the shareholders are directly represented on the board.

“In other cases,” Carla continued, “a shareholder cannot nominate a director—for various reasons. For instance, if every investor had a seat on the board, the board would simply be too big. Also, the shareholders might need to vote somebody onto the board who is truly independent—meaning not connected to the shareholders at all, but maybe an expert in a field that the board needs, such as risk management. And that would make the board even larger.”

“How big should a board be?” Giacomo asked.

“A typical board usually has from five to nine members,” said Carla, “depending on the complexity of the business.”

She paused, then added, “In any case, as a board director, you have a **fiduciary duty** to the company, meaning that a board member must always act in the best interest of the company—not of the individual shareholder.”

“Understood,” said Giacomo. Then he summarized her explanations—in his own way, as always. “You are part of a team, the board. And the board can decide nearly everything, but alone you can decide nothing. So you have to build alliances and majorities.”

Carla nodded approval of Giacomo’s summary, and he followed up with a question: “Does your status of a nominee director help?”

“According to Alberto, it depends. . .” she said, and they smiled at each other, both of them knowing the way Alberto expresses his thoughts. “Sometimes the other directors and managers are eager to learn from your international experience,” she continued. “And sometimes they bitterly resist your movements toward more transparency, professionalism, and clear decisions, because they feel threatened—afraid of losing their power or of having their incompetence exposed.”

“Help me,” said Giacomo, trying to dig a bit deeper. “Is a nominee director independent from orders of IFDB?”

“Normally, yes, as far as I understand the guidelines,” said Carla. “But it is kind of a dual role: On the one hand, I have to contribute to the creation of shareholder value in business operations, banking in this case. On the other hand, I am obliged to steer the company in the right direction concerning development objectives. This means that the development goals of IFDB must be fulfilled, such as improvement of the business conduct, transpar-

Independent Board Director⁴

Independence of a board director describes the mindset for independent decision making. The legal term “independent director,” means a director who has no direct or indirect material relationship with the company other than membership on the board and who meets the relevant criteria in the given jurisdiction that does not disqualify him or her as an independent director. While all independent directors are non-executive directors, not all non-executive directors would meet the standard of an independent director.

⁴ See IFC’s “Indicative Independent Director Definition” at <http://bit.ly/1F0OhVz>.

ency, and accountability; institutionalizing governance structures and processes; making sure the company becomes more sustainable; dedicating attention to certain business segments, such as SMEs. . .”

Carla looked thoughtful, then added, “But I am a bit confused about sharing information with the shareholder, especially the IFDB portfolio manager. As far as I understand, this depends on who else is a shareholder on the board, and what arrangement is generally agreed on after the principle of nondiscrimination of any shareholder.”

Giacomo pondered for a second then admitted that he didn’t understand whether nominee directors are independent or not.

Carla rolled her eyes and thought, *Giacomo can be as persistent as Maggie, but he has a point*. “From what I read,” she told him, “an independent director is one who is not employed by the company, especially not as an executive, or involved in any material relationship with the company—say, as a contractual consultant.”

“And are there independent directors on the board?” Giacomo wanted to know. “Or how would you describe them?”

Carla knew he had a point. “I don’t know yet,” she admitted. “Legally, Bankistan has a one-tier board in the banking sector. This means that the board consists of both executive and non-executive board directors. Non-executive board members should be independent, but, admittedly, at SlavaBanca the board seems to be a board of friends and family.”

Carla sighed at the thought of what she was about to get herself into. Then she continued, “There is, however, one other foreign investor, a private equity firm. But I have no idea whom they will send.”

Giacomo nodded. Then he tilted his head slightly to one side, looking lovingly at his wife. “And you, as a professional and beautiful woman, probably pose an additional threat in their macho culture,” he said. “Or are there other female board members or senior executives?”

“Probably not,” she said, smiling at her husband. “Do you think this is a serious issue, Giacomo?”



Checklist 1: Onboarding Information from IFDB

- Indemnification policy of IFDB
- Contact details of the company
- Contact details of responsible IFDB portfolio officer
- Information on nominee director role as seen by IFDB
- Goals of assignment as nominee director
- Corporate governance assessment of the company
- Profiles of board directors and top management of the company
- Minutes of previous board meetings— if available
- Shareholders agreement
- IFDB’s investment goals and objectives
- Any legal analysis of the directorship duties and liabilities

“It depends. . .” he said, grinning. “In a dog fight, they might have some inhibition to bite a woman. But they also might easily dismiss you as an ignorant female or do-gooder. Remember, in their history, they never had an important woman, no Jeanne d’Arc—”

Before Giacomo could start a lecture about the role of women in the history of Eastern European countries, Carla looked at her watch. “In fifteen minutes we should leave,” she said. “Thanks for the aperitif—you just never fail to clear my head, darling! And you know what? Although this was not the due diligence that I am used to doing before I sign up for such a task, I will write Maggie a quick e-mail. I will tell her that I agree in principle to her request, conditioning it on the details of the assignment. Then I am totally with you for the whole evening and will focus on the Opera.”

1.5 The Acceptance—With Conditions / Checklist for Nominees

Carla left her very beneficial conversation with Giacomo and went straight to her computer. She wrote the following e-mail:

Dear Maggie,

After some careful consideration and due to the time pressure, I would be happy to support IFDB as a nominee director for SlavaBanca, under some pre-conditions. Hence could you please give me input on the following points:

[See Checklist 1 on page 25 for Carla’s points.]

Once I have reviewed these (especially the goals), shall we have a chat on how to proceed?

Best wishes,

Carla

* * *

Carla read through the e-mail one more time, took a deep breath, and hit “send.” *Done!* she thought. Now she could enjoy her evening out.



Key Messages of Chapter 1

- Corporate governance and boards help companies reach their economic, social, and environmental goals.
- There is no one-size-fits-all corporate governance.
- IFDB directors have a dual mandate: fiduciary duty and development goals of IFDB.

ONBOARDING – UNDERSTANDING THE NEW JOB

The next morning:

Carla was happy to sleep in. She and Giacomo had met friends at the opera and gone out afterward for some lengthy and intense discussions on Italian politics and society—a welcome distraction from corporate governance! Now feeling more rested, she turned on her tablet PC and saw that she had an e-mail from Maggie—no doubt a response to the one she sent Maggie yesterday. But she wasn’t ready to open it. Not yet. She wanted to have breakfast first, knowing that digesting this information would take more time than digesting breakfast.

* * *

Maggie’s e-mail included a lot of information on the company and corporate governance—more than Carla had hoped for. But what surprised her was that Maggie thanked her for accepting the nomination! *We’re getting a little bit ahead of ourselves*, Maggie, Carla thought. Then she noticed that Maggie also wrote that the next board meeting would be in three weeks—and she had asked SlavaBanca to send Carla all the necessary information.

“Nothing has changed at IFDB,” Carla muttered under her breath. *Usually things move so slowly that it is almost impossible to slog through the bureaucracy*, she thought. *Then suddenly things are moving at an incredible speed—and they want it all completed by yesterday!*

Carla took a deep breath. “I might as well get started,” she said aloud. Giacomo had an appointment that would keep him away from home until evening, so Carla had the whole day to spend with the information Maggie sent.

2.1 The Risk Assessment / Indemnification and Liability Insurance

First of all, Carla wanted to understand how she would be protected as board director. After all, as a risk expert she knew that—next to avoiding risks altogether—a good risk strategy in uncertain environments has always been to insure risks. And there are many sources of litigation risks when you are responsible for the workings of a company in an emerging economy.

She began jotting down a list of **sources of litigation risks**:

- Shareholders
 - Breach of fiduciary duties
 - Erroneous or misleading statements or representations
 - Withholding or nondisclosure of material facts
 - Prospectus-related liabilities
- Creditors

- Employees (employment practices)
- Customers, clients, and competitors
 - Breach of contract
 - Failure to perform
 - Unfair trade practices
- Regulators and government agencies
- Related-party transactions (RPTs) and conflicts of interest
- Environmental, health, and social issues (EHS)
- Bribery, corruption
- Civil society (NGOs, activists)

Maggie's e-mail indicated that it was SlavaBanca's duty to provide **directors and officers** liability insurance, and that IFDB would provide cover only for any costs above the company's coverage. So SlavaBanca's indemnification and D&O insurance policy would cover directors and officers for financial loss to others due to wrongful acts as director, plus defense costs, settlements, and judgments.

Clearly, the indemnification and D&O insurance were prerequisites to becoming a director and must be in place as long as Carla was a board director. Carla was relieved to read Maggie's clear statement that IFDB was offering help not only in ensuring that the company does provide indemnification and D&O coverage but also that the policy is adequate.

After reading through this material, Carla made two notes to herself:

- Make sure that the SlavaBanca has D&O insurance in place with an adequate coverage.
- Be aware that IFDB's indemnification is supplemental to the company's D&O policy.

She was still thinking about her reputational risks if things went awry and could not be covered by any insurance, when she realized the telephone was ringing.

2.2 The Welcome Call / Preparing for the First Board Meeting

"Hello, Mrs. Feltrini," said a man's voice with a heavy Slavic accent. "This is General Aleksei Chomutowski, chairman from SlavaBanca. I hope I am not interrupting you in anything important?"

Carla was startled. Things were moving way too fast! She opened her mouth to speak, but she wasn't sure what she was going to say.

It didn't matter anyway, because General Chomutowski kept right on talking. "I have heard from your colleague, Mrs. O'Brian, you will be the director representing IFDB on SlavaBanca, and I want to heartily welcome you on board of my ship!"

Carla could hear the General inhaling his cigarette and waiting for a reaction from her, but she kept silent. *This is going to be interesting*, she thought. *He's talking of his ship and about me representing IFDB—something I didn't realize I was doing.*

General Chomutowski continued, "Mrs. Feltrini, you know that our next board meeting will be in one week, and I wanted to express my joy about your presence there and that we are all very excited to have such an experienced addition to our already well-functioning board!"

Now Carla had to speak up and redirect the conversation. "Mr. Chomutowski, it is my

pleasure to be of service to SlavaBanca,” she said. “However, I’m surprised to hear you say the board meeting will be in a week! I was informed that the meeting would take place in three weeks. Furthermore, I have neither received any information from SlavaBanca about the board meeting nor have I signed any legal documents, and—

“But Mrs. Feltrini,” he interrupted, “this is no problem at all. You will be welcomed as friend on my board, and I will see to it personally that you will receive the information you need for the board meeting in time. Please don’t you worry about that too much, Mrs. Feltrini! And please don’t hesitate to address any issue before or after board meetings with me personally.”

Before Carla could respond, he added quickly, “Unfortunately, though, I have to go now. But I am looking forward to meet you in a couple of days!”

With these words, General Chomutowski hung up, leaving Carla stunned. “This is going to be interesting,” she said to herself, “very interesting!”

Knowing that she had to dig into her work even faster now, Carla made a checklist of issues she really needed to study and understand if she was going to be sufficiently prepared for her first meeting. (See Checklist 2.)

Carla was delighted to discover that some of the information she needed was already included in the files Maggie sent. So she took the rest of the day to skim through at least some of the basic company information. She would ask the General or the company secretary—should there be one—for any other information she needed, once she was in Bankistan.

* * *

When Giacomo returned home that evening, he found Carla still busily poring over her preparation materials. She quickly put the work aside, happy to see her husband—and grateful for the excuse to think about something besides SlavaBanca and Bankistan.



Checklist 2: Information for Preparing for First Board Meeting

COMPANY INFORMATION:

- Strategy and business model
- Operations
- Financial data
- Risk profile and risk analysis
- History

BOARD INFORMATION:

- Structure (e.g., committees)
- Member profiles and their relationships
- Calendar
- Minutes of past two meetings
- Book for next meeting

IFDB INFORMATION:

- Performance indicators
- Contractual obligations
- Information on the dual mandate
- IFDB policies for nominee directors

MACROECONOMIC INDICATORS:

- GDP, inflation
- Country risk profile
- Competitive environment

Giacomo, with a gleam in his eye, told her about his day. One of his former students had conducted what he characterized as a fascinating tour of the Galleria d'Arte Antica with its famous renaissance and baroque art. Throughout dinner, Giacomo regaled his wife with one anecdote after another. And Carla almost forgot about her unfinished work.

Then Giacomo asked, "How was your day, darling? What did you find out about your new assignment?"

"Actually, my day was not too bad," Carla said. "Maggie sent a lot of materials, and I believe I am making some progress in understanding my new role. But I just found out that my first board meeting will be in a week already!"

Giacomo raised his eyebrows. "Just one week?"

"Yes," she said, rolling her eyes. "I suspect I'm going to be playing a lot of that meeting by ear!" Then she looked thoughtful. "The weird thing, though," she said, "is that the chairman of the board called me today. What do you make of that?" Carla always valued Giacomo's opinion when it came to personality issues, so this was an obvious question for him. She filled him in on her very one-sided conversation with General Chomutowski.

Giacomo listened with interest, then offered his analysis. "It seems he wants to make sure that no one is interfering too much with the company," he said, "which he views as his company. He certainly seems to want to keep a tight rein on the business. Do you know who else is on the board team?"

Based on the information she had received about the board directors and the main players of the company, Carla had formed some conclusions about the makeup of the board. "Altogether, there are currently six board members: two executive board members, the chairman, and three other non-executives," she said. "Plus me." Then she went on to describe the board:

- The chairman is General Aleksei Chomutowski. He founded the company and still owns much of it directly and through his family's holding company Chomu-Holding.
- The CEO, since the merger with the other bank in 2009, is Sergei Ivanovich. It appears that he is married to the General's daughter. Carla noted that she couldn't find any information on his banking experience—"which is weird," she added.
- There is the CFO, Boris Krohobor, who has been with SlavaBanca from the beginning. Apparently he has also served under the General before, in the military.
- Then there is Oleg Jattschanka, a non-executive who seems to be related to the General. But Carla couldn't find a lot of information on him, except that he is working for Chomu-Holding.
- Also, there is Kakha Kolas, another non-executive. Kakha is a lawyer in Bankistan. "But his affiliation is not quite clear to me," Carla said. "Maybe he is in there for the money."
- Finally, there is Michael Flynt, the third non-executive. He is with Global Equity Partner (GEP), the other foreign investor in the bank.

Giacomo listened intently, trying to figure out the relationships between the different board directors. "What is your gut feeling?" he asked. "Who—if anybody—is on your side? It seems most of them are in the hands of the General."

Carla had come to the same conclusion. But her one hope was that she would find an ally in GEP's director. "My biggest hope so far in my revolutionary activities—as you called it yesterday—is Michael Flynt. He might share my interest in improving corporate gover-

nance and seeing some transparency in the bank's doings."

Giacomo shrugged. "Maybe," he said. "I suspect you'll find out soon."

The two of them continued their discussion as they watched the sunset over Rome. Before calling it a night, Carla sent one more e-mail to Maggie, letting her know about the General's call—and reconfirming her interest in the position.

2.3 Can You Bring Value as a Guest? / The Board Meeting

Danubesk', the capital of Bankistan:

Despite the "confusion" about the day of the meeting, Maggie advised Carla to attend the board meeting as a "guest." This rather unusual role was a compromise between Maggie's position of onboarding Carla as quickly as possible, to get things moving, and Carla's reservations about attending the meeting at all.

The General had invited Carla to join him for a pre-dinner prior to the board meeting, but Carla politely declined. Besides dealing with the three-hour time difference, she had received the board book via express only a couple of hours before she boarded the plane to Danubesk'. She tried to read it during the flight, but she found it more confusing than helpful. It contained tons of details, but their relevance wasn't clear to her.

Carla also couldn't make heads or tails of the structure of the book. It contained chapters of credit approvals, derivative and swap contracts, income from advisory services, the development of savings and loans. . . The information was differentiated by periods of validity, always for the last quarter, but no comparison over time was possible. The quarterly balance sheet was just a pretty summary of the profit and loss account, and it looked like there were some losses. Beyond everything else, this hodge-podge violated her sense of a logical structure and transparency.

She had closed the board book in disgust and rubbed her weary eyes. *Luckily, this time I am only an observer*, she thought. When the plane landed, she had gone straight to The Ambassador hotel and to bed, grateful that she hadn't accepted the General's dinner invitation.

* * *

The next morning, a company limousine picked Carla up from The Ambassador, one of the posh new hotels that shot up—built with foreign money—after the collapse of communism. The limo took her straight to the bank, where CEO Sergeii Ivanovich was waiting for her at the entrance. Carla suspected that the driver had given him a heads-up via his mobile phone. *Good control management*, she thought.

As they walked to the elevator, Carla noted that the bank building was quite luxurious. Sergeii was overly obsequious, asking her about the flight and whether she found the hotel comfortable. Carla tried to read his face, but despite all the politeness, it was closed. *A poker face*, she thought.

As they approached the boardroom, General Chomutowski appeared in the doorway. He was a giant of a man, with broad shoulders and a military short haircut. But time had taken its toll: he was now overweight and had a slightly stooped posture, and his face was bloated and pale. *Probably the result of an excessive lifestyle*, Carla thought.

But the General's most dominant features were his still-energetic blue eyes and his com-

manding voice—which he used when introducing her to her future colleagues. First was Boris, the CFO, a stereotypical bureaucrat, just as Carla had imagined. Then came Oleg, “the undefined,” as Carla had characterized him (and the General’s introduction did nothing to change that impression). And finally, there was Kakha, a young and surprisingly sympathetic lawyer. Michael from GEP would arrive an hour later, she learned; the morning flight from London had been his only option.

The meeting thus started with an almost complete board and with opening remarks by the General. He introduced everybody in extremely polite but nonspecific phrases. He presented Carla as “a high-ranking executive of an extremely important international institution.” Then he turned to her and added, “We are very happy that you took the trouble to join us.”

He exceeds even the Italian diplomats, Carla thought, smiling to herself. She noticed that his comment at least served to get a note into the minutes that she was participating as an observer rather than as a board member, since the paperwork for her nomination was not yet finalized (pending approval by the central bank).

Carla tried to explain that her status was due to insufficient time to accommodate the paperwork, but the General interrupted her. “Don’t worry, milady,” he said. “In Bankistan, we don’t look so much at formalities. You are a friend of our house and therefore welcome, whatever the legal status is!” Carla was taken aback by the old-fashioned expression “milady” but decided to ignore it.

The agenda was on the table, and the General was already going through it, providing explanations for the newcomers and yielding for some comments by Sergei, the CEO. It was basically a review of the last quarter, a review of the increase in employees (one of whom was related to the General and four of whom were from Sergei’s family). Thrown into the mix were stories and anecdotes about some recent business events.

Michael Flynt showed up after an hour. He took his seat and was as silent as the others. Carla tried not to stare at him but quickly sized up his appearance: *a combination of a sleek investment banker and a model*, she thought.

The whole board meeting amounted to a friendly dialogue between the chairman and the CEO—with only one occasion when the chairman asked the CFO a specific question. All other board members listened more or less attentively. What surprised Carla most about the behavior of the board was the non-participation of Oleg.

On a more personal level, Carla was not expecting to find such heavy smoking in the room. Fortunately, she had no adverse reactions to tobacco smoke, but she was struck by the contrast to the nonsmoking policy she had experienced everywhere else in recent years.

Even more surprising was that alcohol was served with lunch, and that the General was already drinking heavily. But, she observed, it didn’t seem to have any visible effect on how he conducted the afternoon session—what there was of it. The board meeting ended early, with the General’s assurance that all was well. “As you see,” he said, “the bank is in great shape and growing fast. You made a very smart investment, and we are going to generate fantastic returns. I call for the next board meeting when required—probably in three months or so.” And he closed the session.

* * *

Carla reflected on her day at SlavaBanca as she rode in a taxi to the airport. *Interesting how quickly things change*, she thought. *The elites' new ideology after communism is fast money, and it is shared only within a small group and definitely not with their previous friends—the workers!* She was rushing to the airport, trying to catch the last flight out so she wouldn't need to stay another night at The Ambassador.

Alone with her thoughts now, she started to wonder whether her attitude during the meeting was appropriate—to just stay silent as an observer. Should she at least have indicated at the end of the meeting that she didn't think this type of board meeting added any value and that she expected to have more discussion next time? Maybe she should have stayed for the evening drink; the General had invited the whole board. Should she have insisted on fixing a date for the next meeting? Carla shuddered, as if to physically shake off this whole second-guessing line of thought. “Enough of this!” she said softly to herself.

But she continued to rehash, analyze, and speculate all during her flight—which she had managed to catch just as they were about to close the doors. Her thoughts kept returning to the chairman. *This General probably is not of the best character*, she thought, *and I don't think I will have a good personal relationship with him*. But then that raised another question: *If I want to improve the business and corporate governance, what kind of relationship do I need with the General?*

* * *

By the time she arrived in Rome shortly before midnight, Carla had pondered many open questions, looking forward to discussing them with Giacomo and getting his perspective on what had happened in Bankistan. But now she was too tired to have any kind of meaningful conversation, no matter how eager her husband was to find out how her board meeting had gone. “We will have a long breakfast tomorrow,” she promised. “But now I just need a bed. Good night, darling.”

2.4 The Retrospection / IFDB'S Expectations

Rome—The next morning:

Carla awoke to the enticing aroma of the breakfast Giacomo had already prepared. She found him reading the newspaper, waiting patiently for her to join him. When he saw her, he put down his newspaper and started to say something. Then stopped. She could tell that he wanted to ask her about the board meeting but knew better than to try to engage her in conversation before she'd had her breakfast.

At last, Giacomo could stand it no longer. “Yesterday evening I had the impression that your first board meeting was not really exciting,” he ventured.

Carla smiled slightly and decided to reward his bravery, despite her usual inclination to start the day slowly. She took a deep breath. “The professional standards are even lower than I had expected,” she began. “They don't really have a clear strategy, corporate governance is lousy—and I don't like most of the people. The General—sorry, *chairman*—is most self-absorbed.” Then, as an afterthought, she added, “And he *absorbs* a lot of alcohol!”

Giacomo nodded knowingly. “History tells you: autocrats start to get control-crazy the older they get,” he said. “They realize that their time is running out, and they respond—not

very rationally—with an even tighter control. That’s one of the reasons for their downfall.”

Before he could elaborate on this point, starting with Ramesh 4,000 years ago, Carla interrupted and brought the conversation back to the topic. “What do you think?” she asked. “Should I expect special resistance from the General when I come up with suggestions?”

Giacomo wasn’t upset about the interruption of his history lesson; he was used to it. “Resistance is probably the wrong word,” he said. “He will fight you aggressively—and try to shut you down, I assume—in order to keep his tight control. Of course, he will do so under the guise of ‘we are all friends and want to earn money together.’ But if you take your job seriously, such a fight is inevitable—”

This time it was the ringing phone that interrupted Giacomo. Carla answered it, and the voice on the other end of the line identified himself as Hank Healey. “You might remember me,” he said in his broad Southern accent from Louisiana. “I am one of the portfolio officers working with Maggie and am also responsible for the SlavaBanca investment. Maggie and I are curious about how your first board meeting went.”

Carla was miffed and in no mood to hide it. “Sorry,” she said sharply. “I have not been officially appointed, because the central bank’s approval is pending. So I attended the board meeting only as a guest.” She paused briefly and then gave in to sarcasm. “Now you probably want to know how much I have already improved the business and corporate governance.” She paused again, then added, “And doesn’t your policy state that I am not supposed to report to you the exact details of a board meeting?”

Following an awkward silence, Hank said, softly, “I beg your pardon, Carla, but you know this investment was a difficult decision, and it is very important to us that things get right here. In general, we have agreed with SlavaBanca to be able to share information, but only as far as the law permits.”

“Well, things are probably worse than you and I expected,” she said. “Business might be fine for the moment, but—I don’t know and cannot know yet—but I assume that every move from our side to create more transparency will be met with heavy resistance.”

Hank was unmoved. “Yeah, that is highly probable,” he conceded. “But that’s why we sent you there, Carla.”

Carla frowned. “So you expected me to do battle with the General?”

“Well, I would frame it a bit more politely,” Hank said, “but yeah. We need to convince him that it is in his own and best interest to ratchet up professional standards and transparency.” Then he added, a bit more cheerfully, “I just sent you an e-mail with the corporate governance evaluation.” (See Figure 6 on page 35.)

Carla checked her e-mail. “Got it,” she said. Then she added, in a warmer tone than she had used with her earlier comments, “Thank you, Hank.”

They continued their discussion for a few minutes more, and then Hank brought it to a close. “Carla, I really respect your independence as a board member,” he said. “And we all agree that you are most suited as a board director on this task. But we are in this difficult situation together; we need your support and you need ours to succeed.”

Carla couldn’t resist the charm of his soft Southern accent and agreed. “Yes, let’s stay in touch, Hank,” she said. “I will keep you posted.”

After giving her conversation with Hank some thought, Carla concluded that the best way forward—although a bit risky—was to write an e-mail to the General, making clear to him the expectations IFDB has for improvement. *And we’ll see what happens*, she thought.

Figure 6: Corporate Governance Assessment

CG AREA	RISK	RECOMMENDATIONS/COMMENTS
Commitment to Good CG	Moderate/High	<p>Comments: This risk is moderate to high, since SlavaBanca's CG structure is not up for the IPO that is planned within the next 18 months, as the leadership has been slow to adapt new structures of corporate governance (e.g., appoint a proper company secretary).</p> <p>Covenants: Make risk management a priority.</p> <p>Recommendations: Need to improve corporate governance and risk management for making a successful IPO.</p>
Structure and Functioning of the Board	Moderate	<p>Comment: This risk is moderate, since the current board functioning is suited to reflect only the interests of the sole shareholder and is controlled by the shareholder's representative—board chair.</p> <p>Covenant: Nominate IFC director as independent director.</p> <p>Recommendations: 1) Add a board member with risk management and banking experience (could be the IFC nominee); 2) Adopt and use a more rigorous definition of independence; 3) Board procedures can be improved, e.g., provide the board meeting package to directors at least 5 days in advance, develop an annual calendar of board and committee meetings, etc.</p>
Control Environment and Processes	Low/Moderate	<p>Comment: This risk is low/moderate because, although the company officially has internal controls, internal audit function, compliance, and risk management systems, the risk management and compliance, functions are not focused and without clear responsibility assignment.</p> <p>Covenant: Improve responsibility and accountability of audit committee and internal audit.</p> <p>Recommendations: 1) Supplement the functions of the AC with risk oversight with focus on all risks; 2) Risk policies should be approved by the full board (or AC/RM committee) but not the executive committee; 3) Compliance function should also be consolidated and combine AML, regulatory, and internal compliance.</p>
Transparency and Disclosure	Low/Moderate	<p>Comments: This risk is low/moderate, since the external reporting requirements by the banking and securities market regulators are fairly advanced in Bankistan and well enforced.</p> <p>Covenant: None.</p> <p>Recommendations: In case of IPO, relevant investor relations function as well as adequate reporting/external disclosure practices should be developed.</p>
Treatment of Minority Shareholders	Moderate	<p>Comment: This risk is low because the bank has no minority owner.</p> <p>Covenant: None.</p> <p>Recommendations: 1) Formalize the approval of related-party transactions and involve the AC for material transactions; 2) Formalize the dividend policy.</p>

Returning to the breakfast table, Carla was already grappling with the content of the e-mail she was going to write to the General. She filled Giacomo in on her conversation with Hank and her decision to send an e-mail to the General.

Giacomo listened to his wife, then said, “Probably you need to write something like the *Emser Depesche*.”

“The *Emser*—what?” Carla asked, with a puzzled scowl on her face.

Giacomo smiled and explained, “Well, it was the decisive communication that led to the French-Prussian War in 1870—”

“Please, not a lecture, darling,” Carla begged. “But can you tell me in only ninety seconds?”

Giacomo, trying not to let his frustration show, said, “The bottom line—to use your term—is that a telegram by the adjutant of the Prussian King to Chancellor Bismarck was published in such a way that it provoked the French into a war, which they lost. It is regarded as one of the diplomatic masterpieces of Bismarck.” He looked pointedly at his watch. “Was that brief enough for you?”

Carla smiled. “Yes, and I appreciate your sacrifice.” Then her expression became more serious. “That was a good analogy. It captures my intention—especially the outcome. And some provocation—couched in politeness, of course—is unavoidable.”

Giacomo sat up a little straighter and smiled proudly. “My wife,” he said, “the diplomatic rebel!”

2.5 The Insights / Thoughts on Improvement Possibilities

Carla had already made an appointment to have lunch with Alberto today. And since he had been so helpful before, and since she didn’t feel quite ready to write the e-mail to the General, she decided to use Alberto as a sparring partner—without divulging any confidential information, of course.

They met in Alberto’s favorite foccaceria, and after their first glass of sprizz (a favorite of the locals), it was Alberto who dived right into the hot topic. “Tell me, Carla,” he said, “how did it go in Bankistan?”

Carla took another sip, considering how to answer. “Ah, well,” she began, “this is not the developed world yet, with all its corporate governance standards and processes.” And then she filled him in on her experience with the board—to the extent she felt she could.

Alberto listened to Carla’s narrative about the board meeting, and then he congratulated her. “Carla, this is great!” he said, “—another challenge that keeps you from getting old and another way to help others with your knowledge! It was a good decision for you to take on this battle—and it *will* be a battle.”

Carla couldn’t hide her surprise at Alberto’s reaction; she hadn’t expected such enthusiasm. “Yes, certainly a battle. . .” she agreed “But where do I start?”

Alberto smiled and continued, “You remember what our boss at Credito Universale always said in such situations: ‘pick your battles carefully!’ You need to understand the structure of the internal corporate governance in order to identify levers. And of course you need to understand the responsibilities and duties of the board to decide what it is that

you want to shape. After all, the board has many a duty, from strategy to finance, from HR to organization—and self-organization. And all of that is in the context of oversight and value creation.”

Carla and Alberto continued their discussion for a few more minutes, but Carla began to fade. She was too exhausted to follow all of Alberto’s sermons on corporate governance. So she thanked him for helping her—yet again—and went home.”

2.6 The *Emser Depesche* – Or a Declaration of “War” / Formulating Improvement Expectations

Once she arrived back home, Carla felt the need to write her e-mail to the General as soon as possible. She wanted to compose it while all her memories—and frustrations—of the meeting were still fresh. She sat down and typed, “Dear General Chomutowski,” pausing to smile wryly at the unusual salutation. But she wanted to follow the expected etiquette. Then she wrote the following:

Upon my return after our meeting, I really want to thank you for your hospitality and the first insights I was able to get during my visit as an observer at your board meeting. I am deeply impressed how you and your team have built a successful bank under the difficult circumstances of the transition from communism to a market-based economy. I really congratulate you and your team for the achievements of the past, which are clearly a great foundation to continue and build the next stage on—the reason IFDB and probably GEP have invested a considerable amount of capital in SlavaBanca.

After the rapid growth in your country during a catch-up phase, the consolidation in the banking sector is now also visible, and we want your bank to continue to prosper and develop so that it deserves a top spot in your country, especially in the important financing support for small and medium enterprises.

For this, we believe and, to my knowledge, it was communicated to you during the investment process, that the bank needs a more systematic strategy, more transparency and efficiency in its processes, with clear accountability and a clear division of labor between management and board.

Regarding the board work, I suggest that we discuss the following improvements:

- *We should think about a smart and effective process to develop a strategy with clear goals, defined actions, and timetables.*
- *We should improve the work of the committees, especially the audit and risk committee, which is legally required and should play a more active role than in the past. I am happy to serve on that committee, if you think I can add value there.*
- *We should improve the board information system. For this, we need to formulate as a board our information needs, prioritize them, and structure them, so that we have common bases, where all of your board members can contribute to better decisions.*
- *We should plan the board meetings a year ahead and set up a board calendar with the key topics that we really want to deliberate in depth: e.g., strategy, Human Resources development. I think we need at least six board*

meetings per year—maybe one or another can be a teleconference, once we have established due procedures.

- *We should establish clear and transparent employment policies for family members.*

I am looking forward to working with you on this board and am sure that together we will continue SlavaBanca's success in the future.

Kind regards,

Carla Feltrini

Carla read the e-mail again—twice—before she sent it to the General, with copies to Maggie and Hank and a blind copy to Gurrkarn. Then she tried to relax and think about something else for a while.

* * *

To unwind, Carla had gone out to her favorite espresso bar around the corner. Now, just when her espresso was ready, her mobile phone started ringing. She answered and was surprised to hear Gurrkarn's voice on the line. He was obviously concerned and, after some small talk, finally said, "I really appreciate the vigor with which you fight for corporate governance. Not all of our colleagues demonstrate the same commitment. . ."

"But?" asked Carla when Gurrkarn paused.

"Well," he continued somewhat cautiously, "I don't know whether you are aware that your e-mail is perceived a declaration of war in their culture."

Carla laughed. "Not really a declaration of war," she said, "but definitely something of a provocation." She went on to explain her thinking along the historical comparison her husband had offered this morning.

Gurrkarn was not really convinced. "If even the skilled French diplomats got it wrong," he asked, "what do you expect from a transition country, shaped by a dictatorial past over the last several hundred years?"

"What would you have done, Gurrkarn?" Carla asked, choosing not to answer his question but rather to move to the practical conclusion instead.

"I believe that the beginning of the e-mail is very well formulated," he began, obviously feeling uneasy about having criticized a good friend. "But if you had asked me, I would have focused on the one or two points that—at this stage—would bring the biggest progress. As you have observed, they have no idea about corporate governance and probably shy away from transparency."

As they continued to discuss the pros and cons of different priorities, Carla began to feel a bit uneasy herself. "I got your point, my friend," she said. "I should move step by step." But she wasn't ready to concede the point entirely, so she added, "But I still think it is fine to outline the whole story, where you want to be. . ." Clearly there was a battle going on inside Carla's own thinking. "But we will see how they react," she said. "And I agree I should focus on the annual board calendar as a symbol for change and improvement—and the audit and risk committee."

* * *

When she returned home from the espresso bar, Carla felt the urge to check her e-mail. Opening the laptop, she saw a brief congratulatory e-mail from Maggie. *At least I am in*

line with IFDB official policy, she thought. But there was no response from the General—not that day, nor the next day.

* * *

On the third day after Carla’s “declaration” e-mail, she and Giacomo finally left for their cruise to the Arctic—and still no response from the General. She had managed to finish all the paperwork needed for the nomination and get it sent off in time. Now was her chance to relax and enjoy the cruise that her husband had so eagerly awaited. But she didn’t really share his enthusiasm. Giacomo was accustomed to their differing tastes, so it didn’t bother him that she had come along somewhat reluctantly. “I know you too well,” he joked. “You like crusades more than cruises.”

2.7 The Response to the Declaration of “War” / Dealing with Personalities

Rome—Two weeks later:

Carla and Giacomo returned from their cruise on a Saturday. And true to her promise to him, she had not checked her e-mail even once during the vacation. When she turned on her smartphone at Rome Fiumicino airport, Carla scrolled through the e-mails and was somewhat relieved: although she found a lot of messages, there were dramatically fewer than she used to get when she was at IFDB. Back then, she couldn’t afford just to turn on the out-of-office reply and disappear for two weeks. *It’s great to have a more relaxed life*, she thought.

Scrolling through her e-mails in chronological order (oldest first), she found one from IFDB and one from SlavaBanca, each confirming that her nomination as a nominee director had been approved by the General Assembly. She continued to scroll.

Carla and Giacomo were already in the taxi when she reached the most recent messages. And there she found an e-mail sent last Wednesday, with an invitation to a board meeting on Friday—the last day of their cruise. At first she was shocked—and then furious! “These rascals knew from my out-of-office reply how long I would be on vacation,” she fumed. “And they scheduled a board meeting precisely on the last day!”

Giacomo attempted to calm her down. “What do you expect? You are up against one of the most Machiavellian minds in the country. And now he’s given you a clear signal: ‘I got your message—here is my response. Full stop.’”

Carla tried to regain her composure. “At least now I know that he will not voluntarily improve corporate governance at the bank,” she said.

“That is definitely a correct conclusion,” Giacomo agreed. “But now it raises another question: What’s your next move?”

2.8 The Preparation for Battle / Many Roles of the Board

Despite her efforts to control her anger—and despite the wonderful experiences and impressions that carried over from the relaxing Arctic cruise—Carla was still furious when she arrived home. She wanted to call Maggie, Gurnarn, Alberto, or Hank about this. But, on second thought, she wondered what to tell them: That she was furious? That she had a great vacation? That the General purposely shut her out of the board meeting?

After some thinking and calming down, Carla decided to call Hank, the portfolio officer

with the nice calming Southern drawl, to inform him about the latest development—which she still regarded as an inexcusable affront! Perhaps he could help her find an answer.

Hank seemed less surprised at the General’s behavior than she was. After some discussion they concluded that Maggie should be the one to write an e-mail to the General to seek assurances that this sort of gamesmanship should not happen again—and to request that there be due process in scheduling meetings and inviting the board members.

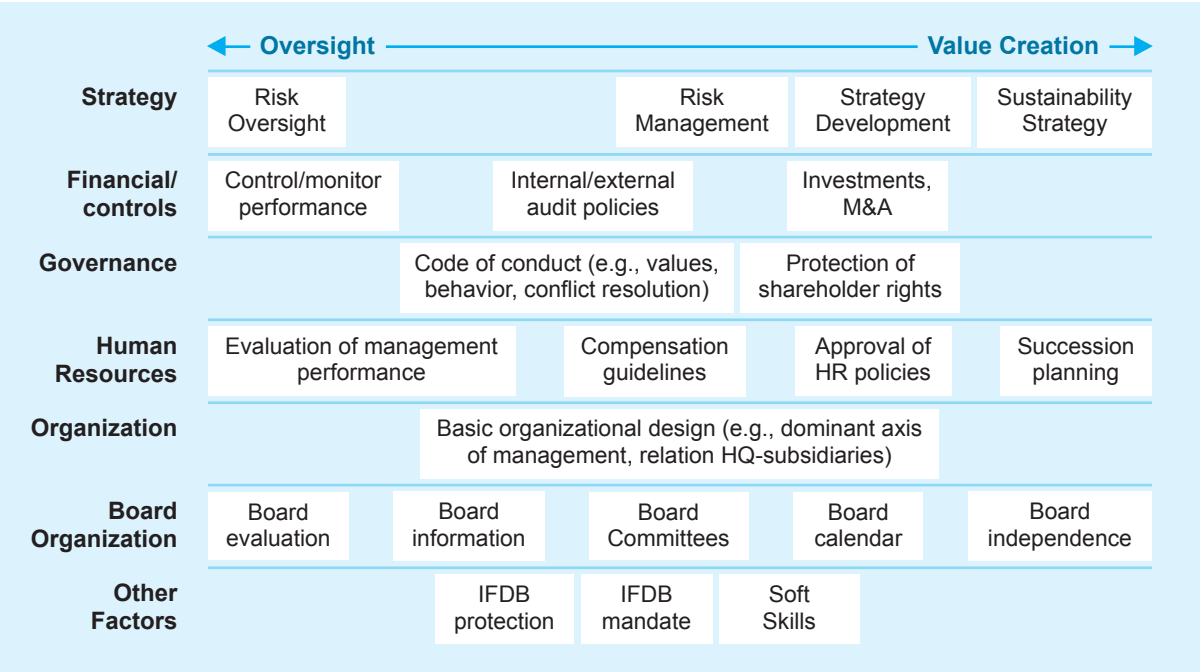
Maggie agreed. And three days later, Carla received a forwarded e-mail of CEO Sergei’s brief response to Maggie, in which he confirmed that “SlavaBanca is very committed to invite the board members in time and inform them comprehensively.” *There is clearly room for improvement*, Carla thought, with a mix of amusement and bitterness as she read the e-mail. All her life, Carla had been a fighter—an *osso duro* or “hard nut,” as her husband sometimes called her. And she knew that this time would not be different: she would fight.

* * *

With this little skirmish behind her, Carla started contemplating her next move—what she wanted to improve and what she wanted to achieve as a board director—with Alberto’s words in mind: “Think of the battles and the levers!” And actually, this was also exactly what Gürkarn said with his counsel, “Prioritize!”

Carla started thinking and drawing, reading and contemplating, and asking questions: What duties should the board have, and what internal structure does it need to make

Figure 7: Overview of the Board’s Role



The board has a variety of roles. This chart shows various duties of the board and classifies them as “oversight” activities and activities of “value creation” for the future. For instance, risk oversight (as part of the strategy) is more of an “oversight” activity (e.g., does the company have all the risks managed properly?), while the sustainability strategy is more about “value creation” (e.g., how can we secure a long-term business model that considers economic, social, and environmental factors?).



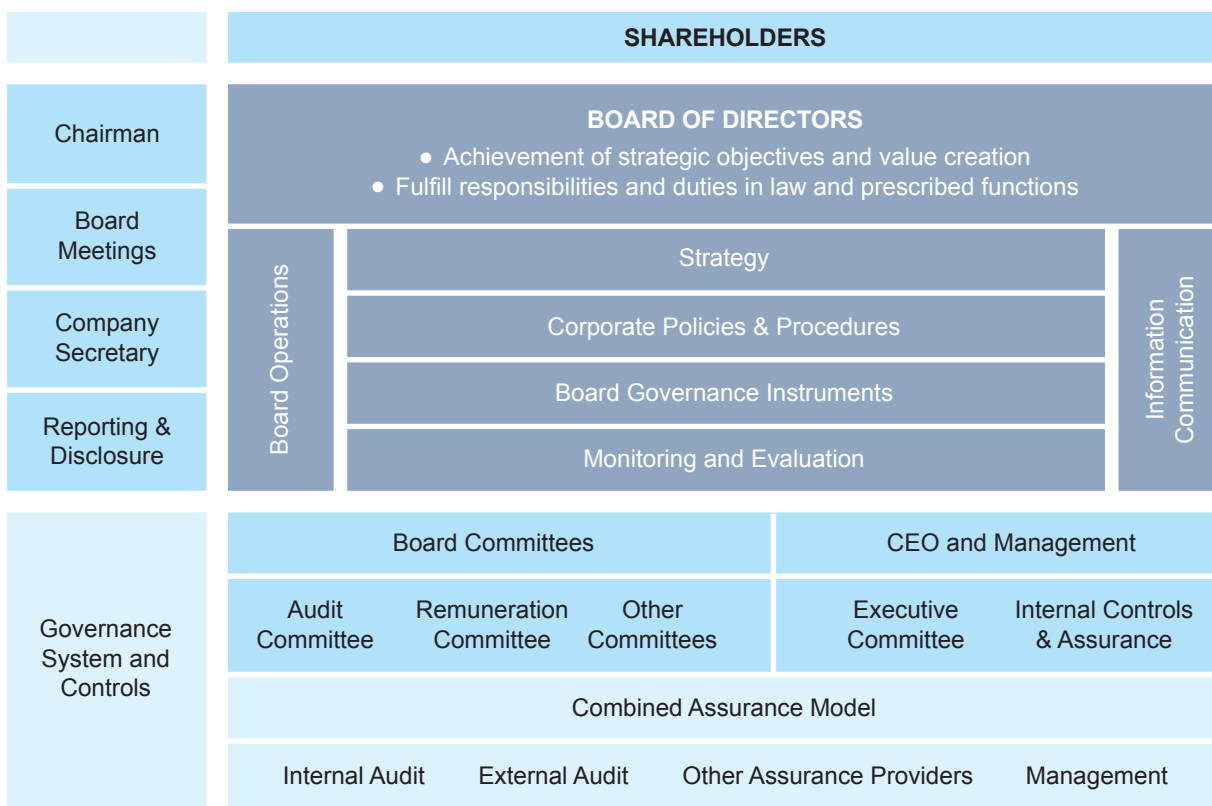
Key Messages of Chapter 2

- Make sure you have enough information and possibly meet some directors before going to the first board meeting.
- Drive change, but pick your battles carefully.
- Make alliances, not enemies.

corporate governance work? Who are the players, and what are the goals? After about an hour, she came up with a chart (Figure 7) summarizing the board's role. She kept in mind what Alberto had told her: the board is about oversight and value creation, and the duties are in strategy, finance, governance, HR, organization, and self-organization.

Carla found the question of levers and structures of corporate governance to be somewhat more difficult. But again, with some deeper thought and another look at the materials that Maggie had originally provided, she also found a good way to depict the relationship between the shareholders and the board and the relationship between the board and its committees. (See Figure 8.) Granted, this was still just theory, but Carla felt sure she could put it into practice in the next board meeting. The question was *how*?

Figure 8: Internal Corporate Governance Structure



The board functions as a unit (the full board) as well as in committees. The board depends on having access to good information and on being well organized. For the latter, a company secretary often takes the lead.

DEFINING THE BOARD'S ROLE

Rome | August 2010

Two months passed without any real information on SlavaBanca for Carla. Then came a call from Boris, the CFO, informing her that another board meeting would take place in one week. Carla asked Boris for some information on the content of the meeting, but he just referred her to the materials that would “arrive soon.” Carla rolled her eyes, knowing that the board book would arrive only a day before she would need to leave for Bankistan—if indeed it arrived at all.

3.1 The Second Meeting / Mental Preparations

Meanwhile, Carla had done her own preparing. Her research had given her a good overview of Bankistan's economy, and she had reviewed the reports of SlavaBanca (as far as they could be reviewed) and had read through the previous board books. So she felt somewhat prepared, even if the board book never arrived in Rome.

Carla also prepared a list of things she wanted to address in the meeting. Clearly, her goal was to improve risk management at SlavaBanca. But she believed that without proper board processes—or in other words, proper corporate governance—risk management can be only so good. And that wasn't good enough for her.

* * *

Bankistan

When Carla arrived at The Ambassador hotel, she found the elusive board book waiting for her in her room, with a short note that the board meeting would commence at 9:00 a.m. She read the agenda and skimmed through the materials, which not surprisingly were plentiful and unstructured. She took special care in examining the financial data as well as anything related to risk management. Her goal was to form an audit and risk committee, which the bank currently had only on paper, as far as she could tell.

What Carla found was actually nothing but self-praise of the company's stellar performance. *Something smells like old potatoes*, she thought, but she couldn't quite figure out what. The numbers provided added up, but she was convinced that something just wasn't right.

Finally, just before turning off the lights, Carla looked at the strategic plan—a glossy and very general part of the board book. It looked more like a brochure, telling investors how great everything is today and how much better it will be in the future. *This is not a strategic plan*, she thought, *but a commercial!* It contained nothing relevant to the board's vital task of driving the company's strategy. *This may be even worse than I suspected*, she thought. And with that, she fell asleep.

3.2 The Stirring / Board Calendar

Carla rushed through breakfast at the hotel then rode to SlavaBanca with the same limo driver as before, arriving at 8:30 a.m. But no one greeted her at the entrance this time, and she had to find her own way to the meeting room—no easy task with her almost nonexistent Slavic.

By 8:45, Carla managed to get herself to the appointed room, where she found Michael, Oleg, Boris, Sergei, and the General already having a lively chat over coffee and empty fruit and croissant plates. As she entered the room, the conversation stopped, and the General stood up and waved a greeting to her. “Welcome, Mrs. Feltrini, we are happy you could make it to our board meeting this time,” he said, as though her absence at the previous meeting had been *her* fault. “We missed you last time!”

Carla fought back an urge to lash out at this infuriating man. Instead, she gave him her best smile and then greeted the rest of the board members one by one. Each of them returned her friendly greeting with a polite nod. Someone offered her a coffee, which she had plenty of time to finish before the board meeting actually started at 9:15 a.m.

The General made the opening remarks, of course. It took some effort for Carla to endure the first hour of the meeting—again, just a friendly dialogue between the General and his son-in-law, CEO Sergei. The topics bore a striking resemblance to those covered in the first meeting Carla attended: the financial performance of the different branches (which CFO Boris presented); employment increases; the cars that the branch managers were driving and the related cost. . .

CFO Boris was showing his calculations on the different cars and their equipment, when Carla interrupted. “Thank you for this, Mr. Krohobor,” she said. “But if I may interrupt, Mr. Chairman, I would like to propose that we move on to more important topics than leather seats and electric versus non-electric convertible roofs.”

The room instantly fell silent, and everyone looked at the General, watching for his reaction. He breathed deeply and looked steadily at Carla with his intense blue eyes. “Mrs. Feltrini, thank you for your input,” he said. “I believe you are right. We should move on and decide about the cars within management.”

The General’s agreement surprised Carla, who couldn’t help feeling that she may have walked right into a trap of her own making. Did she just give permission to management to decide on things that the board should decide on? She looked at Michael, her fellow board director from GEP, to see his reaction. But there was no reaction: just like the other directors, he kept quiet and looked at his papers.

No, Carla argued to herself, *there is a distinction between the tasks of management and those of the board, and it is right to make this call. And this is a management topic—although obviously a topic important to men.*

The meeting continued with management compensation and moved on to strategy. A topic of discussion was whether to open six more branches in Bankistan’s growing cities within the next six months to support the booming real estate and construction industry. Carla articulated her reservations about the supposed boom. She had read about first signs of a squeeze in the market, so she asked for more information on that topic, since the information she had been provided did not suffice, in her opinion.

It was about 4:00 p.m. when the chairman wanted to waive the agenda item “other

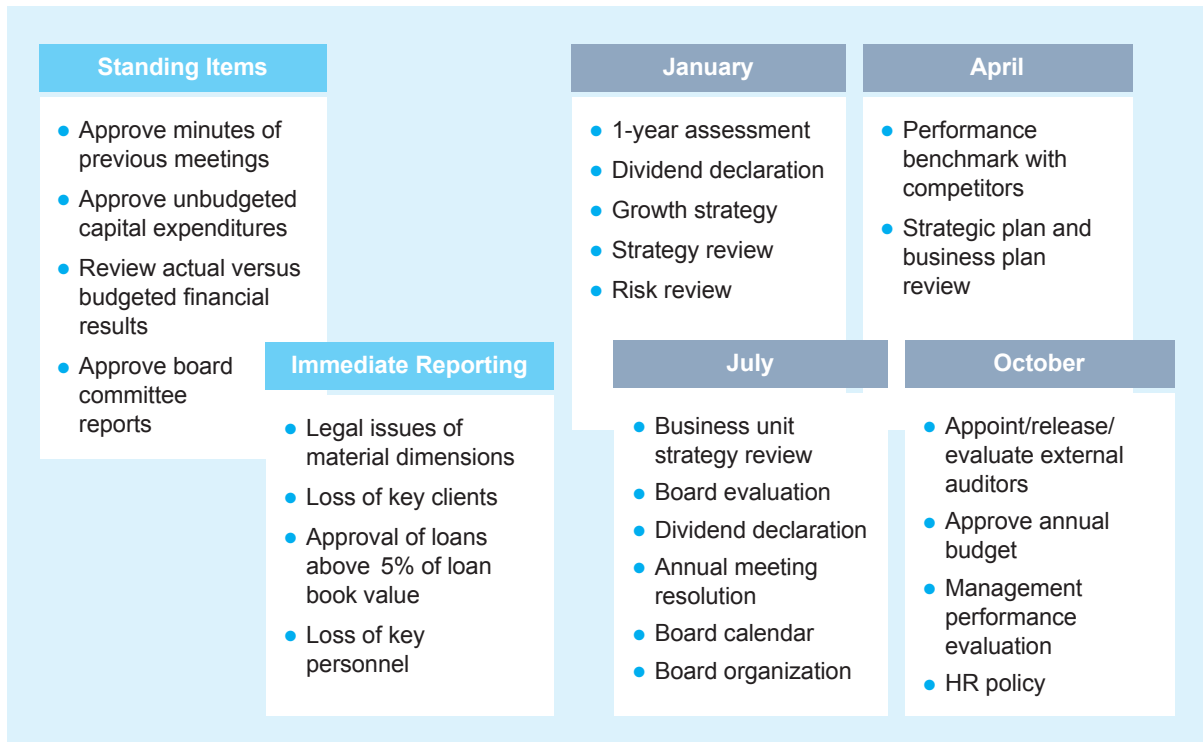
business” and end the meeting. Carla felt conflicted: On the one hand, if the meeting ended now, she could still catch her flight back to Rome that night. On the other hand, she had come here intending to address some basic corporate governance issues to start the process. *I’m here*, she decided, *so I might as well do what I came for*.

She raised her hand, getting the chairman’s attention. “Mr. Chairman,” she said. “I would like to take this opportunity to propose a board calendar for the rest of the year. This way, we could make sure that board meetings take place regularly, giving all the board directors ample time to prepare for the meetings and arrive well-organized.” Emboldened by the lack of an immediate objection, she continued, “Also, we could make sure that all of the important board and corporate governance issues are addressed in our meetings. This would help SlavaBanca tremendously, as the topics are duly discussed.”

Carla saw that all the other directors were looking everywhere but at her. The General looked first at Carla, and then around the room, as he answered, “Mrs. Feltrini, what exactly do you propose here? Are you saying that we are not organized properly? Or are you saying that we are forgetting some of our tasks as board directors?”

Carla knew this line of questioning and was well-prepared, so she didn’t answer directly. Instead, she continued, “I have prepared a list of items that we should put on the calendar. And if possible, we should discuss the frequency with which we should include these items on the agenda.”

Figure 9: Elements of a Typical Board Calendar



The board calendar is a tool to structure the board’s meetings throughout the year and make sure all relevant topics are discussed. The board calendar will be different for every company. Nevertheless, it should always include the core topics of strategy, risk management (including audit), top management oversight and appraisal, and finance.

She glanced up from her list and saw only the General's piercing gaze. Undaunted, she pressed on. "The board calendar allows us to plan the board's schedule for the year. The routine quarterly meetings cover most of the important points, such as strategy, HR development, approval of the balance sheet, et cetera. Certainly, review of financial data should be on the agenda for every board meeting, while serious strategic planning should be addressed once per year, but properly." Then she added, "The company secretary should help us organize this."

As Carla continued to describe her ideas (see Figure 9), some form of discussion began to emerge between her, the CEO, and the General—at first reluctantly. Then, to Carla's surprise, Kakha, one of the local directors, became involved, and things started moving better than she had expected.

After two hours, the General and the board agreed to a board calendar, and Carla was extremely relieved when the board meeting finally ended at 6:00 p.m. Although that meant she had to stay another night at The Ambassador, she was happy about the outcome. She had even managed to be nominated to the audit and risk committee.

3.3 The Lonely Nut / Driving Change as Nominee Director

Rome—Two days after the board meeting:

Carla stormed into the kitchen, where Giacomo was preparing breakfast. "This is a joke!" she fumed. She had just gotten off the phone with CEO Sergei. "How can he call me and tell me—in that tone—that the General is annoyed by my questions?" Not waiting for a response, she ranted on, "And then lecture me that the board is not the place for discussions! Isn't it my role as a board director to ask questions—sometimes even the tough questions?"

Giacomo put aside the breakfast preparations and gave his wife his full attention. Carla had given him an overview of the board meeting when she got back to Rome, but she hadn't provided details of every aspect of the meeting. Their schedules were such that they had not seen each other much since her return. Now he wanted to know what had happened that had caused all of this commotion.

Slightly calmer now, Carla began to fill him in. "During the last board meeting, both the General and Sergei presented the budget proposal for the next year," she told him. "It showed a significant increase in expenses due to the establishment of new branches of the bank. Since I could not see the value of expanding the bank at this stage and under the current circumstances, I asked the management to provide some more information on the matter—like a competition analysis, a return-on-investment and return-on-equity overview, and some information on the liquidity." She threw her arms into the air in exasperation. "Is that really too much to ask?"

Giacomo shook his head. Knowing she didn't really want an answer from him, he wisely kept silent.

Still agitated, Carla recounted the CEO's counsel during the call just now, that the best way to ask questions would be before the meeting and not during. Asking during the meeting, he had told her, might make other board directors uncomfortable. Recalling the remark rekindled her anger. "Just because the board and the management are underperforming and very provincial in their attitude—with an interest in keeping their jobs—it

does not mean that I shouldn't try to bring some professionalism to this bank."

Giacomo could keep silent no more. He tried to sooth his wife. "Darling, you are just ahead of time," he said, "just like Jean-Jaques Rousseau in enlightenment, Nikola Tesla in technology, or Leonardo da Vinci—who was probably the first person to ever draw pictures of the human body and muscles in such detail, but no one understood what to do with it."

Carla shook her head. "Giacomo, what on earth does that have to do with my mess?"

"Look, darling," he explained, "your fellow board directors probably don't fully understand the concepts you propose to them. And besides that, they might even feel that you're pointing a finger at them, telling them that they have not done their task properly before—which they probably haven't."

"That's a good point," she admitted.

Giacomo smiled and continued, "If you want to change things, you need to motivate the others to follow you. You need to earn their trust! It's true, you need to be a hard nut, but as long as you have no followers you will be a lonely nut. Once you have a first follower, others will join, too. And then you can start leading—and help promote the process of changing!"

On that point, Carla disagreed. "I don't need one follower," she argued. "I need to earn the respect of the full board."

"Fine—in the long run," said Giacomo. "But as long as the General doesn't allow you to function, you don't have *any* followers." Then he said something that surprised her: "Hence I would start with the General."

Carla felt uncomfortable with that suggestion and started to protest. But after thinking about it for a few seconds, she knew that her husband was right.

Giacomo continued, "And maybe you follow the advice of the CEO—choose separate meetings to get things moving."

On this point, Carla thought her husband had taken his argument one step too far. She was leery of such meetings; that was not her understanding of how a board should work.

But Giacomo continued, "Well, maybe you have to choose between what is in the rule book and what generates progress. As Pope Alexander VI tried to conquer Naples in 1493—"

"Oh, no!!!" she interrupted. "Please don't compare me with the Borgias! I am not power-driven nor corrupt! Maybe we should just have our tea in peace."

"But at least he was effective," Giacomo persisted. "And the guys he was up against were, morally, maybe not much better." Then he smiled and changed the subject to something unrelated to boards or Borgias.

* * *

Carla felt an uncomfortable sense of urgency when she received the draft of the Slava-Banca balance sheet for last year. "Possibly the most meaningless paper I have ever seen," she muttered to herself. "This lack of transparency is really beyond anything I expected!"

Driving Change as a Nominee Director

- Create alliances, if necessary one by one.
- Show the value of your proposals and actions to the directors who listen to you first.
- In serious doubt, involve the DFI.
- Withdrawal from your directorship is only the last option to exert pressure.

The best she could tell, the balance sheet wasn't in line with the quarterly internal results, and the profits shown were only in line with Sergei's boasting in the last session—and far away from reality. Similar to the previous year, securities gains were stated that did not necessarily make sense to Carla. But then she remembered what she had read about Bankistan in the IFDB country briefing: that the amount of “window dressing” in accounting was nearly unlimited.

She kept trying to make sense of it, but after an hour she stopped digging further into the details. *This is really an opaque system*, she thought. *But the balance sheet probably is in line with the legal requirements, and I as a board member cannot do much about it.*

Carla was on the verge of giving up altogether, when her fighting spirit came roaring back. She remembered the discussion with Giacomo and his advice to start by convincing the General; then the others. —*As though they wouldn't fall in line behind the General anyway*, she thought.

3.4 The Demand for Change / Understanding Power

Carla began pounding out another e-mail to the General. *If he thought my first e-mail was a “declaration of war,” she thought, just wait until he sees this one!* And she typed the following:

Dear General Chomutowski,

Obviously my efforts to contribute to the improvement of corporate governance have met with resistance or even outright rejection. This surprises me, as the investment agreement with IFDB is very explicit on this point. Therefore, I assumed the whole board would discuss the “how,” the implementation of good corporate governance practices, including an effective strategy process. But this is obviously not the case.

Therefore, I would highly appreciate it if the two of us could have a discussion on this topic before the next board meeting.

Sincerely Yours,

Carlotta Feltrini

To her surprise, after only two hours Carla received a response, militarily terse: *Please be in my office at 8:00 before the next board meeting on September 30.*

GK



Key Messages of Chapter 3

- Be a woodpecker: always on the same spot, without getting a headache.
- Start driving change with low-hanging fruits—and avoid Pyrrhic victories.^a

^a. A Pyrrhic victory is a victory with such devastating losses that is tantamount to defeat.

MAKING CHANGE HAPPEN—STEP BY STEP

Bankistan | September 30

Carla arrived at the headquarters of SlavaBanca shortly before 8:00 a.m. This time, she was greeted by the General's secretary, a woman who appeared to be Central Asian. She gave Carla a piercing look while guiding her to the General's office. If the thinking around here is as old-fashioned as her clothes, Carla thought, any change will be impossible. Then she scolded herself for being so judgmental.

4.1 The Meeting with the General / Communication Style Matters

Carla was momentarily taken aback by the size and elegance of the General's office. Until now, she had never been anywhere in the building except the more functional boardroom and its floor of other meeting rooms.

She estimated the office to be about 100 square meters. Its walls sported shelves filled with antique books—interrupted by the occasional Renaissance drawing. An impressive desk dominated the room, which also had a table with seating for 10—everything in leather and teak. *Still old communist style*, she thought. *He shouts his orders to his underlings from his command center.*

The General greeted her formally and asked her to take a seat. Then he spoke brusquely, “What do you want really from us?”

Carla chose her words carefully. “Nothing, other than the implementation of what you agreed to in the investment agreement,” she said, calmly.

The General was unimpressed. “We were clear with your people that we would implement it in a reasonable way,” he said, “according to the situation in our country.”

“But you have not implemented anything yet,” Carla persisted.

The General was silent for a moment, thinking—and uncomfortable with the conversation, Carla thought. After all, this may well be the first time in his life that a professional woman has said such things to him.

At last, the General broke the silence. “Can you give me an example?” he demanded.

“The most recent one is your draft of a balance sheet,” Carla said, “which does more disguising than creating transparency.”

“Do you know what would happen if I am transparent about all our workings and successes?” he asked rhetorically. “I would get a call from the presidential palace with the good news that the President's family is ready to invest here, of course on very favorable terms.”

Carla appreciated his candor but also sensed the bitterness in his tone. Perhaps it was time to transition from confrontation to charm. “But General,” she began, smiling warmly, “you are one of the most powerful figures in this country. I cannot believe that anybody here can harass you in any way. You can be a leader for the future of this country, if you

wish, by setting new standards.” Carla was pleased with herself. *Now I have scored a hit*, she thought. *Giacomo would be proud of me.*

But the General abruptly changed the subject. “Let’s not discuss the political situation in my country,” he said. “Let’s go back to business. The balance sheet, as we will explain in the board meeting, is in line with the legal requirement.” Then he made it clear that the discussion of the balance sheet was closed, by asking, “What else?”

Carla was prepared for this question. “Do you remember the e-mail I sent you after the first board meeting?” she asked. “Why don’t we go through that list? I am happy to explain anything that might be confusing.” She handed him a print copy of the e-mail, adding, “And clearly we need to select priorities.”

To her surprise, the General agreed implicitly, asking her specific questions about some items, expressing doubts about the feasibility of particular points, and so on. Only when they got to **the family employment policies**⁵ did he balk. The General obviously was hesitant to open that can of worms. “We trust our family members,” he said. “And although they may not all be perfectly qualified for the job, they are doing the best they can and are very loyal to the company. It has been our custom in this country to rely on family in key positions.”

Carla knew better than to insult family. “I understand completely,” she said, then added, “We should nevertheless make sure not to penalize other employees. We need to create trust and fairness among all employees, family or not, through transparency—for example, by writing formal family employment rules. This helps make the company more successful.”

The General appeared to listen without further argument, and the discussion continued somewhat amicably until about 8:45, when Carla turned on the charm again. “I am sorry to cut our meeting short, General Chomutowski,” she said, “but the board meeting is starting in a couple of minutes, and I had no breakfast due to our early-morning meeting, given the time difference. I really need to grab a cup of coffee, if you don’t mind.”

Carla noticed the discomfort her comment caused the General. For him, being seen as a bad host was more humiliating than losing any professional argument. “I apologize,” he said at once. “I did not know. Indeed, we need to go, and I will make sure that you get a coffee and croissants.”

“Thank you,” Carla said. “But how do we continue our discussion?” Not waiting for a response, she added, “If you want to go for the IPO soon, General, we cannot waste much time!” She had held back what she thought was her strongest argument until the last.

But the General didn’t really seem to be listening. “I come back to you,” he said, “but not in this meeting.”

Is this an offer for a truce and negotiations? she wondered. But to the General she just answered, “I am looking forward to your response!”

When the General accompanied her into the boardroom, all eyes were on her. A small gesture by the General ensured that she quickly received coffee and her own plate of croissants. Carla was tempted to feel that her special treatment amounted to something of a victory, but she knew that she really had taken only the first step in what promised to be a long journey.

⁵ See also IFC’s publication, *IFC Family Business Governance Handbook*. <http://bit.ly/1vPhU7t>.

4.2 The Third Board Meeting / Making Allies

Carla was unsure how she should behave during the board meeting. It was clear that the General would come back to her and that she'd better not push him now. On the other hand, she could not stay silent all day—neither her temperament nor her mission would allow her to do that!

When CEO Sergei complained about a branch manager, she took the opportunity to jump in. “This is an issue I am curious about,” she said. “Unfortunately, I don’t know any of your operational managers, but I do know how vital the next level of management is for the long-time success of a bank.” She paused, and no one else said a word. So she continued, “I have questions: For instance, how are you rating, in general, the quality of your senior management below the executive board? And what are you doing to enhance the qualifications of these managers and their leadership skills, so that you can compete in the tougher business environment of the future?”

Sergei was taken aback by the questions, but a word from the General made it clear to him that he had better answer. He cleared his throat. “Well,” he began, “I think we have first-class people, best in the industry. And we do a lot to keep them updated about the competition and new developments.”

Before Carla could ask Sergei to be more specific, Kakha entered the discussion. “I am really sorry, but this is not my impression,” he said—a little nervously, Carla thought. “You had a couple of high-level departures after the merger, and with the many new people hired and new levels of reporting, my hunch is that the best people have moved. Anecdotal evidence suggests that all have found great jobs in banking industry pretty soon.” He took a sip of water and continued, “Probably there is room for improvement, and maybe I can suggest that in the next board meeting we deal with this issue, based on a systematic analysis and professional suggestions, how to improve the situation.”

Carla was tempted to hug Kakha, she was so happy that she was not the only one who raised questions and made suggestions. Would Kakha help her become a leader of change as her first follower?

The CEO apparently had the opposite feeling about Kakha’s comments and shot an angry glance in his direction. But the General did not permit any further discussion. “As you know, we are considering anyhow the effectiveness of our board work,” he said. Then, after a brief hesitation, he added, “I think we are doing fine, but good can always be done better. We come back with some ideas in the next board meeting.” And he moved to the next item on the agenda.

* * *

Carla left the meeting with mixed feelings: she was happy that things were starting to get moving, but it was clear that the General alone was setting the pace and deciding on the actions. She knew that when he said “we,” it was the *royal* “we,” which really meant “I.” *I suspect that only a crisis can jolt him out of his comfort zone, she thought, not rational arguments.*

4.3 The Improvements / Audit and Risk Committee, Board Information, and Company Secretary

Rome—One week later:

Carla received a typically terse e-mail from the General:

Dear Mrs. Feltrini,

We think we need to improve our audit and risk committee as well as our board information system. Furthermore, can you make a suggestion for a board secretariat? We await your specific suggestions.

Many thanks,

GK

Carla was not sure if this was a victory for her or just a favor from the General. In any case, she started to research the IFDB website. The easier task was the **audit and risk committee**; she could provide a description of the functions, including the key benefits (see Checklist 3), and a sample charter of an audit and risk committee.

Carla also prepared an overview of the tasks of the internal and external audit, as one of the critical areas of work of the audit committee—to make sure the division of labor is clearly established. (See Table 5 on page 53.)

Finding something “off the shelf” for the board information system proved to be more difficult. Carla grappled with the question of what **board information** really meant and finally decided that it is *what I need to get my job done*. She realized that it is not only the information itself but also how it is structured and the process by which it is delivered. Therefore, she took several blocks of text out the material and merged them into one document. It contained the following elements:

- A description of brief monthly reports with the key performance indicators of the bank and a comparison of the actual results versus planned/budget and last year;
- The quarterly report in a format that can be published when the company is publicly listed, next to a balance sheet and a profit-and-loss account, a report on material business events, and the outlook;
- A description of the format of the other chapters in the board book, which



Checklist 3: Benefits of the Audit and Risk Committee

- Improves board members' oversight of financial reporting, audit-related issues, and key accounting processes
- Enables a small group of board members to focus on major topics in more detail
- Provides an opportunity, through meetings and discussions, for closer interface with senior company executives and the external auditor
- Allows the external auditor to raise issues with the audit and risk committee in a relatively structured environment
- Creates awareness of and potential reaction possibilities to risks
- Fosters internal controls

are not covered by the regular reports: not more than three pages, with appendixes, if needed, but comprehensive and understandable, so that no lengthy presentation by management is needed.

Carla knew she was asking a lot! And once more she was pushing for an examination of the family employment policies. Probably the General would be booting some of the materials, but she recalled a key message from her reading: Board work is only effective if it is comprehensive and systematic, a necessary but not sufficient precondition for a value-adding board.

Carla was pleasantly surprised that the General had included a comment about a company secretary, and she wondered how he was thinking about the position. *It would make sense to promote his secretary to company secretary to support the improvements in corporate governance*, she thought. *But is this really what the General had in mind?*

Continuing her preparation, she looked into possible tasks of a **company secretary** and summed up the main tasks as follows:

- Ensure proper board information (timely delivery of high-quality, useful content);
- Manage internal and external compliance (laws, codes of conduct, business guidelines);
- Manage governance processes (propose rules for effective committee work, ensure transparency of board work to all directors, ensure that all board directors have a shared understanding about board processes, ensure that board meetings are organized effectively).

Digging deeper, Carla discovered that the reporting lines of company secretaries are not uniform: some company secretaries report to the CEO, for example, and others report to the chairman. She had no doubt as to where the General would want the secretary to report. *Clearly, he's the one who would be the boss*, she mused.

Table 5: Important Elements of Internal and External Audits⁶

INTERNAL AUDIT	EXTERNAL AUDIT
<ul style="list-style-type: none"> • Evaluate and monitor on a daily basis the company's risk management, reporting, and control practices, operations, and systems and make suggestions for improvement • Shall be independent of the management; reports to audit committee (the board) • Can be hired and dismissed only by audit committee/board • Annual internal audit plan approved by audit committee/board • Is in charge of following up on the internal-controls deficiencies identified by external auditors, compliance function, and regulators • Evaluate the company's corporate governance structures and processes 	<ul style="list-style-type: none"> • Audit committee/board in charge of selecting an auditor • Auditor independence (attention to non-audit services) • Regular contact with the auditor (through audit committee/board) • Evaluation by the audit committee/board of the quality of auditor's work • Invite representatives of the auditor to the annual general meeting • Follow up on management letters issued by the auditor • Disclosure of the audit report (annual report, website) • Auditor/lead partner rotation

⁶ For an audit committee charter, see the IFC website: <http://bit.ly/1jxXGrk>.

* * *

To be on the safe side, Carla sent the e-mail to Hank and Gurnik, asking them to review it before she sent it to the General. She wanted to be sure everything was in line with IFDB's policy and best practice—and that she hadn't forgotten anything. "I know it is not your job," she wrote to them, "but I really would appreciate your guidance and feedback. I must be professionally absolutely on the right track if I want to move things further in SlavaBanca."

The next day, she had the confirmation she was looking for from each of them. So she sent a confident e-mail to the General, outlining her suggestions and the reasoning behind them—and indicating her readiness to discuss anything further in detail if needed.

4.4 The Rebuff / It Takes Many Steps to Convince

Two days later:

Carla and Giacomo were just about to sit down for afternoon tea, when the phone rang. The call was from Boris, the CFO. "Milady," he began, without even waiting for her to speak, "are we returning to the old days of a centrally planned economy? That is when I have seen last time such bureaucratic reporting!"

The CFO's cynical, even aggressive tone told Carla all she needed to know: *The General has turned his dogs loose*, she thought. But she was determined not to be the chased rabbit. "Listen, Mr. Krohobor," she said firmly, "what I sent to the General is followed by thousands of successful companies throughout the world. In volume it is probably less than the unstructured cemetery of data you are providing now."

Based on these opening shots, a heated debate ensued. It reminded Carla of the many battles she fought for risk management. She stood firm and argued her case time and again.

After nearly an hour of impassioned exchanges, which became highly repetitive, she was fed up. "Mr. Krohobor," she said at last, "I really have better things to do. We both know that, in the end, it's the General who will decide. Give him my best regards and explain to him that I will fight for my proposal as long as it takes."

Carla was not sure whether the General—or perhaps CEO Sergei—might have been listening to her conversation anyhow. *After all*, she thought, *they must have picked up a few tricks during their days in the secret police.*

* * *

"The tea is now cold," Giacomo said sympathetically when Carla returned to the table. "I will prepare a new pot—you look as though you could use it."

She filled him in on her phone conversation with Boris—*although Giacomo surely must have heard my part of it*, she thought. Together they explored the possible deeper meanings of that call. Then Carla sighed and slumped back in her chair. "Not even the smallest step without a fight," she said.

"Do you wonder?" asked Giacomo. "They are comfortable with the status quo; it is their design, and you want to stir up the pot."

Before he could continue, Carla said, "The only historical comparison, I can think of is Asterix and Obelix, the fight of the small Gallic village against the Romans. Except that I

don't have a magic potion."

Giacomo smiled. "There are many cases in history where the powerful were outsmarted by the weak—"

"But even more cases where the powerful *crushed* the weaker," Carla said, with a touch of resignation. She didn't know why she suddenly felt so pessimistic. For the first time since this endeavor began, she doubted that it was worth all her time and energy.

Recognizing the signs of futility in his wife's voice, Giacomo tried to cheer her up. He suggested they give themselves a break from all this board business tonight and have dinner with friends on a boat going down from Rome to the harbor of Ostia. Carla offered no resistance to that suggestion!

4.5 The General's Support / One Victory Is Not the End of the Battle

Two days later:

Carla opened her e-mail and found another one from the General:

Dear Mrs. Feltrini,

Many thanks for your input. Please find attached the proposal on the audit and risk committee and the board information that I will support during the next board meeting next week on the telephone.

Best regards,

GK

When Carla opened the attachments, she was actually surprised to see that the audit and risk committee was nearly as she had suggested. Feeling somewhat pressured that 'her' structure was being implemented, she calmed herself with the knowledge that she was on firm ground on that point, because banks are legally required to have such a committee, although SlavaBanca had managed to have one in name only, not in operation.

On the other issue, she was not surprised to find that the board information system was watered down. It made no mention of the family employment policies that they had already discussed in person. It also failed to mention the quarterly reports, which were falling far short of meeting the standards that would be expected from a company up for an IPO.

What did impress Carla were the guidelines for the board books and the monthly reports. They were substantially the same as she had suggested!

* * *

At tea time, Carla and Giacomo reflected on the results of this, her first major battle. He congratulated her on her victory, obviously sensing the need to highlight the progress. "You are like the early missionaries to a pagan culture," he said. "First, you have to convince them to give up their blood sacrifice before you can convert them to the One God."

Carla smiled at the comparison, but she was not quite convinced. To her, it seemed too easy to just accept the decision of the General without pushing further. "I cannot let him off the hook," she explained, and Giacomo saw her point.

The two of them agreed that Carla's next step should be to write an e-mail to the

General, praising the progress and stressing the need for rapid implementation. But it should also state clearly that, on this level, SlavaBanca has not met the standards required for an IPO.



Key Messages of Chapter 4

- Be alert for opportunities to drive home your points.
- Use IFDB's or other resources (e.g., for audit and risk committee).
- Social competences and communication skills matter for change to happen (develop leadership skills).

INTO THE BELLY OF THE BEAST

Rome | January 2011

Carla wished she could call it a day and go to bed, but she knew she had to work through the 1.5-inch thick board book for the upcoming board meeting. This would be more pleasant if it were poetry or art, she thought. But she had to admit that there had been at least some progress in structure and content, according to the guidelines she had suggested.

5.1 The Emerging Mess / Board and Strategy

Carla's frustration had lessened since those first meetings nine months ago, despite all the exasperating moments along the way and the slow progress. But even though checking numbers was one of her passions, she had hoped to be working more on the strategic side of the business by now, and not so much on the operational side.

Examining the board book involved going through 10 different proposals for the new logo that was part of the rebranding strategy. Furthermore, she had to read about the exact development of loans and savings by different types, about employee benefits, about electricity consumption, and much more. *Ho-hum*, she thought, and turned another page.

"What's this?" she said aloud. She had turned to the new headcount numbers, which showed another 3 percent increase in personnel! "Where does that stop?" she muttered. "Don't we have enough people already? This is simply empire building."

After the merger with Bancia Polozk two years ago, in January 2009, the bank had initially shed some jobs to fully profit from the possible savings. But after only three months—and in the middle of the financial crisis—the bank reversed this course and created more and more jobs, such as in IT and process management, "to weld the banks together," as Sergei put it.

But the constant influx of new employees—with consequent changes and additions to staff responsibilities—lowered team morale and eroded the bonds between the employees.

Thus, many of the qualified employees left the bank and went to work for the competition, which provided more predictability. Carla remembered Kakha's intervention in the last board meeting and what he had said about SlavaBanca's poor employment practices. *He knew what he was talking about!* she thought. It wasn't just that SlavaBanca was engaged in obvious empire building, the bank also lacked a clear strategy and coherent employment policy.

And so much cash flow was going into expansion! Carla remembered the saying, "You can survive without profits for a year, but you cannot survive without cash for a second." She thought, *You must have a value-adding strategy for your customers; otherwise you lose revenues faster than you can save cost.* But she couldn't see a plausible development of such a strategy reflected in the numbers—yet. In this regard, Carla was happy to have halted the expansion of SlavaBanca in a previous board meeting, because under the cir-

cumstances there was no way these branches could become profitable soon.

At the beginning, Carla had been careful not to voice any fundamental dissent on the strategy, especially since she had been focused on the corporate governance side and the effectiveness of the board work. But she was feeling more and more strongly that things could not go on like this for much longer. The bank had grown its staff by 30 percent in the past year—twice the 15 percent expansion rate the General had wanted originally. *Some additional staffing clearly was needed, but some of it seems very redundant*, she thought. *The growth is anything but good for team morale. But even worse, the bank has lost touch with its clients in the rural areas as their account managers changed.*

Carla knew that, as a bank with a focus on SMEs, it was of utmost importance to keep good personal relations with clients. After all, clients often felt obliged to pay back their debt not so much to the bank as an institution, but rather to the people they dealt with; that's where they had the connection. But with so much turnover of field staff, the foundation of trust in the bank could be threatened.

Also, in Carla's last conversation with Hank, IFDB's portfolio officer, he made it clear that it was in IFDB's interest to support SMEs in Bankistan with lending through SlavaBanca. So a strategy that fit this goal was definitely needed. Carla wondered, *Does the company really have a strategy to grow? Or is it only about expansion itself?* Her thought went straight to the common red flags regarding board and strategy (see Figure 10).

Carla decided it was time for the board to step up its role in setting strategy. She could start the process by checking some of the red flags for SlavaBanca. But she suspected that Sergei would not be happy to have the board overstep the boundaries of what he saw as his turf. On the other hand, she could understand Sergei's point of view: only a handful of CEOs would like the board to play a big role in setting strategy.

So the questions came down to these: Where can the board add value? And where is it necessary to reign in the perceived prerogative of management? Carla felt it was necessary to address this topic and would take the opportunity to discuss it with Kakha beforehand.

5.2 The First Ally / Learning Outside the Boardroom

Bankistan—Late January 2011:

Carla arrived in Bankistan on a cold afternoon, the day before her fourth board meeting. Kakha had invited her to the opening of the historic museum that had just been renovated.

Figure 10: Red Flags for Strategy



- Change in external factors does not lead to changes in strategy proposals by the management
- Strategy and internal capacity do not correspond to one another
- Functional, business, and corporate strategy do not feed into one another



- High productivity, poor performance (e.g., cost/income KPIs)
- Strategy hasn't been on the board agenda for 12 months
- Lagging competitive benchmarks

Of course, Giacomo wanted to come, too, but unfortunately his schedule did not allow him to make the journey this time.

After the festivities, Kakha and Carla had a drink in one of Kakha's favorite restaurants. The wine was indeed delicious—and as an Italian, Carla was surprised to learn that it was in Bankistan that the first historic recordings of wine were found. Kakha explained to Carla the importance of Bankistan during the communist times and its fame for its culture, food, and drinks.

For Carla it was very interesting to learn something about Bankistan firsthand and get a better feeling for the history and the culture of this historic country. After their second glass of wine, Kakha changed the subject. “Carla, if I may ask,” he began, “what do you think of Sergei and his performance?”

Carla was baffled by this direct question from Kakha. “What do you mean?” she asked.

“Well, let me phrase it a bit differently,” he said. “I have many clients who tell me they have problems with SlavaBanca, as the service level has become much worse. I think it has to do with the jobs shuffling and the many rather inexperienced employees, and I feel that there is a slip—or how do you say, *drop*—in team morale. I am not sure whether Sergei can turn the boat around.”

Carla nodded. “I see your point, and I am worried about this as well,” she told him. “But it seems to me that the chairman has his hand firmly over Sergei.”

Kakha thought for a second and then said, “The General has his mind where the money is, and I believe we can make the board more active in this regard—to strive for profitable growth and not empire building! Sergei, on the other hand, seems to be more interested in his personal influence and beautiful women.”

The two continued chatting, exploring how best to address the issue tomorrow. And before they realized it, the hour had grown quite late. It was 1:00 a.m. by the time Carla finally returned to The Ambassador, where the staff all knew her by now.

5.3 The Fourth Board Meeting / Asking the Right Questions

The next day:

The board meeting progressed almost as usual, except that CEO Sergei seemed nervous. And the General grew impatient and even asked Sergei serious questions from time to time.

When it came to the HR policies, Sergei introduced his job increases, claiming that this would help the bank grow even further. Carla looked at Kakha, and both nodded—their signal to ask the Gretchen question.⁷

“Sergei, thank you for this,” said Carla. “I have a question, though: What do you think about growth, and what about profitability? If I remember correctly, SlavaBanca is planning an IPO within the next eighteen months. And while growth is certainly a value driver, we should also make sure that we grow profitably. Currently, our competition is much more profitable than we are.”

Sergei first looked at the General, perhaps hoping he would intervene and save him from

⁷ Gretchen's question, or Gretchenfrage, has its origin in Goethe's drama, *Faust*, where Gretchen asks Faust if he believes in God. It now refers to any question that is difficult to answer but crucial for the inquirer—a question whose answer has been deliberately withheld or avoided.

the question. But the General nodded slightly, indicating that he clearly expected an answer from Sergei, who looked trapped. “Mrs. Feltrini,” he asked, “what are you saying—that I am not doing my job? I believe I have done a lot to generate new deals, both with the government as well with some big real-estate developers and construction companies. This helps our bank to make good money. I have the feeling you wanted to obstruct that growth when you stalled the expansion of the branches.”

Carla opened her mouth to respond, but Kakha blasted in, “Sergei, you do have secured deals with the big industry, but the aim of SlavaBanca is to make business with SMEs, a big potential in Bankistan and the region. I hear from many sides that SlavaBanca is not properly serving these clients anymore, and that they are going to the competition.”

Carla could see the anger growing in Sergei, who shot back at Kakha, “You should not be too loud, Kakha. You should serve your clients yourself!”

Now Kakha exploded, “If I would serve my clients as lousy as you do, I would also need a rich father-in-law.”

Carla didn’t know what to make of this statement; it was clearly over the top. But she didn’t want to lose her sole ally. She looked at the General, hoping he would restore order. But he didn’t say a word. She then looked at Michael, who had kept quiet throughout the whole discussion—which by now had turned to Slavic between Sergei and Kakha.

Finally the General stepped in. “Enough!” he said. “This is not a circus, but a board. I suggest that from now on no personnel issues should be discussed on the board. If nobody disagrees, let’s move on to the next topic.”

The rest of the board meeting went rather quickly—and relatively quietly. As they were leaving the boardroom, Carla managed to walk a few steps with the General and said in a low voice, “The heated discussion was not how we should behave. But more important than that, you have a real strategic problem here.”

The General looked at her, this time with an expression more weary than harsh, and only said, “Have a nice trip back home, Mrs. Feltrini.”

Carla saw that Kakha continued to be in a heated debate with the CEO, so she left in a hurry to catch her plane.

* * *

The next morning, Carla received a call from an exasperated Kakha. “Sergei threatened to kick me off the board and to tell my legal clients about my misbehavior,” he said. “Yes, I know I was too aggressive, but I can’t stand this jabbering any more! I know the company is going down the drain.”

Carla didn’t know exactly where her confidence was coming from, but she said calmly, “Don’t worry, Kakha. Sergei no longer has the power to remove you as a board member. But to be on the safe side, we can check the company bylaws. And I will also involve IFDB, if needed.”

Kakha was not quite convinced. But after some back and forth, they turned to the more practical question: what to do next. “Kakha,” said Carla, “if I may give you one piece of advice, as someone who has a few more years’ experience. . .”

“Please do,” said Kakha. “I will appreciate it.”

“Write to Sergei,” Carla told him, “and put the General on cc. Apologize for your

remark, but stand firm that the bank has a serious strategic problem that urgently needs to be addressed—and not only through job cuts.”

* * *

When Kakha’s e-mail arrived, Carla could only guess at the content, because it was in Slavic! But she was sure that Kakha would remain on the board; after his call, she had looked at the bylaws and figured out that it was a pretty laborious process to kick a board member out—at least when an international institution was watching.

Three weeks later, she was surprised that there was already going to be another board meeting—in two weeks. This time, the board meeting would start in the afternoon, with an audit and risk committee meeting in the morning.

5.4 The Objective / Risk Management

Danubesk’, Bankistan—Early March:

Carla’s ride from the airport to SlavaBanca was particularly bumpy—as the highway was being renovated. She half-smiled to herself and wondered whether the bumpy ride was an omen for this day of meetings, which would start with the audit and risk committee this morning and end with a board meeting this afternoon.

Looking out the window, Carla observed that most of the snow had melted and the first spring flowers were straining toward the early-spring sunlight. *There’s something hopeful about spring*, she thought. Then she was jarred out of her reflective mood by the ringing of her phone. Noting that the call was from an unknown telephone number, she answered cautiously. It turned out to be Hank, the portfolio officer of IFDB. Because of the bad cell reception, Carla could hardly understand him, but she guessed he wanted to ask her about the upcoming board meeting. Just before the connection broke off, she heard the words—in between a lot of dead spots—that made her nerves tingle: “Carla, how. . .risk management. . .SlavaBanca?”

Carla was happy that the connection broke off; she didn’t really want to hear what he was about to say. Shaking her head, she thought, *This is so outlandish. Yes, risk management is great and I want to implement it. But we are just about to have our first real audit and risk committee meeting. What does IFDB want? And how do they imagine I could have implemented it in this short amount of time!?*

Carla remembered some materials that Hank had sent some time ago. They were on IFDB’s approach to risk management (Figure 11) and the risk radar tools⁸ to analyze risks (Figure 12 on page 62).

Carla felt sure that the board (and especially the General) agreed with her—at least in some ways—that risk management is important to the bank, especially since it is also a requirement of the regulatory authority that the bank have an adequate and appropriate system in place for the control of credit, market, and operational risk. But so far, the IT systems of the branches of SlavaBanca and the ones from the former Bancia Polozk still did not properly communicate with each other, despite the investments.

⁸ For a full description of the radar tool, see IFC’s publication, *Navigating Through Crises—A Handbook for Boards* (2011).

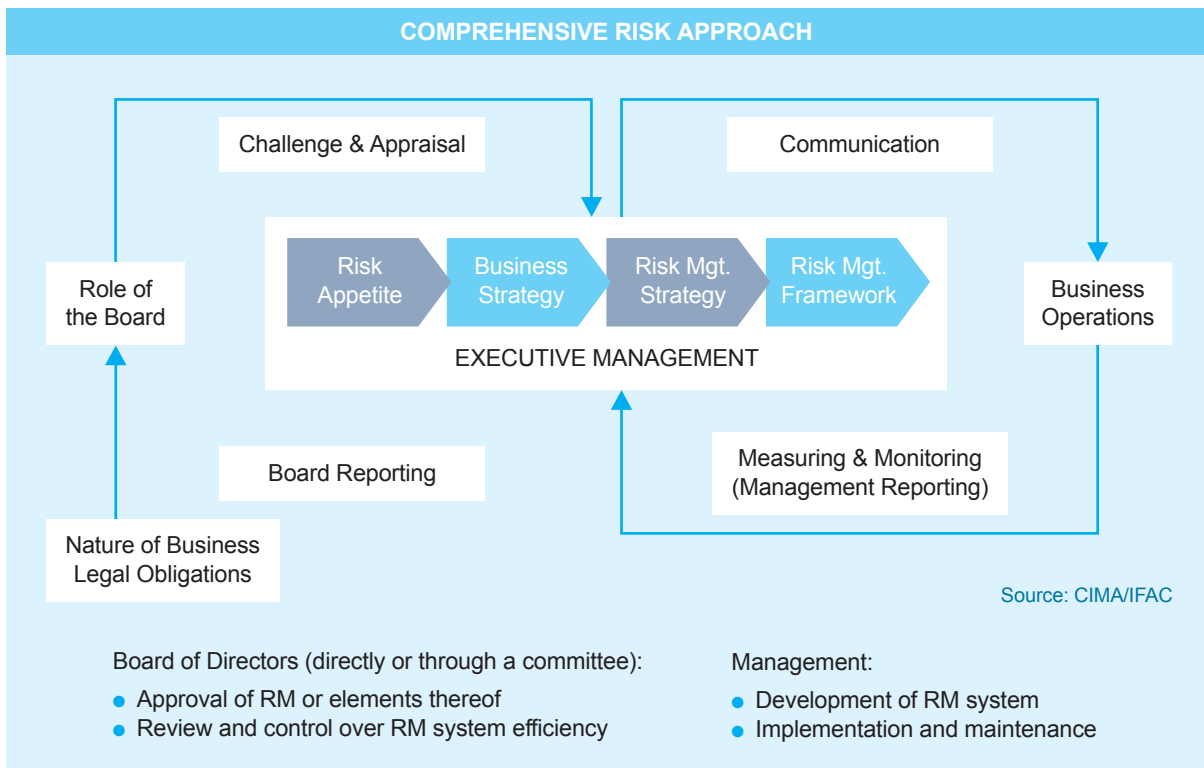
Her hope for this meeting was that it would get them one step closer to having the committee's work be more useful and structured. But Carla also knew that, so far, size was especially important to the main shareholders—the General and his family. This was why the bank had bought Bancia Polozk in January 2009. The General's mantra seemed to have been: The larger the bank, the greater the attraction to an incoming international bank anxious to purchase a large franchise; the greater the attraction to the investor, the higher the multiple over net asset value the investor would be prepared to pay. Also, many shareholders had a desire for political influence, and with size came political clout.

But Carla also knew that a bigger bank meant more complexity, which again entailed risks. *Let's see how far I can push the General on risk management*, she thought. *He has already agreed to ramp up the audit and risk committee.*

While analyzing the financial data, Carla had made the following list of issues she wanted to address in the meeting:

1. Credit was often extended to government-linked enterprises, some with a possible default risk.
2. Government-related risk amounted to 40 percent of the total loan portfolio. (Management pointed out quite correctly that the bulk of the economy was controlled by the government, so the bank effectively had little choice.)

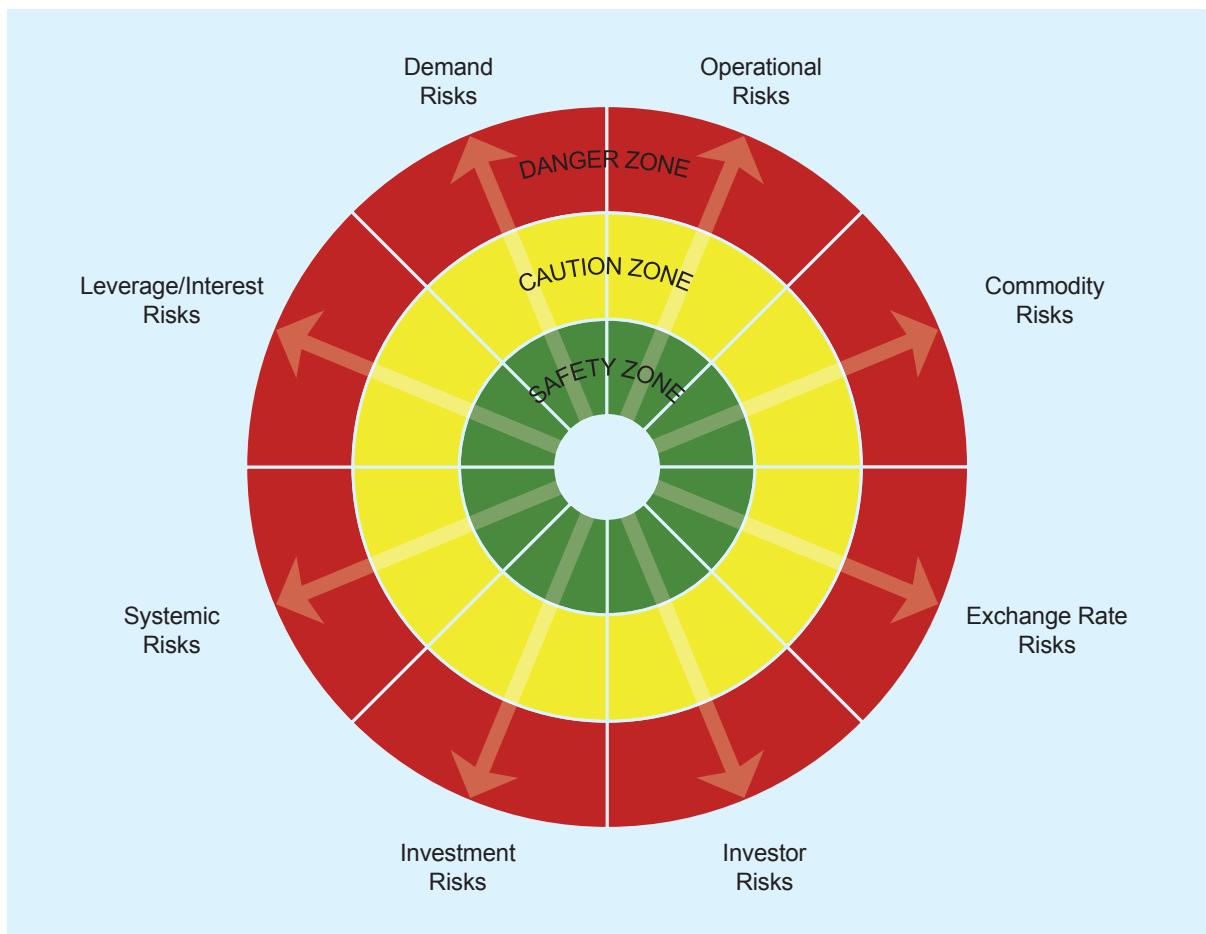
Figure 11: Comprehensive Risk Control and Management



The board is responsible for ensuring comprehensive risk management in the company. This includes setting the risk appetite of the company and consequently ensuring that the appropriate risk strategy is in place throughout the organization.

3. The largest single loan was to a construction company, and it was 20 percent of the bank's assets, which was tolerated by the regulatory authority.
4. The loan portfolio was now approaching 70 percent of total assets. (Management thought only about volume, not fee income; and volume to their mind equated to profit, since margins were high.)
5. Loans were made back to the shareholders, and Sergei the CEO had taken a loan of \$1 million. Again, this was tolerated by the regulatory authority, with insider loans being allowed up to 20 percent of the capital of the bank.
6. To maximize short-term profits, the bank also regularly re-evaluated its loans, for example to make them B loans instead of C loans,⁹ with management citing "soft" criteria such as the value of the collateral rather than the "hard" criteria of the number of days past due.

Figure 12: Financial Risk Radar Tool



Risk radar helps the board take a helicopter perspective to evaluate the most important financial risks. Board directors should use the tool to personally evaluate the perceived risks for the company according to the best of their knowledge and discuss the outcome with the full board. Through visualization, the board and management become aware of risk spots to be improved and can evaluate the risk regularly.

⁹ B loans and C loans are classifications indicating default risk, with C loans having a higher risk of default.

7. Most deposits came from government entities, making them vulnerable to short-term changes. (As management said, “They are the only people with money.”)
8. The bonus paid to senior management was based on the profit for the previous year, not on the future stability and the strength of the bank.

Carla knew—thinking about the discussion she and Giacomo had—that to have success, she had to take a slow and steady approach. In this economic and political environment, she thought, *the secret is to do things step by step—small step by small step—and get the message across!* So far, she had only one ally on the board—Kakha. Michael from GEP clearly proved to be nothing but reluctant to support her. And the locals, other than Kakha, all kept quiet.

With about 30 minutes before she would arrive in Danubesk’, Carla wondered what she should do. Should she try to push through the proposed changes regarding risk management, as IFDB had asked? She knew that this was ultimately right, but maybe not at this time.

If she did try to push it through, how should she convince her fellow board directors of the value of proper risk management—to counter the arguments that it would reduce profits and diminish the possibilities of providing cheap credit to government-linked entities? Could she convince her colleagues on the board that risk management was ultimately a much greater opportunity than they thought—for example, to retain employees, create a credit-rating program, avoid defaults, create a long-term perspective, and make quicker and sounder decisions?

5.5 The Audit and Risk Committee Fiasco / Management Compensation versus Keeping the Agenda¹⁰

The audit and risk committee meeting started an hour after Carla arrived in Danubesk’. She had just enough time to check into The Ambassador and reach SlavaBanca’s headquarters before the meeting started.

Besides Carla, the committee consisted of Oleg the non-executive director and Boris the CFO, plus two managers whom Carla had met once before, one of them in a board meeting and the other on the telephone. She had tried to convince the General that the audit and risk committee should consist exclusively of independent directors, but he had insisted on putting Boris and the two managers on the committee.

Then this will be a battle between me and Boris, she thought. *Let’s see which way Oleg will lean.* She assumed that the other two would probably be proxies of Boris.

The meeting was scheduled to last two hours, and Boris was supposed to start it by giving an overview of the latest figures. However, he opened the meeting by saying, “It is interesting to have such a committee meeting, of which I don’t see any value. We are doing everything by the law, so why bother?”

His remarks startled Carla. She wondered whether those were the General’s words in Boris’s mouth or Boris’s own personal opinion. She tried to be diplomatic with her response. “Mr. Krohobor, I would appreciate it if we could get to work and look at the numbers,” she said, “which I want to understand better. I am sure they are by the law, yet I also would like to better understand what they mean!” As soon as the words were out of her mouth, she regretted them.

¹⁰ For further reading: <http://bit.ly/1r5yjC8>.

“It is not my job, Mrs. Feltrini,” Boris shot back, “to give you a finance or accounting lesson in order for you to understand these numbers. Maybe you should learn that first then. But to get something done in this meeting after all, I looked through some materials from your institution’s website. And it does interest me, how to better structure our income—and maybe even the income of the board. I have found these two schemes and would like to discuss that with you!” (See Figure 13.)

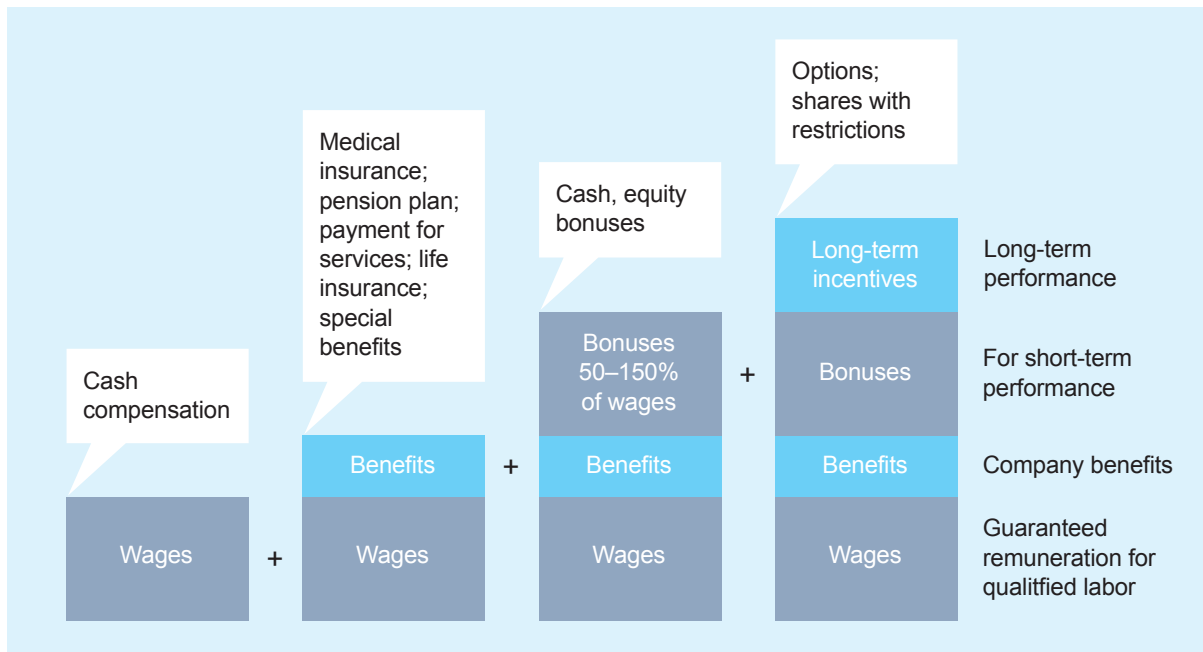
Carla was aghast. *Has he gone rogue?* she wondered. *Instead of showing any numbers, he wants to raise his income!* “Mr. Krohobor,” she said, trying to sound civil, “although these are good charts, this is not the right forum to discuss any of our salaries or compensation levels.” She went on to explain that the audit and risk committee of the board of directors is primarily concerned with ensuring the following:

- that the company’s financial statements are timely, relevant, and reliable;
- that financial controls are adequate;
- that the company complies with relevant regulation;
- that the internal and external auditors are fulfilling their proper roles; and
- that external auditors are selected and adequately compensated.

“The audit and risk committee is not supposed to raise your income,” she explained. “So I would like to ask you not to drift away from the topic but to present the numbers!”

The tension escalated, and Carla and Boris almost started a fight! But the committee didn’t make any progress on the agenda. Oleg sat quietly, smoking one cigarette after

Figure 13: Compensation of Managers



Compensation of managers depends on a variety of factors and can include the fixed wages, company benefits, bonuses for short-term performance, and long-term incentives. The right mix of factors depends on the company strategy as well as the individual manager. Key performance indicators for incentives should differ between the levels of hierarchy and between functions.

another, and the two managers just looked down, not moving a muscle. And an exasperated Carla was more and more convinced that Boris was trying to hide something.

Just as she managed to bring that discussion to an end and was about to move on to what she had prepared, CEO Sergei entered the room. “Hello, I don’t mean to interrupt,” he interrupted. “But I would like to listen in and learn what is happening in this committee!”

Carla almost lost her temper. “Mr. Ivanovich,” she said as evenly as she could, “this is a committee meeting, and I would like you to let us do our work.”

“Mrs. Feltrini,” Boris intruded, smiling slyly, “maybe you can ask our CEO to explain you the numbers.”

This is not going anywhere, Carla concluded and wondered whether the General was aware of this collusive play. What should she do? Ask the CEO to present the numbers? Ask him again to leave? Perhaps she could do both: She turned to the CEO and said, “Mr. Ivanovich, I would very much like to hear your interpretation of the numbers as well—but in the full board meeting. Now, it is the audit and risk committee’s work.”

Sergei gave her a big smile. “Of course, as you wish, Mrs. Feltrini! No problem, we will discuss later in the full board meeting.” And he left the room.

Oleg kept quiet throughout, making Carla wonder which side he was on. Just as she tried to get him to share his thoughts, Boris announced, “Well, it seems you don’t want an explanation for the numbers, otherwise you would have taken the opportunity to discuss with the CEO. As such, I will go to my office and work, as this is a waste of my time!”

Before Carla could even respond, Boris left the room. Still flabbergasted, she got up and went to the restroom, trying to calm herself after this performance.

5.6 The Chairman’s Past / Understanding Personalities

As soon as she regained her composure after the disaster in the audit and risk committee, Carla looked for the room where the full board meeting should take place—hoping to catch the General. But he was nowhere to be seen. So she decided to join the others for lunch—despite not feeling too hungry. She knew it would be unwise to miss the opportunity to socialize with her colleagues.

To her surprise, Oleg approached her and took her aside. “You do not know much about our history, right?” he asked.

Carla was surprised, since Oleg never had said anything at all to her, other than small talk about the weather or her travel. “Well, I tried to read something about it,” she said, “but of course I focused more on the economic development.”

“Well, then you should know that the General lost a bruising power battle against the president in the time of the transition,” said Oleg, referring to the collapse of communism in the early 1990s.

His comment piqued Carla’s curiosity. “Oh, I did not know that,” she said, almost relieved to hear something unrelated to the previous meeting. “Can you tell me more about it?”

“Well, as in Moscow, Gorbachev was the candidate of a reformist wing, led by the KGB,” Oleg began. Then he stopped, noticing that Carla’s face registered surprise that the Soviet Union’s secret police had a reformist wing. He smiled slightly and explained, “These were the smart people, who understood that you need to break out of the stagnation and sclerosis of those years in order to remain in power.”

“And the General was heading those forces in Bankistan?” Carla asked.

Oleg nodded. “But we lost against the old nomenklatura, and the current president managed to grab the power, now nearly twenty years ago. The General managed to negotiate a truce: he withdrew into business with his allies and stayed out of politics.”

“Thank you, Oleg,” said Carla. “That helps me understand certain things. I definitely need to learn more.”

The conversation with Oleg ended abruptly as the General called the meeting to order. *Besides the history, I learned something today about how information is distributed in this system*, she thought as she opened her board book. *Never directly, never immediately.*

5.7 The Attack / Carla on the Defensive

The board meeting went on as usual—with the CEO telling success stories, the CFO supporting them with numbers, and the General commanding the room with his stern gaze. Carla was exhausted and felt her concentration fading, when—it seemed out of nowhere—the General addressed her in front of everyone. “Mrs. Feltrini, you are very quiet today. I hope the meeting of your audit and risk committee went as planned.”

Carla was still groping in her mind for how to respond, when the General continued, “Boris told me it was very productive, and I am glad that it seems you agreed on our accounting procedures.”

Carla instantly felt her face flush. This was beyond “over the top,” and she was duty-bound to dissent—for reasons of protocol as well as indemnification. “I beg to disagree, Mr. Chairman,” she protested. “The meeting did not go at all as I suggested, and numbers were not discussed at all!”

The General frowned and looked at Boris. Immediately, CEO Sergei jumped in. “Mrs. Feltrini, as Boris explained to me, you seemed not to have read or understood the numbers, as you wanted an explanation for everything.” Now, turning to everyone, he continued, “But let me explain the numbers for everyone, so no one feels excluded.” And he proceeded to brag about his performance and how well the bank was doing and the growth.

Carla felt dizzy but shot back, “Mr. Ivanovich, I remember that at the last board meeting we wondered about the job increases, and we agreed that we want to see some profitability path for the bank! We are currently losing money, and I don’t see how you want to stop that. Also, I wanted to address the loan portfolio that seems to be skewed and risky. And furthermore, I would like to ask you to present the financial reports as we agreed in the specifications.”

Sergei was about to respond, when the General called for a coffee break. Carla felt lost. And after the break, the General just moved on to the next item. Carla tried to steer the discussion back to the points she found pressing, but she was shut out.

5.8 The Rude Awakening / Recognizing Diverging Shareholder Interests

The board meeting finished just in time for Carla to catch her flight back to Rome, and she was happy to leave this “hellhole,” as she had come to think of it. Although she wanted to be alone, Michael insisted on sharing a cab, since he needed to catch a flight as well.

Immediately, Michael jumped into the middle of the conversation. “Carla, what are you trying to prove on the board?” he asked. “The bank is growing quickly, and IFDB will be getting a fair share of the returns. So what’s all the fuss about?”

Carla was amazed! *How could he say something like this?* Already fighting fatigue, she tried to respond patiently. “Well, Michael, aren’t you also interested in getting some transparency, performance standards, and perspective into SlavaBanca in order to know what you are doing with your money, what you are maybe missing out on, get some profits, and have an exit with an IPO?”

Michael just shook his head. “We at GEP are invested for two reasons: to make money and to extend our business and influence in Bankistan and the region. Although SlavaBanca has been losing money lately, we are not worried, as this is only a small investment for us. And honestly, if I were a businessman in Bankistan and had to think of investors for my venture, I would rather take someone who supports my business, and not someone who constantly obstructs it.”

Carla felt like she had just been punched in the stomach. If not even the other experienced director was on the same page as she was—not even remotely—how could she succeed in making her IFDB assignment happen? What were Michael and GEP after—other business in Bankistan?

When they finally reached the airport, Carla was relieved to learn that they had different airlines. She was grateful to be alone in her business lounge.

5.9 The Last Straw? / Resignation as a Possible Directorship Tool

Rome:

Throughout her flight back, Carla thought about what she should do now. Michael from GEP certainly was no help and probably wouldn’t ever be. Kakha had been of some help, but so far he didn’t have enough clout. CEO Sergei is definitely hard to control and has his own agenda. CFO Boris is smart—obviously—but too much under the control of Sergei, and thus not of much value to drive SlavaBanca to the next level. Oleg opened up a little but not nearly enough to be called an ally. *And worst of all*, Carla thought, *the General seemed like he had started to come around, but now he apparently doesn’t value my input whatsoever.*

Carla felt lonely on the board. She had tried everything she could. *But this is not going anywhere*, she thought, *and I don’t want to be blamed for negligence. And I don’t want to waste my time—there are nicer things in life.*

* * *

The next morning, Carla called Maggie. After a minute of chit-chat (which Carla usually tried to avoid), she put the fish on the table: “Maggie, I want to resign from my position at SlavaBanca!”

There was silence on the line for a few seconds. Then Maggie simply asked, “Why?”

Carla explained the situation and the most recent developments, and Maggie listened carefully, asking questions from time to time. Carla mentioned some of her successes with the General and how she felt that all the progress she had made had been shattered in the last meeting.

At last, Maggie said, very softly, “Carla, this is a difficult situation for IFDB—and you, obviously. But we need you. You are the best person to help us with this investment.”

Then suddenly Maggie changed her tone, becoming very friendly (almost charming, Carla thought). “And I would very much like to ask you to continue your great work on SlavaBanca’s board,” she said. “You are absolutely on the right track, and we will give you all the support you need. SlavaBanca should be sold soon through an IPO, so this is when we get out anyway. Please bear with us and SlavaBanca until then, and don’t let your successes—that you obviously have already had—be in vain!”

The last sentence was really spot-on; Carla hated to start something and not finish it properly. She sighed, and after some discussion about how to continue, she agreed to proceed with her efforts. Also, Maggie agreed to write an e-mail to the General to express the clear interests of IFDB’s investment in SlavaBanca and remind him of the investment agreement.



Key Messages of Chapter 5

- The dynamics in the boardroom (and hence the effectiveness of the board) are determined by human interaction perspectives.
- A nominee director has the chance to lead by example.
- The board (through an audit and risk committee) should create an environment of trusting the management to provide complete and accurate information and controls, but verify it independently.
- The directors should seek to identify the red flags and then drill down to the root of the problem (take the helicopter view but see the main issue).

JUST WHEN YOU THINK YOU'RE BACK ON TRACK. . .

Rome | Late April:

Carla and her friend Alberto strolled along the Tiber, enjoying the sunny spring day. It had been nearly two months since Carla almost resigned. During that time, there appeared to have been some progress. She had received a call from the General telling her that he understood her desire to improve things, could see some value in it, and would support her as far as he could. But Carla was not fully convinced. I'll just wait and see how the next meeting goes, she thought.

She also had received some surprising e-mails from SlavaBanca, involving her and the rest of the board in lending decisions. And there had been a short board meeting on the telephone to discuss some latest rulings of the central bank and their potential impact on SlavaBanca.

But at this moment Carla was enjoying a break from thinking about business. She and Alberto were discussing the latest gossip of Roman (and hence Italian) politics. “The problem with politics is that nobody really knows anything about the performance of the individuals,” she opined. “All we know of them is through the press.”

“And no press is without its own interests,” Alberto agreed. “So their evaluation will be biased.”

They continued chatting for an hour, before Carla had to meet her husband in front of the National Opera for Verdi’s *La Traviata*. But before they parted, Alberto asked, “What about your performance on the board? Are you fairly evaluated?”

Alberto’s words struck a nerve with Carla. *Why should they evaluate me?* she thought. *What about evaluating the board of SlavaBanca?* That was an interesting concept! She wondered whether that was something they should do. Could a board evaluation help her cause for the improvement of corporate governance and maybe the company’s performance? *More to the point, she thought, could that help me get rid of Sergei?*

Carla wasn’t sure how to answer Alberto’s question, so she just shrugged and said, “We’ll see, I guess.”

She left their conversation with her thoughts swirling. She wondered how she should approach the topic—especially after the last board meeting. But then she thought that this might be exactly the right thing to do after that last disaster—to move on and push relentlessly for change and identify where the shoe is pinching.

6.1 The Lunch Meeting / Board Evaluation

Bankistan—One week later:

Carla had arranged for an informal lunch with the non-executive directors—to float her

idea of board evaluation.¹¹ For some reason that she couldn't explain, Sergei turned up at the meeting as well. *Somebody must have tipped him off*, she thought. But she didn't want to alter her plans for sounding out the non-executive directors on the idea for board evaluation.

Carla made it clear to everyone that evaluation of the board should not be seen as a bureaucratic exercise. Rather, its purpose would be to help drive corporate governance to the next level and improve the board. Toward that end, she presented some slides that she had prepared. (See, for example, Figure 14.)

To no one's surprise, Sergei fought back against the suggestion. "This is a typical American idea," he said. "You see what this has achieved in the financial crisis! We don't need this anyway, since our corporate governance processes and structures are better than those of any of our competitors. And—much more—in our culture we don't do this and point at each other's performance."

However, Carla was not about to give in to Sergei's outburst. She had anticipated these arguments and had come to the meeting prepared. For instance, she brought the following list of points defining the purpose and benefits of board evaluation:

- Evaluate board processes.
- Ascertain the effectiveness of the board as a unit.
- Obtain insights into board functions.

¹¹ For more information on board evaluation, see also "Leveraging Board Assessment for Sustained Performance," by Elise Watson: <http://bit.ly/1yhrJ0l>, and "Board Performance Evaluation," by Simon Osborne: <http://bit.ly/U9tWcC>.

Figure 14: Board Evaluation Process



Board evaluation is a tool to improve board performance. It consists of specific steps: 1) getting everyone on the board to agree to a board performance evaluation, 2) the process itself, and 3) the follow-up actions, depending on the outcome. The first step is often the most difficult!

- Consider issues relating to reporting/information.
- Test views on relations with management.
- Identify any major areas of concern.
- Seek consensus on board focus/priorities.
- Describe the role of board chairman.
- Use an independent facilitator.

After some discussion—without any input from the other directors—the CEO retreated by pushing the responsibility off onto the General. “I know you will be meeting with the chairman later,” he said. “And if you have any suggestions for improvements, you can of course always talk to him.”

Indeed, Carla saw a lot of room for improvements for better board work and the board’s performance, such as the comprehensiveness of the board book, the far too lengthy management presentations, the need for involvement of the board in strategic decisions. . .

Initially, she had hoped that some of her colleagues on the board shared her concerns and would support her ideas. But the silence of her fellow board directors during the discussion with Sergei made it clear to her that none of them openly supported her request for a systematic board evaluation process.

* * *

After lunch, Carla had half an hour before meeting the General. She needed to come up with a way to move this board evaluation forward. *I cannot come up with a laundry list of suggestions all by myself*, she realized. *It must come out of a comprehensive brainstorming process, where we put the fish on the table.*

But how could she convince the chairman—and then his other colleagues—to engage in such a process? What was the real breakthrough argument she could use that would make them want to conduct a proper board evaluation?”

6.2 The Fishy Odor / Corruption, RPTS, and Conflicts of Interest

Carla made her way to the General’s office to show him her ideas on board evaluation—whistling to herself and thinking, *My orientation in the headquarters of SlavaBanca has obviously improved over the past months.*

She was greeted by the “company secretary,” as the General’s secretary was now called, who told Carla that the General had to cancel his meeting with her to meet with “some investors” and the CEO.

Carla frowned and opened her mouth to respond, when the secretary handed her some papers. “Here,” she said brusquely. “This is the new agenda for the board meeting and some materials you can read through before the meeting starts in two hours.”

Carla took the papers to a quiet room near the boardroom, where she could read through the new information in private. The material was nothing particularly special, she thought, until she reached Page 6: “The management proposes that SlavaBanca acquires all of the shares from Sergei Ivanovich of Boutique Investment Bank (BIB) for \$4.5 million.”

At first, Carla wasn’t sure what that meant. *Why should we buy a bank that belongs to Sergei?* she wondered. Reading further, she found a rather simplistic explanation: “Only

as a universal bank with a strong investment banking arm does SlavaBanca have a chance to realize the true value of our bank in an IPO.”

That doesn't smell right, Carla thought. She continued reading, hoping to find some more details. And at last she did find a rather complex evaluation of BIB. Some of the assumptions were unique in her experience, and some were not made transparent or not backed by clear figures.

Finally, Carla reached a page that showed the shareholder structure of BIB. Sergei was majority owner, with 75 percent. *I'm sure he bought that with the loan he received from SlavaBanca*, Carla thought. Chomu Holding, belonging to the General and his family, was a co-investor, with 25 percent.

It was now 90 minutes before the board meeting, and Carla's thoughts were running wild: Should she just go to the board meeting and wait for more information there? Should she try to find other board directors to discuss this and learn more? Should she ask for a delay of the vote in order to consult IFDB?

She asked the board secretary to see to it that she not be disturbed in the room, so she could work and think. She trusted her instincts that this whole transaction was fishy. Trying to think how to at least stall the decision, Carla recalled the responsibilities of the audit and risk committee and how such a decision would need to pass through that committee before it went to the full board. Perhaps that was the answer. She wondered whether this could fall under corruption, related-party transactions, or conflicts of interests.

Carla turned on her laptop and located the material that Maggie and Hank had sent her. Then she started reviewing the information that related to this issue, hoping to find something that would help.

6.2.1 Corruption

The first thing Carla found was this description of **corruption**: fraudulent conduct by those in power, for example through bribery, theft, fraud, extortion, blackmail, nepotism, or exploiting conflicts of interest. *Clearly illegal*, she thought, *but this does not relate to the BIB transaction*.

6.2.2 Related-Party Transaction

Carla moved on to the material about related-party transactions—after all, this was a transaction between two related parties. Skimming through the materials, she found that a **related-party transaction** is a business deal or arrangement between two parties joined by a special relationship prior to the deal—for example, a business transaction between shareholder and corporation, issuing shares to related parties, or setting executive compensation.

This BIB deal is an RPT then—at least in some ways, Carla thought. *After all, shares were offered to related parties, or at least bought from them*. Reading further, she confirmed her assumptions when she read that entities under common control are considered related parties.

Check! she thought, making a little clicking sound with the side of her mouth. She was sure she had found the solution: the related parties should be excluded from voting on this deal. (See Figure 15 on page 73.)

But upon reading further, Carla learned that, depending on the particular transaction, an RPT can also involve a conflict of interest. And while RPTs are common and can easily be managed (for example, by obtaining competing offers), conflicts of interest are more common on a personal level.

6.2.3 Conflicts of Interest

Carla read further and saw that a **conflict of interest** occurs when personal interests can obscure judgment to the detriment of the company’s best interest (see Figure 16, next page). Thinking about this sentence, Carla wondered whether this deal would actually be a conflict of interest. *Sergeii clearly has a personal interest in selling his stake in BIB at the maximum price, she thought, while—hopefully—he is still interested in the success of SlavaBanca.*

But what about the General? Wouldn’t he also have a conflict of interest, as his company Chomu-Holding is also invested in BIB? She continued to read and found a passage indicating that conflicts of interest are similar to RPTs in that it is the chairman’s responsibility to create transparency about the conflicts of interests and the processes to deal with them, while it is the individual board member’s responsibility to disclose conflicts of interest—for example, to the chairman.

Also similar to RPTs, conflicted board directors should abstain from voting in the concerned decisions. And should conflicts of interests become systematic—for example, if a director has a material interest in the competition, such as through directorship or employment—the director should resign, as all decisions are subject to conflicting interests. *This is clearly not the case, Carla decided. BIB is not a competitor, and as far as I know, neither the General nor Sergeii nor any of the other directors has a systematic conflict of interest.*

Figure 15: Related-Party Transactions

“A business deal or arrangement between two parties joined by a special relationship prior to the deal, e.g., business transaction between shareholder and corporation, issuing shares to related parties, executive compensation.”	
RELATED PARTIES	NON-RELATED PARTIES
<ul style="list-style-type: none">● Controlling company● Entities under common control● Significant shareholders including members of their families and business associates● Key management personnel● Board members	<ul style="list-style-type: none">● Two enterprises with a shared director or manager● Two venturers with joint control over a joint venture● Providers of finance, trade unions, public utilities, government departments and agencies in the course of their normal dealings● Customers, suppliers, etc., with whom an enterprise transacts a significant volume of business

Related-party transactions are not uncommon, but they must be managed transparently.

6.3 The Solution? / Code of Conduct

Ten minutes before the board meeting:

Carla knew that, in any case, this went against the very reasoning for the investment: SME lending would be made much harder, because the purchase price of BIB would make a hole in the bank's equity—taking it almost to the minimum capital requirements.

Carla was also sure that the acquisition made no sense strategically. *Maybe this has something to do with family as well*, she thought, suspecting that throughout the board meeting she would probably be the lone opposition.

She wondered whether a proper **code of conduct** would have made any such proposal impossible from the beginning. Thinking about this for a second, Carla knew that a code of conduct wouldn't stop Sergei from proposing this transaction, but it would give her a stronger voice on the board, because it would be even clearer that this suggestion goes against corporate policy.

This whole matter made Carla suddenly realize that a code of conduct would definitely be necessary for the IPO. A code of conduct not only influences the behavior of the employees and management, but it also shows investors the company's commitment to ethical business behavior.

6.4 The Decision Not to Make a Bad Decision / Decision Biases

As Carla walked to the boardroom, she was determined to halt the BIB decision. *Letting this decision go forward*, she thought, *would itself be a bad decision*.

She reminded herself that bad board decisions are the result of board dynamics, personal issues, or structural issues. (See Figure 17 on page 75.) *And on this board we have all the ingredients to make bad decisions*, she thought, *from dominant personalities to conflicts of interests, lack of competence, and lack of transparency*.

Figure 16: Conflicts of Interest

"A conflict of interest occurs when personal interests can obscure judgement to the detriment of the company's best interest."

EXAMPLES OF CONFLICT OF INTEREST

- A company makes a deal in which any of the directors may have a personal interest
- Direct or indirect purchase by a director of the company's shares on basis of non-public information
- A director enters into contractual relations with a competing company

DEALING WITH CONFLICTS OF INTERESTS

- The chairman is the key person in the whole process
- The potential conflict of interest should be fully transparent to the board and the corporate officers and reported appropriately
- The corporate governance rules should describe the process, procedural conduct of the director, including whether he or she is permitted to vote

Conflicts of interests must be dealt with transparently and should be managed by the chairman. No permanent conflict of interest (e.g., a board director also sitting on a competitor's board) should be tolerated.



Key Messages of Chapter 6

- The board has a responsibility to create value for all shareholders, protecting against shareholder-value destruction.
- Of particular concern should be related-party transactions and situations involving conflicts of interest.
- Anti-dilution and profit-sharing rights are important to attracting investors and upholding the company's reputation, particularly in closely held companies and family-owned firms.

But this time it would be different, she decided. And she knew that the board needed to get two things right for that to happen: the process (so the vote would be valid) and the vote itself.

Knowing that she could not let this acquisition happen, she pondered her options: Ask for an interruption of the meeting to call IFDB? Threaten the company and the family with legal action? Refer the decision to the audit and risk committee?

Carla was lost in this whirl of thoughts, when she realized that the company secretary was waving at her to hurry to join the others in the boardroom.

Figure 17: Reasons for Bad Board Decisions

BOARD DYNAMICS	PERSONAL ISSUES	STRUCTURAL ISSUES
<ul style="list-style-type: none"> • Dysfunctional group chemistry (personality, competency) • Follow own decision, no admittance of external knowledge • Throw good money after bad money • Interpersonal relationship • Dominant personalities/ weak leadership • Conflict of interest • Fear, ignorance • Board lacks strategic focus 	<ul style="list-style-type: none"> • Lack of competence • Motivation • Bad preparation of board members • Conflict of interest • Fear of risk • Emotional attachment ("my project" syndrome) 	<ul style="list-style-type: none"> • Lack of transparency • Lack of information • Bad planning of meetings • No clear rules on decision-making processes • Too little time to mature decision • No control of old decisions

Boards consist of real people and so are subject to the same biases and other reasons for bad decisions as everyone else. Being aware of those reasons should help a board overcome certain behaviors, such as lack of preparation or an emotional attachment to problems, that lead to poor decisions.

FAILURE IS A CHANCE FOR A FRESH START

Nine months after the BIB deal was halted | January 2012

The sale of Sergei's shares in BIB had been referred to the audit and risk committee and finally halted by SlavaBanca's board, with the help of Kakha and—to Carla's initial surprise—Michael from GEP. Obviously GEP has no interest in diluting their shareholding in SlavaBanca, Carla had thought at the time.

Since then, things had moved steadily at SlavaBanca toward the planned IPO, but it became obvious to Carla that Sergei's position was weakened. As always, she found it helpful to use her husband as a sounding board for her thoughts about her director role. "Although I am very excited that SlavaBanca is actually going for an IPO in three months," she told him, "this doesn't seem like the best time."

Giacomo tried to encourage his wife. "You are too critical of yourself," he said. "I assure you that you have been a great revolutionary over the past year and a half. A bit like Garibaldi's revolution—you came from nowhere, collected a bunch of allies, and liberated a great part of Italy in a series of bloody battles. But remember: it took two more wars to finish the job."

"And that's just what worries me, darling," she said. "What kind of battles are they hoping for me to take on at the investor event in Frankfurt tomorrow?"

7.1 The Crisis / Firing the CEO

Frankfurt:

With the IPO planned in three months, CEO Sergei had been on a roadshow to attract investors for the past three weeks. He had started it in Vienna in January 2012—not an easy time. The finance industry was still worried about the euro crisis, and new regulations were feared. Convincing investors to give money to a bank was obviously no stroll in the park. To support the CEO, the General had asked Carla and Kakha to accompany Sergei and the General on the fourth event of the roadshow, in Frankfurt, hoping that this would be a strong sign to potential investors.

After she saw Sergei's performance and the reaction of the potential investors at the event in Frankfurt, however, it became obvious to Carla that things were not turning out as hoped: Sergei's presentation of the strategy (or the strategy itself) didn't fly with the potential investors. Rather, the investors criticized the relatively meager performance compared to the competition.

Some potential investors even approached Carla and Kakha, asking whether there was anything more behind the story of SlavaBanca than was presented. When they asked her whether IFDB was trying to rid itself of a company that was a nonperformer without strategy, that was the moment when Carla knew this was going to end in a disaster.

Back in her hotel room, Carla decided to write an e-mail to Hank and Maggie to tell them about the “challenges”. But before she could begin writing, her telephone rang. She looked at her watch—10:00 p.m.

“Hi Carla, it’s Kakha!” said the caller. “The General has asked me to call you to meet together in the hotel conference room in ten minutes to have a discussion.”

* * *

When Carla entered the conference room, she was surprised to see not only Kakha and the General, but also SlavaBanca’s CFO Boris. The General greeted Carla: “Mrs. Feltrini, as you can see, this is not an official meeting. Things aren’t going well. Boris, could you please tell us what happened?”

Carla thought, *I know what happened—everyone knows what happened!*

Boris cleared his throat. “T-t-two days ago,” he stuttered, “we have discovered a deal in our books that is worth almost one-fifth of our capital, and there is a good possibility that the individual might not be able to pay back the money. I am s-sorry!”

Carla was stunned! This is not what she expected. When Boris showed the numbers, she was furious. “Why wasn’t this deal flashed in the board’s audit and risk committee,” she demanded, “and in the whole board for approval in the first place? Did anyone know about it? All credit transactions above five percent of our capital have to be approved by the board!”

Now everyone was talking loudly, but they fell silent when the General asked Boris to explain what he knew so far.

“We have found out three things until today,” said Boris. “First, this seems to be a deal with a construction company that—as it seems—Sergeii has some shares in. Second, the deal went through a subsidiary. And third, the deal was declared a trading transaction, not a credit transaction. This way it was not brought to your or my attention.”

Carla was baffled. It was true that Boris had sometimes complained that it was difficult to get subsidiaries to report in time, blaming the lack of proper IT systems. Therefore, some deals flashed up much later. But this was not a mistake; this deal had been deliberately made this way. This brought CEO Sergeii into the spotlight—and not only in Carla’s mind.

Kakha jumped right in. “This is outrageous,” he said. “We cannot continue like this. We must fire Sergeii now!”

The General looked pale and nodded cautiously. Suddenly Carla realized how much the General worried not only about the company but also about his own reputation. After all, he was the one who had brought Sergeii into the company, and he was the one whose daughter was married to the CEO. *He must feel really cheated now*, Carla thought.

Trying to find the right balance of moving forward and yet not pushing too hard, Carla said, “I agree with Kakha that this is absolutely dismal. However, we need to tread sensibly. We definitely need to change the CEO immediately—and cancel the roadshow. But we need to carefully communicate with all stakeholders, so we don’t lose everyone’s confidence. And don’t forget the shockwaves in the company itself—from staff to management. And worst of all, we have no replacement for Sergeii!”

“And we need to develop a strategy to satisfy our shareholders and bring us back on a proper course,” Boris added, to Carla’s surprise.

The General and Kakha suddenly realized what Carla had been saying for such a long time: SlavaBanca lacked a strategy to grow profitably and lacked proper succession planning.

The four of them agreed that they needed to come up with some ideas before facing the whole board and the investors. Carla started to write down her most burning questions on a flipchart—they were many: What was necessary to make this change happen? When should the CEO be informed? Where should a new CEO be found? Could the company work with an interim CEO? When should the investors be informed? What should they tell the investors? And how could a leak of information be averted to avoid the rumor mill and a possible panic?

Having raised all the questions, they now needed to find the answers and get the process right! (See Checklist 4.)



Checklist 4: Crisis Management¹²

- Accept the reality: we are in a crisis.
- Act fast to contain the crisis.
- Modify the board and processes to adapt to the new realities.
- Assign clear responsibilities.
- Communicate your action plan.

7.2 The General’s New Hat / Role of Chairman and CEO

The roadshow was cancelled immediately after the Frankfurt event, and CEO Sergei was fired—personally by the chairman.

Carla was pleasantly surprised to see the General swing into a crisis management mode and order the development of a new strategy, with a clear focus on SMEs—and expansion only in neighboring countries. He oversaw the communication with the stakeholders himself and took on the role of interim CEO until a new one could be found.

In fact, Carla had to admit to being impressed with the General’s work, although his style continued to be rather rigid. This was a side of him that Carla hadn’t seen. As chairman, the General frequently had let the CEO conduct the business, seeing his own role as someone who was there only to guide the board. *He kept his nose in, but his hands out*, Carla observed. He maintained a relationship with the external environment (and still does), but he didn’t get involved in the internal discussions with staff.

Now, as interim CEO, the General actually took care of little things, too. And he cared for the problems of management and helped implement the new strategy (see Figure 18 for the roles of chairman and CEO).

¹² For more information, see IFC’s publication, *Navigating Through Crises—A Handbook for Boards* (2011).

Figure 18: Role of CEO versus Chairman

THE CHAIRMAN SHOULD	THE CEO SHOULD
<ul style="list-style-type: none">• Ensure that the board is effective in its tasks of setting and implementing the company's direction and strategy (Leadership)• Chair at general meetings and at board meetings, and be responsible for setting the agenda (Leadership)• Take a leading role in determining corporate governance structures and processes (Leadership)• Ensure that the board receives proper information, keep track of directors' contributions, and involve all directors in discussions (Gatekeeper)• Ensure link between board and stakeholders, sum up meetings—preferably in consensus (Mediator)• Act as leading representative, especially to the outside (Representative)	<ul style="list-style-type: none">• Ensure that the company as a whole is running with motivated staff (Leadership)• Oversee operations of organization, manages human and financial resources (Management)• Formulate policies and planning recommendations to the board (Strategist)• Support operations and administration of board by providing information and interfacing board and staff (Gatekeeper)• Ensure link between company, community, and stakeholders (Mediator)• Act as a leading representative to the inside and outside (Representative)

The roles of CEO and chairman are ideally separate. Whereas the chairman has the primary oversight function and leads the board, the CEO is responsible for running the company and bridging between the board and the day-to-day operations of the company (e.g., by developing and implementing the strategy).

7.3 The Productive Dinner / CEO Selection Criteria

Rome:

Although things were moving ahead with the General as interim CEO, it was clear to everyone that a new CEO for SlavaBanca had to be found as quickly as possible. The General had asked Carla to support the search for a new CEO. She knew that IFDB probably didn't like her heavy involvement in this crisis management process, so she didn't ask anyone there for advice about how to proceed. Instead, she just did what she was good at—getting things done!

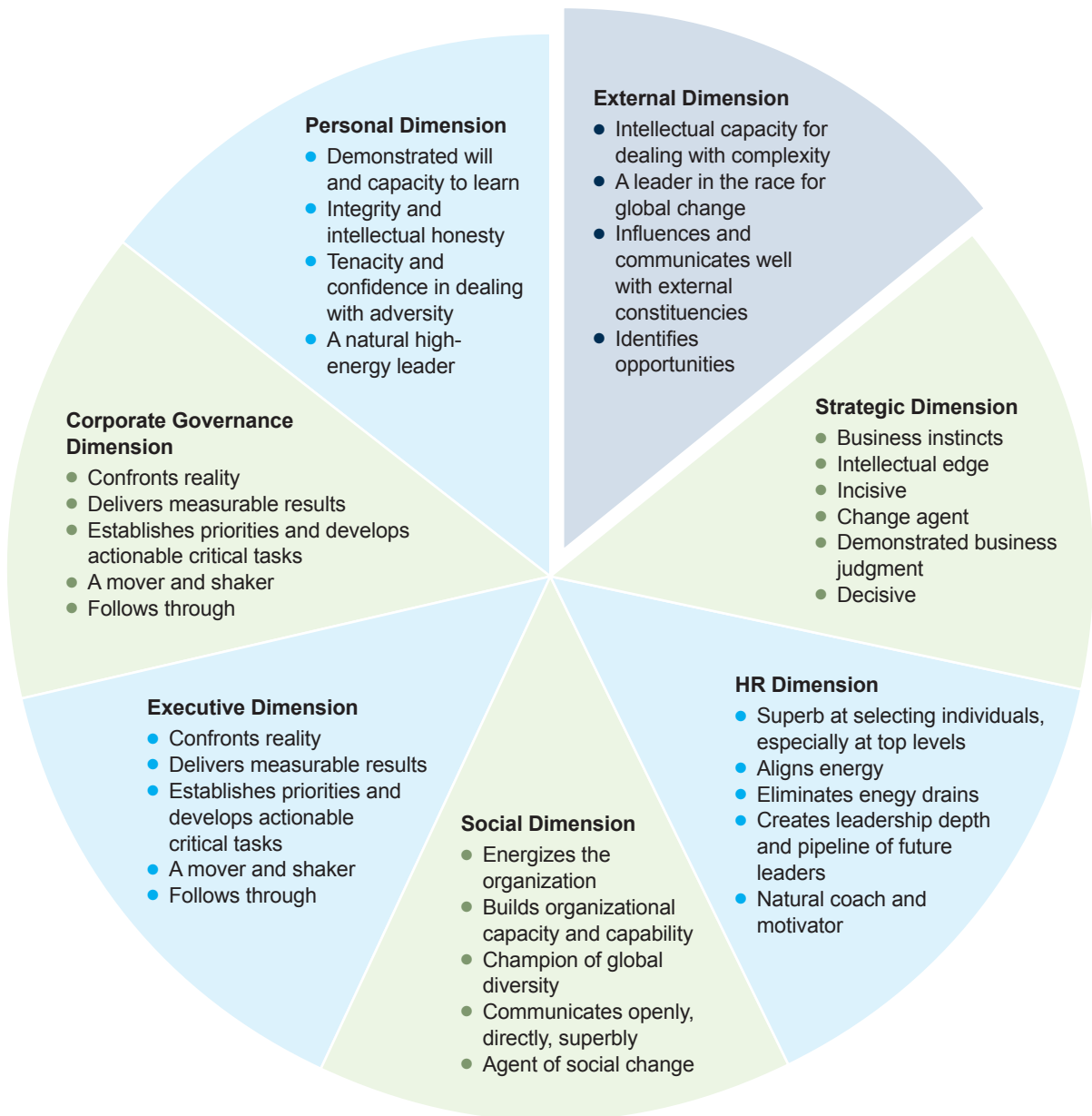
Carla did feel that she could use some advice, though. She wanted to be sure she was on the right track in her search for somebody to head SlavaBanca, so she asked her friend Alberto to dinner—maybe he would provide a fresh perspective.

She and Giacomo hadn't seen Alberto in a while. Alberto had been on a six-month sailing tour around the world (of which Giacomo was very jealous—but not Carla, who typically preferred land to water, and if she had to be on the water, the vessel should provide some comfort).

Alberto was well-tanned and looked very happy to see Carla and Giacomo again. They talked a long time about their respective adventures of the past months. It was not until

coffee was served, that Carla got around to her business agenda. “With all the mess at SlavaBanca,” she said, “we are looking for a new CEO to make change happen and bring SlavaBanca back onto a growth course. Believe it or not, it is my responsibility to lead the search, together with the chairman. But where do I start?”

Figure 19: Dimensions of Selecting a New CEO



Selecting a new CEO is a difficult task. He or she has to be a good fit with the overall organization and make the strategy happen. The seven dimensions shown above help structure the selection.

“Well, Carla, although I learned on my cruise that I shall not say ‘it depends,’ as this infuriated my shipmen, I have to say it: it depends!” Both Giacomo and Carla had to laugh.

“What does it depend on?” Carla wanted to know.

“The CEO selection in general depends on two things,” Alberto explained. “One of them you can already rule out, since the first is the timing of the selection—before or after the incumbent CEO departs. The second is the hunting ground.”

“You mean national or international?” Carla asked.

“Well, yes, you have to decide that, too,” Alberto continued. “But it’s more whether you want a new CEO from inside or outside the company.”

“I see,” Carla said, nodding, “although we don’t really know that yet. From inside it would have the advantage that the new CEO knows the culture and the processes, and the people know him or her. From outside, the new CEO could breathe some new life into the company and bring fresh ideas.”

Carla thought for a second and then continued, “There are some potential candidates inside the company who know the systems and are very well-connected.”

Alberto signaled the waiter to bring some new wine and a sheet of paper. “You have to come up with clear selection criteria, depending on the strategy the board has chosen, Carla. In other words, what qualities are you looking for in the CEO regarding the following six dimensions: external, strategic, HR, social, executive, and personal?”

“Let me add a seventh dimension,” Carla interrupted: “Corporate governance.”

“Great point, Carla!” Alberto said. “Absolutely!” He began to draw on the sheet of paper the waiter had brought (see Figure 19 on page 80). “When you have come up with the clear criteria of these dimensions, you just need to find the person.” He looked back and forth at each of his dinner companions and added, “Easy, right?!” And they all three laughed.

But Carla knew that this part would probably be done by an external agency, or—if the selection were from inside—Katharina, the HR manager, would certainly have a good idea where to look.

It was 1:00 a.m. when they left the restaurant. Alberto and Carla hugged each other goodbye and agreed that, besides being productive, this was actually a very fun evening.

7.4 The Strategy Retreat / The Fluid Role of the Board in Strategy

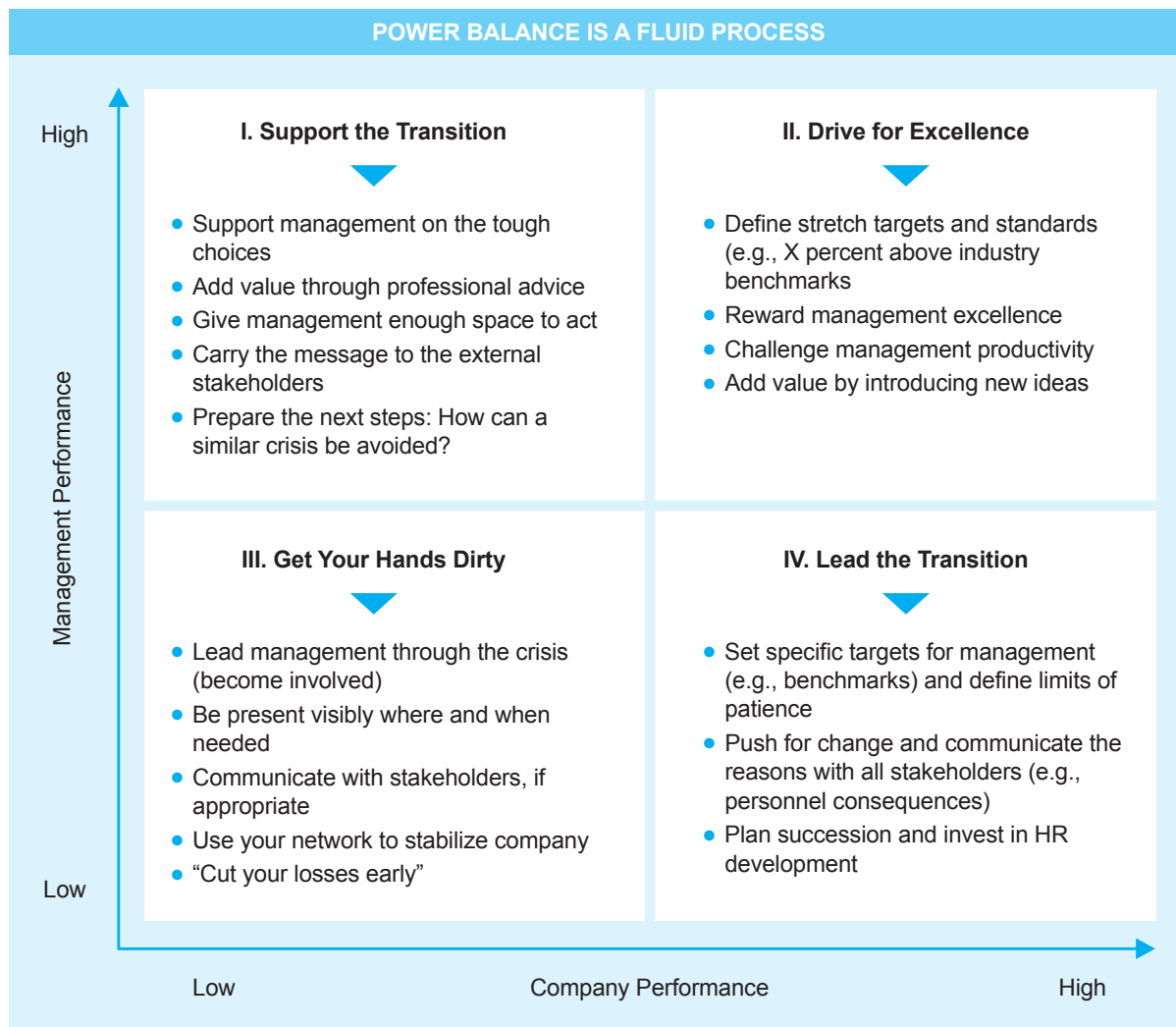
Bankistan:

While it was decided that the new CEO must come from the outside and the search had been started with the help of a head hunter, the new strategy was to be developed at a retreat—with the General, board members Carla, Oleg, and Kakha, and some selected senior staff: CFO Boris, Katharina (HR manager), Pjetro (head of the branches), Michail (head of sales and marketing), and Vladimir (head of controlling).

Actually, Carla had been asked to join the meeting only two days before. Although she thought that this retreat was almost overstepping the board’s role (and probably IFDB’s mandate), she understood that, in crisis situations, the board needs to step up and take on more responsibilities (see Figure 20, next page).

She hurriedly prepared a roadmap for the retreat, which she adapted from IFDB materials and which outlined in general the process. It was important to her that this not be a one-off activity, but that it be firmly established in the governance process of SlavaBanca.

Figure 20: The Fluid Role of the Board and Management



The power balance between the board and the management is fluid and depends on the company performance as well as the management performance. For example, if the company and the management aren't performing as expected, the board needs to broaden its duties and become more hands-on.

Carla also pulled from textbooks a couple of slides to help explain the questions that needed to be answered by the strategy process. Foremost was the famous "Strengths-Weaknesses-Opportunities-Threats" (SWOT) matrix. (See Figure 21 on page 83.)

After she sent everything to Boris for further distribution, Carla was curious to meet the other people in the group, the ones she hadn't met before. Her opportunity came at the informal kick-off dinner that Boris had organized near The Ambassador hotel.

Carla had hoped to get an open discussion going that evening, but that didn't happen. Most of the others were very polite but reluctant to dive into any critical subject. *They know the General is watching them, even if he is not present*, Carla thought as she went upstairs to her room after the dinner. She knew that she needed to take a leading role tomorrow, but she was not sure how to do so.

7.4.1 Putting the Fish on the Table

The next morning Carla found herself with an unforeseen golden opportunity. For whatever reason, the chairman could not be present, so it was unclear who would chair the meeting.

Carla grabbed the opportunity! “I am the oldest person in the room,” she announced in a loud and authoritative voice. “And since your culture values age and experience, I am taking the liberty to serve as chairwoman.” With that, she took her seat at center stage.

Hearing no protest, Carla continued, “Let’s put the fish on the table: We are here to develop a new strategy, because the old strategy—or perhaps better said, opportunistic non-strategy—has failed. We will be wasting our time, if all we do is beat around the bush instead of addressing the issues, confronting the brutal reality, and coming up with innovative but realistic solutions.”

Following a brief silence, the usually quiet Oleg surprised Carla by speaking up. “I agree, SlavaBanca is in a crisis,” he said. “Yes, we must confront the brutal reality, look for the causes, and address them properly. There can be no sacred cows—neither in the discussion nor in the elements of the new strategy.”

For the others, this signal was as clear as a bugle call for combat. They were sure Oleg would not have made this statement without the explicit approval—probably encouragement—of the General. And a no-holds-barred discussion emerged rapidly, like dammed water finally breaking free!

Carla sometimes had difficulty maintaining a certain structure to the debate and keeping everyone focused on results. But she had no trouble getting the SWOT matrix filled in quickly, with a dominant bias to the side of weaknesses:

- demoralized staff, due to the blame culture and permanent layoffs
- too much bureaucracy

Figure 21: SWOT Analysis

Internal factors External factors	Internal Strengths (S)	Internal Weaknesses (W)
	External Opportunities (O)	External Threats (T)
External Opportunities (O)	S - O Strategy: Maxi-Maxi Use strengths to capitalize on external opportunities	W - O Strategy: Mini-Maxi Develop weaknesses to be able to capitalize on external opportunities
External Threats (T)	S - T Strategy: Maxi-Mini Use strengths to cope with external threats	W - T Strategy: Mini-Mini Develop weaknesses to either defend from or avoid external threats

The SWOT (Strengths, Weaknesses, Opportunities, Threats) analysis helps identify internal factors (strengths and weaknesses) that can be used to make the most of opportunities—or must be improved to counter, minimize, or avoid threats of the market.

- not sufficient resources to serve the clients properly
- no clear sense of priorities
- falling behind the competition
- etc.

But it was not all bleak. They listed strengths:

- SlavaBanca still enjoyed a strong franchise with SMEs, especially outside Bankistan's capital—an important building block for any new strategy.
- The IT system in general could easily be improved to create a common platform throughout all branches.
- The loss-making operations outside the core business could easily be closed or sold, setting capital free for new investments.

Oleg proved invaluable with his knowledge about the competition and their strategic plans (Carla wondered where he had gotten that information). Kakha had all the industry data and regulations on his laptop. The head of controlling had an absolute mastery of the internal data. And even Boris came through with a degree of strategic thinking that Carla had not expected.

When the team broke for lunch, Carla and Kakha were the last ones to leave the room. “Haven’t I told you that the mind of the General is where the money is?” he asked her. “Luckily he recognized that the company is in a mess and needs to break out of the downward spiral!”

“Yes,” Carla agreed, “just like twenty years ago with the country.”

7.4.2 Defining Key Performance Indicators

In the afternoon session, the team attempted to define clear goals and key performance indicators in the framework of a tight timetable—and match them with actions and allocate resources accordingly.

This was an iterative process, to say the least! Sometimes the team struggled with the interdependencies between the actions, the competition for resources, and the value contributions of actions with what turned out to be too loosely defined goals.

At 7:30 p.m., exhaustion was beginning to creep into the meeting, and Carla decided to call it a day. “It is always helpful to get a good night’s sleep and review the results so far with fresh eyes in the morning,” she said. “I think that we will get the missing links better with a rested mind.”

The team enjoyed a light dinner—in a much more relaxed mood than the evening before. Boris even invited Michail, who had an education as an heroic tenor before going into business, to close the evening with one of Bankistan’s famous sentimental folks songs of love and suffering, which brought tears to everybody’s eyes. They hugged each other, saying good-night.

Carla hung back for a moment to invite Oleg and Kakha to join her for breakfast to prepare tomorrow’s meeting and structure the questions that still needed answers before the team could make decisions. Then she went to her room, suddenly aware of how tired she was. *I am no longer twenty-five*, she reminded herself. But she took some time to call Giacomo, and together they tried to distill a list of the open questions from her notes. Soon she was in bed and asleep, her last thought being, *This was a good day*.

The next morning over breakfast, Oleg was very supportive and added a few points to the open questions, strengthening especially the HR dimension of the planned transformation. Oleg continued to impress Carla with his contributions.

After reviewing the “loose ends” and open questions, the full team worked together to sharpen the goals:

- SlavaBanca should be focusing as a full-service provider on SMEs, including independent professionals and farmers with attached business, which also requires the development of new financial service products; and it should be withdrawing from big loans, especially in construction, where the heaviest losses had occurred; altogether the turnover of the bank should increase approximately 50 percent over the next three years, with the goal being a healthy return on equity of 15 percent.
- Cleaning up the balance sheet will require a huge write down on non-core business and a significant increase in provisions for nonperforming loans, which would lead to a heavy loss. But Boris was confident that by the end of the year the income from the asset sales would lead to a “black zero” and a balanced cash flow, so the bank would not fall foul of regulatory requirements.
- Two investments in personnel were needed: more employees in customer service —“foot soldiers for combat, not staff officers for planning,” as Oleg put it—and an acceptance of a leadership training, as Katharina had suggested in detail the day before.

In the next round, the team divided into subgroups of two to write in detail the required actions, look at the financing and cash-flow requirements, and come back to the whole team. Then the team would all work together on an integrated strategy with a financial plan, allocated resources, and clearly established accountabilities.

7.4.3 Getting the General on Board

By the time the team broke for lunch, they had already put together an action plan to be implemented as part of the strategy. Oleg suggested that after lunch they pull all the pieces into a presentation for the full board—which really meant “for the General.”

This preparation of a presentation turned out to be an exercise in systematic clustering, streamlining, and framing. And everybody was pretty happy with the result.

When Carla called the coffee break, she had no idea how to continue. But this issue solved itself: halfway into the coffee break, the General showed up, and Carla was sure that this was not accidental.

“Just looking if I can be of any help,” he explained. (Carla immediately recalled an old joke about the three big corporate lies, the biggest being, “I am from headquarters, and I am here to help.”) She noticed that all the people in the room stiffened and lowered their voices when the General appeared. *He is spreading fear*, she noted.

She decided to greet him warmly. She smiled at him and said, “Most welcome, General. We can save some time at tomorrow’s full board meeting by giving you a preview of what we have done so far.”

The General nodded and asked, “When will you be ready?”

“We are ready right now, if you don’t expect a perfect PowerPoint presentation,” she said, with some pride in her voice.

The General agreed, took a cup of coffee, and sat down. Everybody immediately followed his lead and took a seat.

Carla made sure that every member of the team had a share of the presentation. The General was mostly silent, nodding or making an occasional request for details. At first, the staff were very nervous, if not anxious, but they gained some confidence during the course of the presentation as they saw the General’s acceptance.

At the end, the General thanked everybody and said in his military style, “I am ready to lead this transformation, although I hope that soon a new CEO will join us. But how can we convince our people and motivate them to work in this direction?” He gave part of the answer himself: “I am thinking of a management conference with all heads of the branches, everybody with a responsibility. We should hold it the day after our board meeting tomorrow.”

While the others were nodding approval of the General’s remarks, Carla was thinking, *Obviously he has learned something*. Then she heard herself saying, “That is a great idea, Mr. Chairman. You are self-confident and successful enough to start your speech by admitting that, after the merger, errors had been made and that you are sorry for that—before you present the new strategy.”

The room fell silent, and Carla thought, *you could hear a pin drop*. The General finally broke the uncomfortable silence. “I agree,” he said and stood up. “Let’s then prepare the conference.”

7.5 The Positive Feedback / Enjoying Victories

Rome:

Carla was glad to be home! She could not attend the management conference, because she needed to fly back right after the board meeting. And once again, Carla shared a taxi to the airport with Michael from GEP. This time, his attitude had been quite different from the one she had encountered on their earlier cab ride.

“Congratulations, Carla!” he had said. “You really changed something at SlavaBanca. I recently was asked by a chairman of a microfinance institution in Bankistan, with whom GEP is doing business, what had happened to SlavaBanca. They wondered why they didn’t get any more applications from SlavaBanca employees. Not only that, but some of the ones that had quit and had gone to the microfinance institution actually went back to SlavaBanca.”

Carla had not been able to hide her joy. “Thanks Michael! That is really good news,” she said. And she couldn’t resist adding, “And I am happy that you can see the value of it after all!”

Soon after Carla arrived in Rome, she received an e-mail from Kakha, giving her an account of his impression from the conference:

The old battle horse still can deliver. He really admitted errors and gave a credible speech about the new direction. He even mentioned the value contribution of the board.

Carla was pleased with the report. *That’s a great start*, she thought. But then she added

a note of caution to herself: *A plan and a speech is not the turnaround. In the months to come, we need to relentlessly focus on implementation.*



Key Messages of Chapter 7

- The role of the board is fluid, and in a crisis the board may have to take on more responsibilities.
- The division of labor between management and board must be clearly defined again after the crisis.
- Sometimes it takes a crisis to light the spark of change; so use the energy.

IPO—Round Two

June 2013:

A year and a half into the turnaround, the board and the new management had made steady progress in implementing the new strategy. A new CEO was hired in May 2012, three months after Sergei had been fired. The new CEO had worked for an international finance institution in London and was now returning to his home country, Bankistan. Carla was really pleased with his work, which—thanks to the improved board information system—the board could track much better.

The board remained very involved in overseeing the progress of the new strategy implementation and had professionally driven debates on dilemmas, new issues, and competitive moves. Slowly but steadily, better results were trickling in. Boris, still CFO, managed the “black zero” and balanced liquidity—“without the old tricks,” he assured the board.

8.1 Ready for The Next Step? / The IPO Preparation

Rome:

Carla was just enjoying a beautiful evening on her terrace with her husband and a glass of Campari Orange, when she received a call from Hank. After some small talk, Hank asked her directly, “Carla, do you think that SlavaBanca is ready for an IPO?”

Carla was hesitant to answer the question with a clear “yes” or “no.” “Well, Hank, over the last eighteen months we clearly made progress, but I am not sure if the fruits of the turnaround have fully matured yet,” she hedged. “Why are you asking?”

“The General is pushing for it,” Hank said. “And don’t be offended—that’s just the usual process. It’s also defined in the investment agreement that it is a decision by the owners. But I wanted to have your expert opinion, because you know the company so well by now.”

Carla took his comment as a compliment. “I clearly understand,” she told him. “And don’t worry—I am not unhappy about the development. Honestly, the board work even started to get boring—relentless focus on implementation, marginal improvements in board work, as far as the General allows, and no fights.”

“How is the new CEO doing?” Hank asked.

“Fine,” said Carla. “It was a good decision. But to come back to your question: the balance sheet is clean, the operational processes have improved significantly. But despite a good CEO, the leadership quality throughout the bank is definitely not on an internationally competitive level—but probably not worse than in other banks in the region. That is also the main reason the bank needs to stay in the region for the near future.”

Then Carla remembered something else. “Oh, now I think of it,” she said, “so far my various efforts for board evaluation have gone nowhere. Maybe the IPO is an opportunity to push anew, right?”

Hank agreed. “And also we will remind the General that this is a necessity for an IPO,” he promised.

8.2 All’s Well That Ends Well? / The Next Step

Bankistan—December 2013:

It was all smiles and champagne, when the successful IPO of SlavaBanca was celebrated simultaneously in London and Danubesk’. Carla glided through the crowd in a bright-green Italian designer dress, closely followed by her husband. Giacomo didn’t especially like this role, but he understood that his wife was proud of her achievements and wanted to celebrate her success.

During the last months before the IPO, the board had enjoyed a calm period of routine duties, because the main work for the IPO was done by the owners and their investment bankers. But it was the board that ensured that, after more than two years of hard work and changes, SlavaBanca was in a shape to be brought to the stock market.

When Carla bumped into Oleg, she couldn’t resist asking, “Did the president try to cut a favorable deal with SlavaBanca shares?”

Oleg smiled, the first time Carla ever saw him smiling. “The son-in-law of the president tried,” he said. “But the General convinced the president that the country needed a successful IPO to attract foreign investors and that a tunneling of assets under the watchful eyes of IFDB was impossible.” Oleg had stayed on the board as a representative of the General, who still held a stake in SlavaBanca.

Carla couldn’t help smiling, too. “I know you really suffered under me,” she said, “but in the end it seems to have paid off.” She raised her glass in a toast to him, and he smiled even more broadly.

She turned and almost ran into the General, who introduced her and Giacomo to his wife, Olga, and his only daughter, Jekatarina, an attractive woman in her early 30s. The three women immediately began chatting, and at one point Carla said to Jekatarina, “I am so sorry that your husband suffered a lot in the process and ultimately lost his job.”

“Don’t worry,” Jekatarina said. “I am not so sorry for him—and luckily for me, we have been divorced now for a year.” Then she added, “It was a mistake to marry him. It was my father’s idea—I should have listened to my mother.”

“You have my deepest sympathy,” Carla said.

Then she saw an opportunity to speak to the General privately. She took him aside and asked, “What are you doing now, after your baby has grown up and is running alone?”

The General sighed. “I assume I ruined my health in earning money; now I will spend a lot of money to restore it,” he said, only half jokingly.

“In Italy, we have a number of great spas for all purposes,” Carla said. “One of them may be just right for you.” She wondered whether she could ever have any real sympathy for this man. But she added, politely, “And when you are near Rome, do come and see us.”

Carla started to walk away but then turned back and said to the General, “But most of all, I want to thank you for what was in the end a good cooperation, although I know it was sometimes a painful learning process for all of us.”

The General became distant and formal again. “You are most welcome, Mrs. Feltrini,” he said and turned back to his wife.

Giacomo and Carla left the celebration early with Kakha and his wife. Carla wanted to thank him especially for his support by taking him and his wife to dinner—with the great Bankistan wine, of course. When the two couples parted that night, they agreed to meet again in Rome on the anniversary of their first board meeting—in May 2014.

* * *

Carla was feeling almost nostalgic, wondering whether this was the last time she would enter The Ambassador hotel, when Giacomo asked, “What are you going to do now that you don’t have the board seat?”

She smiled lovingly at her husband, then winked. “I’m going to start studying history and then write a book about what companies can learn from historic events,” she said playfully. “—At least until Maggie calls me again.”

APPENDIX

The Interview—Carla's Takeaways and Learnings

Carla Feltrini, IFDB Nominee Director at SlavaBanca, was interviewed by the authors after a presentation on her directorship journey.

Authors: Carla, this morning you presented to your peers your personal experience of serving as an IFDB nominee director at SlavaBanca. Will you please share with our readers some of the highlights of this presentation?

Carla: Well, it was a long journey, with a greater investment of time and nerves than I had originally expected. But it was also a most fascinating learning experience all along the way—and a reward that goes beyond the financials and the value addition for IFDB. We not only contributed to the wealth protection and enhancement for IFDB, but we also set an example that, even under difficult conditions, good corporate governance can be implemented, and adds economic value—maybe establishing a role model that others could follow.

Authors: How would you describe your personal role in this process?

Carla: That is difficult to say precisely. IFDB sent me out as change agent, and I was naïve enough to assume that everybody not only understood this but also appreciated it. When you are up against vested interests and deeply entrenched behaviors, battles are unavoidable. It is easy to *start* a war but much more difficult to *win* it!

Authors: Did you win all the battles?

Carla: Definitely not! In the beginning, I was probably too ready to go to war and only later understood what I really already knew from my professional experience before: as a board member you need to pick your battles carefully, get your allies onboard beforehand, and determine whether you have the time and resources to go through a trench war if needed. But in the midst of the controversy it is easy to get carried away.

Authors: Well, somebody said that if your husband were a professor of diplomacy instead of war, he would have advised you differently. . .

Carla: (Laughing) Definitely not! First, he was very careful not to “advise” me and compete with the folks from IFDB. He helped me think more deeply, analyze the situation and detect the pattern in it, and see the forest and not just lots of trees. That’s what his analogies are about. And I think for such a task it is important that you have someone who is outside the battle and can therefore help you keep cool and stick to your professional judgment and behavior. To take a deep breath during stressful situations and put it into perspective can help a lot! I want to thank my husband for accompanying and helping me on this journey.

Authors: In the beginning, you thought it was difficult to learn all about corporate governance. Was this the biggest challenge?

Carla: This is also a clear *no*! The best practices—in processes, structures, framework, and so on—are relatively easy to learn. For every professional question you find as a nominee director you can find an answer on various websites or you can ask an expert, your peers, or the investment and legal professionals. The most difficult thing to learn was how to implement the theoretical concepts in a specific company with real people, real interest and hidden agendas, diverging goals, individual (and sometimes surprising) behaviors, unknown cultural traditions, and so on. I guess you can say that the “human dimension” of corporate governance is the real challenge.

Authors: What are the key success factors in this “human dimension”?

Carla: I would go for three: First, you need to know the key people, your colleagues, the chairman, the CEO and his team—not just their professional background, but where are they coming from, you know, their previous experiences, perspectives, the formative elements of their culture, their goals. Observe them carefully, how are they communicating, how openly and transparently they behave. I should have definitely spent more time on this when onboarding—for example, through a half-day with the management and by visiting the branches of the bank at the beginning. The second is the pattern of decision making—not the formal process, but who is really in charge, who is the driver, the key influencer, what levers he or she is using, whether you are part of the decision-making process or are excluded. And the third is the potential for change of the current—mostly bad—behavior: What are the obstacles? What are hardwired old behaviors from former times? What are vested interests, not aligned with the benefits for the company as a whole? Out of all of this you can assess how much weight your professional and rational arguments will carry, and you start to ask, what other leverages do you have to get things moving?

Authors: And what were the levers you had in SlavaBanca?

Carla: The IPO was definitely one of the levers, and here IFDB and IFDB’s “seal of approval” were instrumental for a high-level evaluation. But this was not sufficient. If there had not been a crisis, the rapid and positive development afterwards would not have happened. We would love it if people learned through rational arguments, but the unfortunate fact is that in most cases people and behaviors change only under pressure.

Authors: Coming back to your role, especially as “a slave of two masters,” as you have called it. What do you mean by that?

Carla: Being a slave of two masters is what being a nominee director is pretty much about: As a board member, you have a fiduciary duty to the whole company and should use this as the dominant criterion for your actions on the board. On the other hand, IFDB nominated me to the board with specific expectations: IFDB wanted to be informed and wanted me to look after their money. The investment folks from IFDB wanted me to make sure that there was no “tunneling” of assets, and they wanted me not to do certain things, to avoid triggering any liabilities. Maybe they even wanted to be consulted beforehand.

Authors: But was this a specific difficulty?

Carla: In most situations this was not a specific difficulty; rather, I enjoyed the very helpful professional discussions. But sometimes, as we all know from experience with big organizations, you get different answers, such as from a portfolio officer or a lawyer. I was

sometimes not sure what was really feasible and what was compatible with IFDB's development mandate for good corporate governance. And—maybe you don't print this (laughs)—in very specific situations, you have to ignore the guidelines. When I was thrown into the situation to run the strategy development with a mixed team after the failed IPO, I am sure official IFDB guidelines were against that involvement. But if I had refused to get involved, I would have destroyed my hard-won credibility and authority. Therefore, I decided to inform IFDB only after it was too late (smiles). I guess sometimes it is easier to ask for forgiveness than for permission. And naturally, IFDB only has limited knowledge about the messy situation on the ground: for example, I felt encouraged by my counterparts at IFDB to go for the board evaluation rather early. In hindsight, that was really not a smart move at that time. But I guess that's what you learn from it.

Authors: Next to board evaluation, IFDB also expects its nominee directors to push for a sustainability strategy, integrating the triple bottom line into the business model of the investee companies. What was your experience here?

Carla: Probably this is another area where I was not able to meet IFDB's expectations, not because I don't think this is important—and indeed it is a topic close to my heart. But we talked about priorities, and it was pretty clear that sustainability, unfortunately, didn't come out on top. I tried to discuss this issue during the strategy session, but I met blank stares: nobody had any idea what it was all about. And no wonder, considering where they were coming from. And there was no obvious pressure, say from NGOs or the government. After all, this is a bank focusing on SMEs. So I dropped this topic. We did introduce some elements of it under a different label, such as the discussion about the importance to stakeholders of “sustainable,” or long-term, success and to support the customers, the SMEs, on a wider range of issues.

Authors: Last question: Was there anything you would do differently next time?

Carla: That is really an easy question to answer: Yes! But in hindsight you always know better, and I guess being a board member requires making judgment calls. You can never be sure that you'll get your desired results through your actions—especially with the “human dimension” we talked about before. Sometimes it also takes longer for your actions to turn into positive change. But if I could, I would do three things differently, some of which we talked about before: First, I would prepare with more diligence before onboarding; second, I would take more time to get to know the human side of the business and would engage more in social interactions and activities; and third, I would push for changes much more gently but with less fear of being rebuffed and, hopefully, therefore, at least as decisively.

Authors: Thank you very much for your time!

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About the Authors

Ulrich Steger is associated with the International Institute for Management Development (IMD) in Switzerland, working corporate governance and leading IMD's board program. He has published extensively on corporate governance and has co-authored three books, including *Corporate Governance — How to Add Value*. His other publications range from cases in the developing world to a book on crisis management: *Corporate Diplomacy: The Strategy for a Volatile, Fragmented Business Environment*. Ulrich currently serves on boards in Germany, Switzerland, and Malaysia and is actively engaged in solving corporate crises in three of his directorships. He has worked with IFC in the training of nominee directors since 2007 and has worked extensively with IFC's sister organization, the Dutch FMO, on corporate governance and board director workshops for more than 10 years.

Christoph Nedopil is an entrepreneur and researcher, who successfully founded (and partly sold) YOUSE, an award winning innovation research agency, and SHÄRE, a company in the digital sector that provides application for the share economy. He began his research on corporate governance and sustainability and his delivery of executive education programs for board directors and senior management during his tenure as a research associate at IMD and for his PhD. He has worked and taught in this field in over 15 countries as a consultant for the World Bank, the African Development Bank, and the German Agency for International Cooperation (GIZ). Christoph has written more than 60 case studies for international companies, banks, and institutions and authored or co-authored three books. His publications have been translated into several languages, including Russian and Chinese.

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