Enhancing Board Effectiveness: What about Induction and Training Programs for Directors?

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Agenda

• Background
• Objectives of the paper
• Regulation and Literature Review
• Methodology, Sample and Data
• Results
• Conclusions
• Further Studies
Background (1/2)

• Over time, the job of a director has become more difficult since boards must deal with a wider variety of complex issues and have less time to study and analyze each topic in detail (Lee and Phan, 2000)

• Boards are often criticized for failing to meet their governance responsibilities in firms when detailed knowledge about the business processes is lacking within the board and an information asymmetry exists among executive and non executive/independent directors (Levrau and Vanden Berghe, 2009; Ladipo and Nestor, 2009)

• These considerations are especially true for bank boards considering the complexity of the business, the high dynamism and volatility of the markets in recent years and the responsibility of banking boards in supervising and monitoring as a prerequisite for the sound and prudent management of financial intermediaries (OECD, 2004; BIS, 1998, 2006 and 2010; BIS, 2005; CEBS, 2006)
Background (2/2)

• Law, regulators and experts outline some possible good practices with regards to the “best” configuration of the bank board such as: board independence, board diversity, presence of board committees, degree of directors’ turnover, that may contribute to the value creation process.

• In the wake of the recent financial crisis, some authors (Stilpon Nestor, 2009; Walker, 2009) have identified several areas of improvement in banking boards referred also to a growing “professionalisation” of non-executives, more financial industry expertise (especially for Chairmen and members of the Risk Committee) and an effective induction of the new directors and a life-long program to alls.
Objectives of the paper

• The paper discusses the idea that an institutionalized and effective board induction and training process could maximize the director’s contribution and thus improve board effectiveness in banks, mostly where there is a high turnover of non-executive and independent board members.

• Our research describes the state of the art on board induction and training programs in European banks and highlights the opinion of an Italian panel about the topic.
Regulation and Literature Review (1/3)

• Self-regulation on corporate governance encourages the development of structured induction programs for all new directors - which are tailored to specific individual requirements to facilitate their activities on board in the shortest possible time – as well as the appropriate training of all directors on the board; these practices include directors’ visits to individual businesses and meetings with senior management.

• Some recent International Code on Corporate Governance (UK Corporate Governance Code, King Report III) emphasizes that board members should have the knowledge, necessary skills and experience needed to judge the company's activities and, should the directors lack business experience, the firm should give them details and support programs based on their roles and responsibilities. Such board practice ensures that directors continue to have the necessary competence to lead complex firms.
Regulation and Literature Review (2/3)

• With reference to banks, contrary to previous documents (BIS 1999 and 2006), the recent international rules on corporate governance (BIS, 2010) stress the importance of training for directors. To help board members acquire, maintain and deepen their knowledge and skills and to fulfil their responsibilities, the board should ensure that board members have access to programs of tailored initial and ongoing education on relevant issues.

• In addition, other banking regulations recognize the importance of such practices as a contribution to good governance (for example The Netherlands Bankers’ Association Code, 2010).

• The resource-based theoretical framework (Wernerfelt, 1984; Barney, 1991) support the relevance of the induction and training programs: directors must be adequately competent, skilled and informed to offer a large and high contribution to the task of the board and, ultimately, to the process of creating value for the firm.
Regulation and Literature Review (3/3)

• There are very few studies on induction and training programs for directors:
  – overall studies on the state of the art of corporate governance that describe, even if in the summary, among other points, also the type of training given to the directors (Mori, 2003; Spencer Stuart, 2008; Board Index Spencer Stuart for the Italian and English studies)
  – specific analyses describing best practices for implementing programs for induction and training of executives and non-executives (De Lacy, 2004; Long, 2004; Long, 2008)

• The analyses focused on the banking sector are few and are not sufficiently analytical (Ladipo, Nestor and Risser, 2008; Walker, 2009; Bright, 2009)
Methodology

• Our work is structured in two different phases (A and B), both based on qualitative research methods

A. In the first one we present the organizational characteristics of board induction and training programs run by European banks (layout of the programs; timing; type of training; promoters; topics; the presence of board member site visits and of meetings with senior/middle management; the forecast of an ex-post evaluation on the effectiveness of training, etc.) and highlight the differences towards the best practices proposed in theoretical studies

B. In the second phase we present the results of a survey about the opinions and experiences of an Italian panel on board induction and ongoing education practices adopted by firms
Sample and data (1/2)
Phase A. List of 25 Largest European Bank (2008)

<table>
<thead>
<tr>
<th>Bank Name</th>
<th>Country</th>
<th>Main Listing(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>ABN AMRO</td>
<td>Netherlands</td>
<td>Euronext Amsterdam</td>
</tr>
<tr>
<td>Banco Santander</td>
<td>Spain</td>
<td>4 Spanish Stock Exchange</td>
</tr>
<tr>
<td>Barclays</td>
<td>UK</td>
<td>London Stock Exchange</td>
</tr>
<tr>
<td>BBVA</td>
<td>Spain</td>
<td>Madrid Stock Exchange</td>
</tr>
<tr>
<td>BNP ParisBas</td>
<td>France</td>
<td>Euronext Paris</td>
</tr>
<tr>
<td>Credit Agricole</td>
<td>France</td>
<td>Euronext Paris</td>
</tr>
<tr>
<td>Credit Suisse</td>
<td>Switzerland</td>
<td>Zurich Stock Exchange</td>
</tr>
<tr>
<td>Danske Bank</td>
<td>Denmark</td>
<td>Copenhagen Stock Exchange</td>
</tr>
<tr>
<td>Deutsche Bank</td>
<td>Germany</td>
<td>Deutsche Borse</td>
</tr>
<tr>
<td>Dexia</td>
<td>Belgium</td>
<td>Euronext Brussels</td>
</tr>
<tr>
<td>Erste Bank</td>
<td>Austria</td>
<td>Vienna Stock Exchange</td>
</tr>
<tr>
<td>Fortis</td>
<td>Belgian</td>
<td>Acquired by Bnp-Paribas in 2009</td>
</tr>
<tr>
<td>HBOS</td>
<td>UK</td>
<td>Acquired by lloyds Bank Group in 2009</td>
</tr>
<tr>
<td>HSBC</td>
<td>UK</td>
<td>London Stock Exchange</td>
</tr>
<tr>
<td>IntesaSP</td>
<td>Italy</td>
<td>Milan Stock Exchange</td>
</tr>
<tr>
<td>KBC Group</td>
<td>Belgium</td>
<td>Euronext Brussels</td>
</tr>
<tr>
<td>Lloyds Bank Groups</td>
<td>UK</td>
<td>London Stock Exchange</td>
</tr>
<tr>
<td>Natixis</td>
<td>France</td>
<td>Euronext Paris</td>
</tr>
<tr>
<td>NBG</td>
<td>Greece</td>
<td>Athens Stock Exchange</td>
</tr>
<tr>
<td>Nordea</td>
<td>Sweden</td>
<td>Stock Exchanges of Stockholm, Helsinki and Copenhagen</td>
</tr>
<tr>
<td>RBS</td>
<td>UK</td>
<td>London Stock Exchange</td>
</tr>
<tr>
<td>Societe Generale</td>
<td>France</td>
<td>Euronext Paris</td>
</tr>
<tr>
<td>Standard Chartered</td>
<td>UK</td>
<td>London Stock Exchange</td>
</tr>
<tr>
<td>UBS</td>
<td>Switzerland</td>
<td>Zurich Stock Exchange</td>
</tr>
<tr>
<td>Unicredit</td>
<td>Italy</td>
<td>Milan Stock Exchange</td>
</tr>
</tbody>
</table>

Information drawn from Reports 2008 available on the websites (Board of Directors’ Regulation, Code of Conduct, Report on Corporate Governance, Annual Report, etc.)
Sample and data (2/2)

Phase B.

- A panel of 20 directors who attended a seminar on corporate governance at SDA Bocconi School of Management (Milan) in November 2010

- The panel was made up of five banks and fifteen non-banks, half of these listed on Borsa Italiana S.p.A.
Results (1/6) – Phase A

A. The empirical analysis related to the Phase A confirms shows the following findings, what follows:

A.1 Board Induction and Training

- **20 banks formally adopt induction and training programs for their directors**

- In three cases, the Nomination Committee assesses the competences, structure and performance of the board. It also discusses the professional skills and expertise required by board members to match the sphere of interest of an international financial services provider such as the bank
Results (2/6) – Phase A

A.2 Approach to induction

• In all circumstances, the bank provides its new directors with a **personalised approach to induction**; each induction program is tailored to the individual director’s specific needs and requirements and further meetings are arranged where a director requires a deeper understanding of a particular area.

• In two cases, the directors receive, on appointment, a formal letter clearly setting out what is expected from them and also contains a proposal of a tailored induction and orientation plan.

• In few circumstances, the **programs of board induction are aimed at new non-executive directors** on the board and therefore do not foresee plans of development or solutions of lifelong learning for the existing directors.
Results (3/6) – Phase A

• In one case, the bank itself detects “a priori” the areas of competence which it considers should be necessarily represented in the board requesting that administrators, in addition to the requirements of professionalism provided by law, are in possession of a good knowledge and experience in preferably two or more of these areas of competence.

• In three cases the induction program also forecasts a series of meetings with other directors and senior executives to enable new directors to receive information and familiarise themselves with the strategy of the bank, its operations and its internal controls.

• Only in one case all non-executive directors are formally required to meet major shareholders as part of their induction programs.
Results (4/6) – Phase A

A.3 Topics of the induction program

• In most cases, the learning program for directors covers:

  - relevant developments at the bank and in the financial sector,
  - corporate governance in general and in the financial sector in particular,
  - responsibilities of board members,
  - the duty of care towards the client, integrity, risk management, financial reporting and audits,
  - other specific aspects unique to the bank and its business activities.
Results (5/6) – Phase B

B.1 The results of our interviews to the panel of 20 directors show also that:

• only one firm has already organized an induction program for new appointed directors and a second one has planned to do it; the limited diffusion of these practices is due to a poor importance given to board training, as it is considered not relevant due to the high professional profile of board members and to cooptation practices in the nomination process.

• 5 of the respondents stated that their firm organizes training programs for the board on a regular basis on topics such as risk management, business law and corporate governance standards and regulation, business and company practices.

• initial documentation and information on the industrial sector and the company’s organization and internal regulations are forwarded to new members either in paper or through management presentations.
B.2 On the basis of the expert’s opinion, the overall relevance of board training processes is the following (1 - minimum; 6 - maximum)

<table>
<thead>
<tr>
<th>Assessment</th>
<th>Degree of Relevance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Board induction is a fundamental process because it allows new member to give a more active contribution to the decisional processes of the board</td>
<td>5.8</td>
</tr>
<tr>
<td>Directors do not need specific training on the industry and the company, since they are appointed on the base of their experience and professional profile</td>
<td>3.0</td>
</tr>
<tr>
<td>Board members are not always able to give an active contribution because they do not have a deep knowledge of the company’s internal processes and organization</td>
<td>4.6</td>
</tr>
<tr>
<td>Board members must be trained by the company before important decisions regarding strategic and technical issues, such as risk policies</td>
<td>5.2</td>
</tr>
</tbody>
</table>
Conclusions (1/2)

• Induction and training programs for directors are a fundamental tool to improve the effectiveness of corporate governance

• However there is a substantially limited dissemination of the practices of induction and training for board directors: in most banks they are absent or limited. In those cases where these practices are used more extensively, it is possible to spot some areas of improvement compared to best practices

• Overall, the most disappointing results, in terms of the dissemination of induction and training programs for directors, emerge from the interviews carried out on the Italian panel
Conclusions (2/2)

• In our view, the limited dissemination may be justified by:

• a delay of regulation on corporate governance about induction and training programs
• an excess of self-confidence of directors who believe to be too senior and experienced to benefit from a training program on corporate governance
• a possible disappointment of executive directors in banks
• the high costs of the programs for the banks
Further Studies

• Further empirical studies are of course necessary to analyse the implications of a poor boards induction practices

• Suggestions for research development are:
  – the investigation of larger samples, differentiated by industrial sector, by geographical area or by the size of the firms, in order to define best practices that are distinct for business and characteristics of the firms
  – the measurement of the impact that the plans of board induction and training produce on the overall effectiveness of the board and on the performance of the company during the time