

NACD Directorship

Boardroom Intelligence

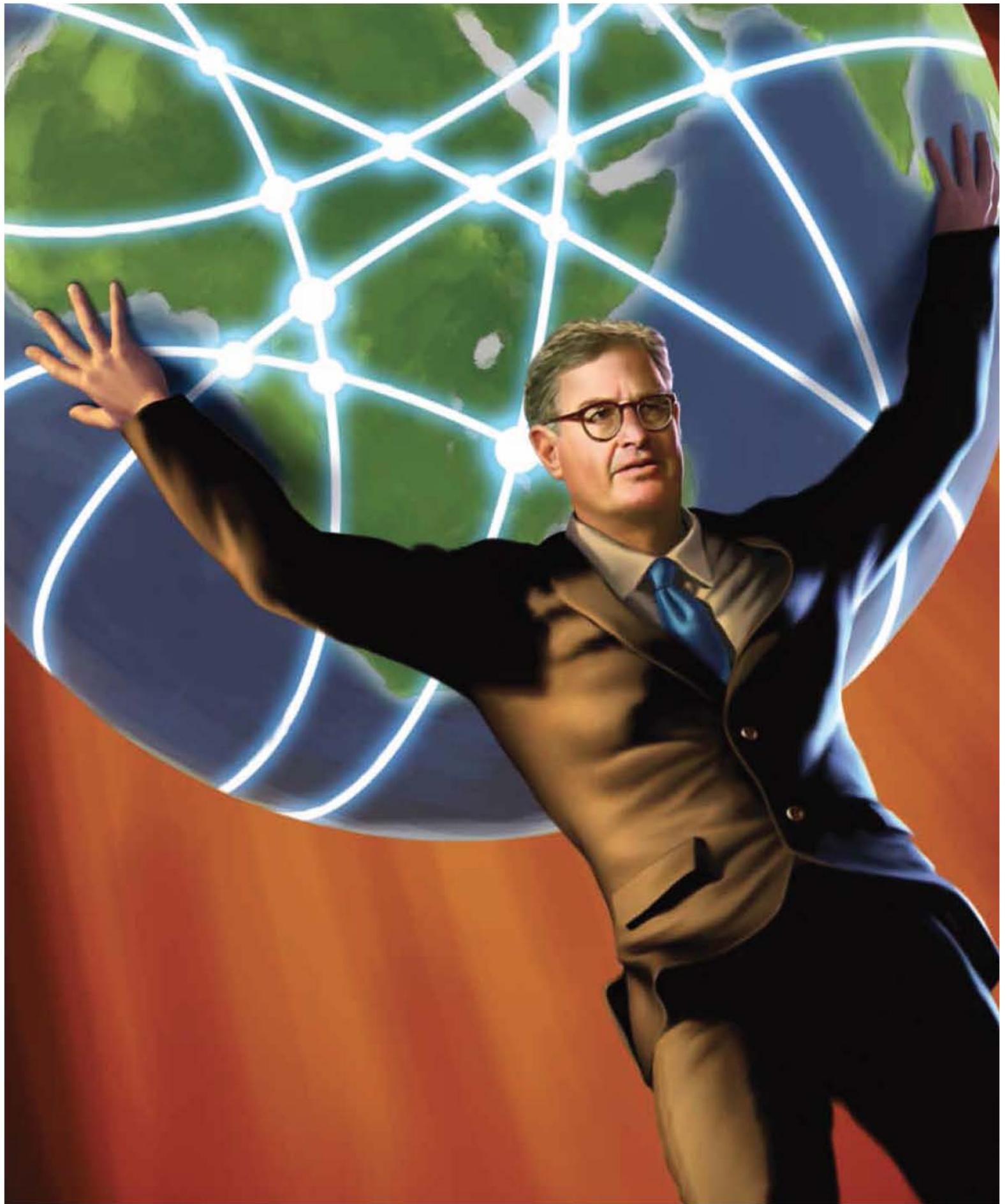
May/June 2014

- President's Letter
- 6 A New "Relativity Theory" for Boards
By *Kenneth Daly*
- Editor's Note
- 8 Local Connections
By *Judy Warner*
- The Director's Chair
- 10 Overwhelmed by Board Books? You're Not Alone
By *Denise Kuprionis*
- Need to Know
- 13 Pfizer Sets Sights Overseas, A Look at Audit Quality, More
- Delaware Watch
- 22 Business Judgment Rule, Board's Ouster of CEO Affirmed
By *Francis G.X. Pileggi and Kevin F. Brady*
- 40 Leading Minds of Compensation Readings
- 66 Inside Knowledge: Raised by Mother Merrill; Lessons From Avon's Jung
- Postings
- 70 Newly Appointed Directors at Dropbox, MetLife, Nike, More
- Boardroom Journal
- 80 California Dreamin', Immelt Watch, Quick Thinking
By *Jeff Cunningham*



Globalism 2.0

Former IBM Chief Samuel Palmisano reemerges with a globally focused think tank. Plus: Braving the governance maze and liability considerations for the "global director." 26





GLOBALISM 2.0

A perspective on the sometimes errant consequences of global business from 14th-century problems to a likely solution in the form of Sam Palmisano's Center for Global Enterprise.

By Jeffrey M. Cunningham

1347 was a not a good year for globalism.

The Hundred Years War was a melee of din and disorder, as England and France fought over disputed land dating back to William the Conqueror. Population waned from the effects of famine. Medieval Wall Street witnessed the world's first global credit meltdown. Genoese bankers gambled on good times and lost not just their ruffled shirts but had to watch as angry depositors busted up their benches where they sat and made loans—the term *banca rotta*, meaning “broken bench,” being the origin of our more modern *bankruptcy*.

Just when the Middle Ages thought things could not get worse, suddenly and maddeningly they did. Trade was in full bloom as ruthless Mongols turned entrepreneurs arrived in Western ports with leathers and spice, oblivious to the virulent bacteria in the stomachs of fleas that married themselves to the local rat community. Merchant sailors were infected by what was soon known as the plague. Disease spread along the trade route killing as much as 60 percent of the known world.

The bubonic plague of the 14th century ushered in the world's first anti-globalism movement. This consequence was not entirely absurd. Mayhem, death, the total destruction of villages, quarantines on a massive scale, and certainly ships and sailors avoided—well, like the plague—brought commerce to a crawl, everything but sanitation and population density considered the culprit, and in the end globalism got the blame. The famed tulip crash two centuries later in 1637 didn't help matters.

ILLUSTRATION BY BOB KAVGANICH

In that regard, not much has changed, according to Joseph E. Stiglitz, professor of economics at Columbia University and former chief economist of the World Bank. He writes in *Globalization and Its Discontents*, “International bureaucrats—the faceless symbols of the world economic order—are under attack everywhere. . . . Virtually every major meeting of the International Monetary Fund, the World Bank, and the World Trade Organization is now the scene of conflict and turmoil.”



Workers assemble toy cars at the production line in Dongguan, China, in this 2007 file photo. China’s reputation as a reliable export power has been on the line since millions of toys were recalled in scores of countries over fears of lead-tainted paint and potentially hazardous parts.

Globalism has always been controversial. Because its outcomes are inconsistent and winners and losers appear to be churned up like lottery drawings, it is hard for the average non-economist to get cozy with globalism—and it certainly doesn’t fit neatly into a 140-character tweet. Unlike famine, unemployment, outsourcing, downsizing, contamination, child labor, and the developing world, globalism has no face. Perhaps that’s why people retreat and deny it is a natural outgrowth of capitalism, which it is. Looked at presently, it may hurt on the local level while improving life somewhere else, usually far away. It takes a large heart and a superior mind to appreciate those benefits.

The challenge, as it turns out, is not to de-globalize but to learn to do globalism right, to anticipate its disconnects and discontents, and for CEOs, boards of directors, and public policy types to enlighten both business and society.

Even the plague ultimately had a bright side, at

least for the survivors: with fewer people to do the same amount of work, labor was scarce and wages rose; medieval overlords, while not exactly arranging 360-degree feedback sessions, made efforts to be more congenial; and indentured servitude began to vanish. People left declining villages to find better opportunities, and so language and culture were spread and society began to homogenize; skills became mobile and transportable; and small, poor farms and estates were deeded to the few remaining inheritors, increasing the wealth of survivors. These changed circumstances set the stage for the post-medieval Renaissance, and ultimately our modern world.

The Sum of Its Parts

Globalism is a team sport, accurately viewed by the sum of its parts. It is not warm and fuzzy like a child’s Pillow Pet or tasty like Nestlé chocolate or flashy like a Maserati, but collectively it is all those things. The world wants what globalism provides: easy access to goods, and not only the consumer kind, but also medical and technical innovations. We worship two words—cheap and available—and since globalism provides these better than any other “ism,” the argument should be not whether but how to be global.

Just as those who perished in the plague would be hard-pressed to admit the benefits of global trade, some folks decidedly do not want to bargain for a better collective future by losing jobs, wages, and commerce in their village markets, hard fought and sweetly desired, in whatever part of the world they happen to live. These are the challenges for policy-makers, management, and boards, and it is fitting that consumers from time to time boycott or bellow a decidedly non-global response until those problems get solved. A Google search of toys made in China today produces not brand names but headings such as “Toxic toys: Is China poisoning *your* child?” And how’s this for warm and fuzzy: “Child Slave Labor News: Children Making Toys for Children.” Do you really need to see more on the potential for globalism to go rogue? (The Chinese government should make a note to itself: in the future, spend as much on toy research as you do on cyber warfare.)

Globalism may move in mysterious ways, but it is inexorable and closely intertwined with capitalism,

according to someone who ought to know, Richard Fisher, CEO and president of the Dallas Federal Reserve: “Public policies associated with globalization do correlate with improved quality of life and greater economic freedom.” Writing for the Yale Center for the Study of Globalization in 2006, Fisher underscores this point, adding, “Citizens and companies do not seek to do business in faraway places for the sheer adventure of it. They do it because it makes them better off.” The point is that globalism is good but it can go bad. Fortunately, it is self-correcting; it has to be in order to triumph. Globalism’s presents obstacles are mainly a management and governance problem, and a public policy issue—the sorts of challenges American business is trained, or can be trained, to handle.

Globalism’s impact on specific regions gets a good deal of attention, although the ebb and flow is often caused by how these regions are governed. As Fisher points out, “Companies flee economies for a variety of reasons but primarily they run from those that burden them with high taxes, excessive regulation, and capricious administration.” These issues have clear and rational solutions for countries that wish to compete by winning, not by government fiat or instituting regulatory roadblocks.

By encouraging globalism, Fisher reasons, not only do we get a better economy but a better country. In economies with more emphasis on globalism, public policy tends to “support more accountability in the private and public sectors. These nations are more likely to maintain courts that recognize property rights and enforce the rule of law. Their governments are more effective and less corrupt. Policies in these more globalized countries tend to be more stable, essential for long-term planning by business,” he writes.

Global economies are more open, humanitarian, and modernized, according to A.T. Kearney and *Foreign Policy* magazine, which ranked roughly 60 countries from the most to the least globalized. The United States is the world’s fourth most-globalized country, behind Singapore, Switzerland, and Ireland, all countries known for peaceable policies and modern economies. By the way, Iran comes in last.

But there are warning signs too. Some drawbacks of globalism, Fisher notes, are that “governments tend to get bigger as nations become more inter-

connected to the world economy. Public transfers and subsidies increasingly pervade nations as they globalize, and personal income taxes become more burdensome as well....Likewise, as long as workers refuse to acknowledge they are competing in a global economy, they petition wealthy governments to protect their jobs...raise unemployment, in turn creating a greater demand for expensive safety nets for idle workers.”

Countries will need to recognize the importance of agile labor markets in a world that is more closely connected and competitive than ever—and companies will continue to look for the best workers at the best price. Managements will be charged with promoting employment policies that are effective, profitable, and sustainable over great geographic distances and cultures. Labor’s best chance to participate in the global economy is to develop skills that lead to high performance, or, as Fisher puts it, “adapt, compete, and get stronger.”

Think Global. Act Local.

Harvard’s Theodore Levitt wrote this pithy tagline in a 1983 *Harvard Business Review* article that popularized the concept of globalization for a new generation, and it has become a core principle for companies that want to do business abroad. That sentiment is amplified and taken to a new level by Sam Palmisano and his Center for Global Integrated Enterprises (CGE). Finding the right balance between global and local will be vitally important for international trade and world economies, poor and rich, big and small.

First, however, our companies need to be trained for globalization, and simply because it is a force of nature does not make it a natural. That is why what Palmisano is doing to help business and major corporate CEOs and their teams is so important, not just for the positive forces of globalism but for American business.

Ultimately, ensuring that the enterprise is a smart, sustainable, and responsible player on the world stage is the best, most practical, and least troublesome means of going global, according to Palmisano. The new challenges will be exciting and will require boldness to administer. So it’s time to get professional about globalism—online and in factories, retail shops, corporate headquarters, and the boardroom.

“Public policies associated with globalization do correlate with improved quality of life and greater economic freedom.”

—RICHARD FISHER

Rethinking the Corporation

In the future, multinational companies will organize around a transparent value system and supply chain.

Samuel J. Palmisano was chairman, president, and CEO of IBM from 2003 until 2011, a period of dynamic growth and change during which the company was transformed into a globally integrated enterprise (GIE), the modern version of what has traditionally been called a multinational.

Palmisano began his 39-year career at Big Blue after graduating with a degree in history from Johns Hopkins University. He currently serves on the boards of Exxon Mobil and American Express. Since his retirement from IBM, Palmisano has been quietly building a nonprofit think tank. The Center for Global Enterprise (CGE), which launched officially in April, is committed to improving the stewardship of global enterprises by working directly with CEOs and business schools.

In conjunction with the CGE, his recently published e-book, *Re-Think: A Path to the Future*, pays homage to the philosophy of IBM founder Tom Watson, who kept a one-word declaration on a notecard: "Think." The book, as well as the work of the CGE, is designed to "advance awareness among private and public sector leaders of the worldwide benefits that can result in the 21st century from corporate best practices and economic success" in what Palmisano calls a "new age of discovery." It details global efforts at IBM, China's Geely, India's Bharti Airtel, and Mexico's Cemex. The corporation of the future, Palmisano says, will organize around a single global supply chain for services, capital, talent, and intellectual property, managed as one entity, and with no duplication of services.

Palmisano, who agreed to be interviewed by NACD's Jeffrey M. Cunningham for this story, outlined his aspirations for this latest chapter in his career, his first outside of IBM that capitalizes on what he learned as a one-time steward of that 103-year-old enterprise.

You believe that if companies employ the best practices of the globally integrated enterprise (GIE), then the perception

of business will improve, shareholders will be rewarded, risks reduced, and society will be better off. Have I missed anything?

It may sound incredible at first, but I witnessed this example at IBM, where I spent 39 years and [which] quite literally was my laboratory for global experimentation. The experience gave me a bias that business does a tremendous amount of societal good and society wants business to be successful, and on the flip side business can do some unfortunate things from time to time that have hurt credibility. So we need to understand how to operate more effectively in different cultures, because without them our business would cease.

Can you give us the Cliffs Notes version of a globally integrated enterprise?

Simply put, I believe companies need to go far beyond merely building a global supply chain and offshoring product manufacturing, or what I refer to as the "hub and spoke" method. Instead, we believe in developing a new type of global operation, one that is structured to cross borders both culturally and operationally, placing teams and divisions where they make the most sense, create the best work, and deliver a profit for shareholders. Driving cohesiveness in that structure is the challenge of the GIE, not necessarily finding the cheapest market for labor or production.

Where do you propose business leaders start to build a GIE?

Start by changing how you lead your company. Second, consider how business schools prepare future leaders, especially at the CEO level. To do that properly, you will need to have a global mind-set and a value system that connects both locally and globally. A commitment that transcends geography will be crucial.

What's the downside to sticking with a traditional multinational mind-set?

If you bring a legacy mind-set to the



INDIA TODAY GROUP/GETTY IMAGES

modern business climate, I don't think you're going to be in the game very long. Sovereign countries simply aren't going to give you the freedom to operate that business enjoyed, say, 25 years ago.

OK, so a major industrial company with a huge labor component has to toe the line, but what about Silicon Valley or technology companies—will they have the same challenges?

There may be misperceptions in certain industries that they are excused from this, as in "Our company is flying like a rocket. We are far beyond these kinds of things." But my argument is that you are only in Act One. You will have to get to Act Two, and when you do, you'll be globally integrated along the lines I am suggesting, or you may learn the hard way that nothing lasts if it doesn't change and adapt.

What inspired you to develop the globally integrated enterprise?

The idea first came to me when I was in mid-career at IBM. I was heavily influenced by the time I spent working at IBM Japan, which was a truly Japanese company, and so I got to look at the world through a Japanese lens. I recognized that to be successful you needed to have more of a global perspective, not define yourself by any one particular geography. Second, I saw that it would be useful to take an outsider's objective view, and even be a bit of a contrarian. This view was what led me as CEO to sell the PC business at a time when everybody thought that was crazy.

What made IBM Japan such a good a role model for global integration?

IBM Japan was never a joint venture, and that's the main takeaway. It was a country operation in the global IBM, and it was very successful, representing nearly 17 percent of the earnings of the company. So I asked myself the question, why? It turns out the reason was because we were fully integrated and we were committed to and embedded in Japanese society and business culture. From there the idea just sort of took hold for me.

What are the main practical benefits about operating as a GIE?

You're going to be much more productive and, at the same time, you should be faster. Now, someone asked me, "What if you got your strategy wrong?" I said then we get to the wrong place faster. So, if you have the right strategy, or a wrong strategy, either way, you will find out sooner, and from a management perspective, you win.

What about corporate controls and risk management?

I say, get over it. You have to lower the center of gravity by moving decisions to where the local intelligence resides. You have to

trust the people that are really smart. You have to let them operate and hold them accountable to a set of values and standards that are beyond those required by regulators anywhere on the earth.

Help me understand just what's wrong with command and control then.

In today's world, it's too slow and redundant. You are engaged in a replicative process that might make headquarters feel warm and fuzzy, but in fact what you get is mirror versions of treasury, IT, training, [and] hiring, and essentially you are going to have many, many versions of IBM headquarters in 100 countries. I call that inefficiency. I also think it does not really control anything, which is the greater problem.

Is there a CEO management style that best suits the GIE?

It's not about your reputation for brilliance in the corner office. It's about your team and about having the best people you have in the critical functions of your business, anywhere in the world, and letting them run their show. When Joe Montana got on the football field, his coach would let him throw the ball to [wide receiver] Jerry Rice. He didn't go out and put his hand on Montana's and help him toss the ball over the offensive line.

Does training play a role in building GIE culture?

It takes training, to be sure, but it's on behalf of something very potent, a standard of behavior and comportment. I think all companies should have a standard we call the value system. And at IBM the highest of those values was integrity and trust in all relationships. We did this in person and online so that we could train literally everybody, half a million people, including the CEO, so I went through it as well. That's what takes the place of command and control in a GIE culture.

Does training mold people, or does it, like the SEAL team bootcamp, weed out those who can't hack it?

IBM's secret was its onboarding program. When you join IBM, part of the onboarding process is to learn the value system, what it means to be an IBMer, and what the brand stands for. You will learn with certainty, it stands first for integrity. And you can't compromise the brand identity regardless of the temptations. I don't care how strong of a performer you are.

Did everyone get the value system?

Most, yes, but not all. Those that don't quickly decide they don't want to work in a place like that, which is why we never had a problem with people leaving during the onboarding process.



Sam Palmisano speaking before the Asia-Global Dialogue conference in Hong Kong last year.

So, to some this probably sounds great for companies with a legacy of appropriate behavior, but does it work in other industries, particularly in what I will call more cynical geographies?

Jeff, we had people in 170 countries, and one thing I have learned is that the United States may be culturally different but not culturally superior. People have told me more times than I can recount, “Sam, really, it’s different there.” I’ve got news for you, it is not different there. You have to teach your value system all over the world. Then you have to put your money where your mouth is, and you have to reward them for conducting themselves in a certain way. You have to reinforce the value system. The U.S. doesn’t have a monopoly over integrity and trust.

You had a 39-year career at IBM and rose to CEO. What inspired you most?

I was the eighth CEO in 100 years, and I learned that I was a steward of a wonderful enterprise for a defined period of time. I found it was important not to try to be defined by what I’ll call charisma, or making yourself the brand or the headline, or showing up on TV, you know, waxing eloquently about whatever you want. I’m not knocking CEOs who favor that approach, I’ll just say it wasn’t for me, and I don’t think it’s particularly effective over the long term.

To me, as a CEO, you are given the opportunity to be a steward of an incredible legacy and your job

is to leave it better than you found it. It’s not about yourself, it’s not about how much you got paid, it’s not about how many press releases you issued, it’s not about how many conferences you went to with heads of states. It’s about the value of that enterprise and was it stronger after you left.

I think many would agree. But sometimes things go wrong.

Yes, stuff happens, as the expression goes. The question I ask myself is: “How did you react when it did? Were you totally transparent? Did you fess up and deal with the financial implications? Were you out front taking responsibility and staying on the case until it was solved?” I really still have a bias that you’re much better off standing up and speaking factually, when you know the facts, or keep your mouth shut until you have the facts, and state that you may not have them. But don’t hide behind public relations, lawyers, and allow rumor to set the agenda. Transparency, action, resolution—then put it behind you.

Sometimes we find American companies have trouble operating in countries where rules can be more ambiguous than ours. What do you say in those cases?

You have to choose your countries of operation, that’s for certain. It’s not just where there is growth and we will go there and figure out how to do business. There has to be a fit in the value systems. To the country, I would say, “We want to do business, but we are not going to legitimize your behavior until you have a rule of law, you’re going to agree to the international arbitration, you’re going to have stronger intellectual property regulation, and so we’ll come back when you’re ready, when your society is ready to enter into what we will call global international compliance.”

Is it about fundamental ideologies?

At IBM we were OK with whatever ideology a country had. And frankly, it wasn’t any of our business. We never got ourselves confused by ideology. It’s more about consistency. And if they were consistent with us over the long term, we felt that was a

JEROME FARRELL/OLYMPIA VIA GETTY IMAGES

very good place to operate. So even during the [business] cycles of Mexico, IBM did pretty well because there was consistency.

Are there new sets of stakeholders for the GIE?

At the end of the day, you work for your owner, and your owner is the shareholder. I feel there is an equation for GIEs that makes sense and is quite simple: You have to work for the shareholders; they own. You have to serve your clients or you don't have any revenue. And then if you did those two things right, well, you should reward your employees and give back to society.

Is there a new role for board directors in the GIE, and does it require new skills?

It gets back to looking for directors that have broad global experience. I am on two boards, Exxon Mobil and American Express, that are splendid examples of boards that meet this kind of chal-

lenge. As far as having to change out directors, more likely, if you see yourself playing this role of becoming a GIE, you need people on the board that understand what you're going to go through. So I would start with your specification of a job, and as director assignments come up as they always do every year or two, I would basically take that opportunity to build out the right skill set.

What made you start the Center for Global Enterprise?

I thought about that as I was getting ready to retire. There are lots of different ways to spend your time. You could be a resident executive at a business school, for instance, but I was looking for something that would provide the same involvement but at more scale. So the CGE sort of appeared from that thinking. Our plan is to engage global CEOs to help us guide the research, and then expand the primary data so that future generations of leaders are better prepared than I when I became the CEO of IBM. It's going to be exciting.

Braving the Global Maze

By Alexandra R. Lajoux

Corporate leaders have known about our global economy for centuries, but until recently it was more tempting to focus on opportunities than on risks. To be sure, there were those pesky financial panics, but these could be scapegoated. From Dutch tulips to Mexican debt to Asian banks, big crises have always had a specific national and even industrial origin. But the one that burst on the world scene in 2008, sporting an unprecedented label of “global financial crisis,” was different. It was utterly, intrinsically, and permanently global. This chain of events—in which the collapse of several large multinational firms triggered worldwide economic fault lines—has proved beyond a shadow of doubt that national economies today are part of a larger system.

One indicator of this is the annual outflow and inflow of goods, services, and investments in any given country. Take the United States. We have had a balance-of-payments deficit for decades (it's currently nearly \$400 billion), but that's not new. What's new is the relative magnitude of the numbers that it comprises. According to the Bureau of Economic Analysis (BEA) in the U.S. Department of Commerce, by the end of 2013 the United States had exported \$1,589.7 billion in goods and imported \$2,293.6 billion in goods. Service exports totaled \$681.7 billion, imports \$452.7 billion. Regarding investments, income receipts on U.S.-owned assets abroad were \$782.4 billion (essentially exports), while U.S. income pay-

ments on foreign-owned assets (essentially imports) were \$545.0 billion. Of these six numbers showing the outs and ins of payments for goods, services, and investments, only one number was down—imports of goods. Most of the component numbers grew from the previous year—a clear indication that the global interdependence of the United States is increasing, a trend that may become even more obvious in July, when the BEA launches a more integrated reporting format for these global trade numbers.

How are boards responding? Some have added standing committees with a global focus. Sonic Foundry has a new markets committee to “to assist the board in fulfilling its responsibilities in relation to assessing and managing the company's entry into foreign markets.” (See sidebar, page 34.)

Other boards are looking to find more directors with international expertise. In 2013, when asked what attributes were most important for director recruitment in the past year, 16 percent of respondents to the NACD *Public Company Governance Survey* selected global expertise, making this the fourth highest-ranking trait, after financial expertise, industry expertise, and leadership experience. As of November 2013, a majority of the companies in the Fortune 200 had at least one non-U.S. director, according to Spencer Stuart. In Western Europe, there has been a pronounced trend to recruit directors from outside the company's national base, reports Russell Reynolds. Denmark, Germany, Norway, Spain, Sweden, and Switzerland have all seen notable increases in the percentage of direc-

tors of foreign nationality over the past three years, while Belgium, France, Italy, the Netherlands, Poland, and the United Kingdom have also seen increases, albeit slight ones. At NACD, 5 percent of our 14,000 members claim a non-U.S. address.

Global Financial Literacy

As part of global expertise, boards are looking for new levels of financial literacy, commonly defined as the ability to read and understand financial reports (e.g., balance sheet, income statement, and cash flow statement). “We get a lot of calls for directors who have had global P&L responsibility,” notes Judy Smith, chief board recruiting officer at NACD who manages NACD’s Directors Registry, referring to the challenge of making profits and avoiding losses in the global arena.

For more than a decade, financial literacy has been required of audit committee members in companies listed on both the NYSE and Nasdaq, and there are parallel requirements or expectations in other countries. For example, Canadian Securities Administrators’ National Instrument 52-110 on Audit Committees requires

financial literacy of all members of the audit committee, and the Corporate Governance Code for Russia states that audit committee members “should possess special knowledge of the basics of accounting and financial reporting.” But what do all these financial literacy requirements really mean for the director of the *global* enterprise, which may involve more than one set of accounting or reporting standards?

Global Accounting Convergence

As far as accounting goes, global directors may need to know the International Reporting Standards (IFRS) of the International Accounting Standards Board (IASB), but they need to know their domestic standards too. For example, directors of multinationals based in the United States must heed the requirements of the U.S. body, the Financial Accounting Standards Board (FASB), known as Generally Accepted Accounting Principles (GAAP); other countries have equivalent bodies and principles. In fact, representatives of 12 such bodies, including, for example, those from the United States, Australia, Germany, Japan, and South

Bylaws of Sonic Foundry’s New Markets Committee (founded January 2013)

Purpose and Responsibilities

The Committee shall have the following purpose and responsibilities:

1. To provide expertise to assist management in developing market entry plans for China and other selected markets;
2. To assist the management team in assessing responses from potential partners in the selected markets;
3. To provide access to contacts that may be influential in facilitating entry;
4. To monitor the outcomes of market entry strategies;
5. To review general market conditions and how these may present or limit entry into new markets;
6. To monitor new opportunities for international expansion;
7. To assess the risk related to undertaking business in foreign countries, including but not limited to the following:

- difficulties in establishing and managing international distribution channels or operations;
- difficulties in selling, servicing, and supporting overseas products, translating products into foreign languages, and compliance with local hardware requirements;
- the uncertainty of laws and enforcement in certain coun-

tries relating to the protection of intellectual property or requirements for product certification or other restrictions;

- multiple and possibly overlapping tax structures;
- currency and exchange rate fluctuations and controls;
- difficulties in collecting accounts receivable in foreign countries, including complexities in documenting letters of credit;
- economic or political changes in international markets;
- difficulties in complying with conflicting and changing governmental laws and regulations, including international employment-related requirements; and
- law and business practices favoring local competitors.

8. To recommend risk management strategies related to the above;
9. To report to the board on a regular basis, and not less than once per year; and
10. To perform any other duties or responsibilities expressly delegated to the committee by the board from time to time relating to the company’s business operations.

Korea, serve as advisors to the IASB. In the end, though, the national standard setters are not obliged to conform to IASB.

The FASB has worked with IASB on a global conceptual framework for accounting, as well as a global standard for revenue recognition—arguably the single most important accounting issue—and the two organizations are still working together on lease accounting despite some differences there. On some topics, however, they are so far apart that they have halted previously launched collaboration. For example, they have parted ways on how to account for securities appearing on a balance sheet, and on how to classify elements of compensation (the old equity versus debt dilemma).

Still, despite the IASB's differences with national standard setters, IFRS accounting standards are increasingly important. Many subsidiaries of multinationals based in Europe must comply with IFRS reporting requirements rather than their parent company's requirement in the headquarters country. (See Washington Update, page 20.)

Global Reporting Convergence

But accounting isn't the whole story. There is also the question of financial reporting requirements, which extend far beyond the financial statement numbers to include other numbers—as well as narratives. In the United States, mandated narrative reports to supplement financial accounting include the Management Discussion and Analysis (MD&A) within the annual report/10-K, and the entire text of the proxy report/Form 14A, which is generally not about financial matters (with the exception of compensation reporting), but rather about governance.

Hot disclosure topics in global reporting include the following:

Multi-country reporting—still a dream. Most annual reports of global companies are consolidated. Companies are under no obligation to give a country-by-country breakdown of financial results or economic activities. Transparency International is urging this level of geographic transparency in reporting.

Reporting payments to governments—attention extractors. Country-by-country disclosures of payments to governments are mandated in the U.S. and Europe for payments made to governments, but only in extractive industries. In the U.S., this is covered by Dodd-Frank Section 1504 (where vacated rules are still pending). The European Union passed a directive on this in 2013, to be implemented by July 20.

Non-financial Reporting: Multiple Alternatives

In non-financial reporting, there is a wealth of options, including a reporting template from the Global Reporting Initiative (GRI), guidance on integrating material non-financial information into the financial reports (Integrated Reporting), as well as two other sources—a

U.S.-based sustainability accounting body and the United Nations.

GRI—unveiling G4. Thousands of companies, including over 90 percent of the largest 250 companies in the world and over 70 percent of the largest 100 companies in 41 countries, disclose sustainability in detail, some within their annual reports and some in a separate report. More than 5,000 organizations of all types and sizes have used the GRI guidelines. In May 2013, the GRI released its fourth protocol for reporting on non-financial matters, G4.

Integrated reporting—tell your story. The International Integrated Reporting Council (IIRC), founded in 2010 and based in London, unveiled integrated reporting in 2013, but it is not merely about reporting; it is about thinking—or, as the IIRC explains, “the active consideration by an organization of the relationships between its various operating and functional units and the capitals that the organization uses or affects.” This approach recognizes that financial accounting fails to capture all items of value. The IIRC foresees “a world in which integrated thinking is embedded within mainstream business practice in the public and private sectors, facilitated by IR as the corporate reporting norm.”

SASB—a U.S. voice. The U.S.-based Sustainability Accounting Standards Board (SASB), founded in 2012, is developing a set of standards for reporting non-financial data in financial reports. It aspires to be the “U.S. voice for material non-financial issues and how to recognize and account for them as part of corporate reporting.”

The United Nations—we are the world. At its 66th session in 2012, the United Nations approved “The Future We Want,” also known as the Rio Outcome Document, named after the location of its historic 2012 Conference on Sustainable Development. A key paragraph declared: “*We acknowledge the importance of corporate sustainability reporting and encourage companies, where appropriate, especially publicly listed and large companies, to consider integrating sustainability information into their reporting cycle.*”

How They Fit Together

These reporting reforms overlap and compete, but their convergence is promising: we need them all. As sustainability blogger Elaine Cohen writes, they can “each deliver unique and equally valuable elements of corporate transparency and accountability.” The IIRC and SASB are focused on reporting, improving accuracy for investors, while GRI and the U.N. are focused on improving world conditions. Fortunately they are all working together. The GRI CEO has a permanent place on the IIRC board, and in February 2013, GRI and IIRC signed a memorandum of understanding promising to share information and strive for “complementarity” in their respective frameworks. So it looks as though convergence is happening at last.

Liability Considerations for the “Global Director”

By Holly J. Gregory

With the globalization of business operations and investments, opportunities to serve on the board of directors of a foreign company, or on the board of a U.S. company that has a majority of its assets and operations outside the United States, have increased. Those contemplating serving on such boards need to be aware of the laws that govern director responsibilities and the potential for liability.

When invited to serve as a global director, consideration should be given to the potential legal risks related to director obligations, and also to the systems that the company has in place to ensure that it is in compliance with the laws and regulations that generally apply to its operations. Director candidates are advised to undertake due diligence regarding their anticipated responsibilities and obtain assurance that the company has adequate controls in place related to legal and regulatory compliance, as well as appropriate information systems.

Candidates should also review D&O insurance coverage and indemnification provisions and any exceptions or exclusions that apply. Attention should also be given to understanding any differences in business culture and ethics in the primary jurisdictions of operations. Finally, honest self-reflection is required with respect to whether one has the capacity for service as a fiduciary in circumstances that likely present significant travel demands, potential language barriers, and cultural challenges.

Both U.S. and foreign companies seek directors from other jurisdictions for a host of reasons, including:

- the need for specific international or geographic expertise with respect to business objectives and operations;
- the need for international or geographic oversight capacity related to strategy or risk management; and
- in some jurisdictions, compliance with gender quotas.

Where a company is incorporated and on what exchange lists its shares may also be a factor. For example, a foreign company listing shares on the New York Stock Exchange or Nasdaq may seek to enhance investor confidence by adding American directors to its board. Similarly, a company that is substantially operated in a foreign jurisdiction may incorporate in Delaware or another U.S. state and seek U.S. directors to gain credibility with investors.

The jurisdiction of incorporation generally provides the law that governs the internal affairs of the company, including the duties of directors. For example, Delaware corporate law governs the fiduciary duties of directors of companies incorporated in Delaware, and New York law governs the fiduciary duties of directors of companies incor-

porated in New York. A similar choice of law rule generally applies in the United Kingdom and in other European Union member states.

Thus, in the European Union the law of the jurisdiction of incorporation determines the duties of the members of the board of directors or supervisory board (in a two-tier system). Outside of the United States and the European Union, it is likely that a similar rule applies with respect to defining director duties in most instances. There may be circumstances, however, in which the laws of the jurisdictions in which the company operates could impact director liability for corporate actions. Therefore, understanding the specific areas of potential liability for a director resulting from international operations requires advice of counsel.

The jurisdiction of the incorporation generally provides the law that governs the internal affairs of the company, including the duty of directors.

Note that in most jurisdictions directors are recognized to owe duties that include concepts of care and loyalty, although there is significant variation in how the duties are framed and who can enforce them. Additionally, in some jurisdictions directors may have circumstance-driven obligations to provide heightened consideration to the interests of specific constituents (for example, in some jurisdictions, the board may have specific obligations to employees or, in certain circumstances, to creditors).

What constitutes prudent care by directors is context driven. To serve as an effective steward requires a general awareness of the business operations of the company and oversight regarding compliance with the laws and regulations that apply, including laws and regulations that may extend well beyond the jurisdiction of incorporation. For example, the laws of the jurisdiction in which a company has operations will generally apply to issues such as labor relations, business conduct and contracts, and environmental protection in that jurisdiction. Other laws have broad extraterritorial reach, such as anti-bribery and anti-corruption laws including the Foreign Corrupt Practices Act of 1977 (FCPA) and the U.K. Bribery Act of 2010.

Individual directors generally are not expected to have expertise regarding the laws and regulations that apply in all the jurisdictions in which the company operates. However, they should confirm that

the company has access to adequate internal and external legal expertise. Directors should also confirm that the company has established compliance and reporting systems that are designed to ensure that the company abides by applicable legal and regulatory obligations.

In an unusual bench ruling in February 2013, in the *Puda Coal* case, Chancellor Leo E. Strine Jr. of the Delaware Chancery Court addressed the obligations of directors of a company incorporated in Delaware with significant assets and operations located outside the United States. The case involved a fiduciary duty claim brought by shareholders against the members of the board of a Delaware corporation for their alleged failure to protect against the unauthorized sale of substantially all of the assets of the company located in China by the company's chairman. Upon learning, after the fact, that the company's assets had been sold and the proceeds taken without any board authorization, the U.S. directors resigned. In denying a procedural motion to dismiss the case, Strine chastised as follows:

"Independent directors who step into...situations involving...the fiduciary oversight of assets in other parts of the world have a duty not to be dummy directors. [I]f the assets are in Russia, if they're in Nigeria, if they're in the Middle East, if they're in China...you're not going to be able to sit in your home in the U.S. and do a conference call four times a year and discharge your duty of loyalty. That won't cut it. [T]here will be special challenges that deal with linguistic, cultural and other [issues] in terms of the effort that you have to put in to discharge your duty of loyalty. There's no such thing as being a dummy director in Delaware, a shill, someone who just puts themselves up and represents to the investing public that they're a monitor."

Strine reminded directors that they should be concerned about taking on service as a fiduciary where the flow of information is in a language they don't understand and the culture, the legal strictures, or ethical mores may not be as advanced as those with which they are generally familiar. By emphasizing the relation between these issues and the duty of loyalty, Strine put directors on notice that service on the board of a company with significant foreign operations without appropriate attention, and the opportunity to provide that attention, poses a significant risk of personal liability for directors.

Candidates for a seat on a foreign board or a board of a domestic company with significant foreign operations should consider the following before accepting an invitation to serve:

- What is the role and duties of the board of directors under the specific laws of the jurisdiction of incorporation?
- What are the duties of individual directors? Can individual directors be held personally liable for a breach of those duties?
- What information systems are in place to ensure that all directors are well informed about corporate activities? How will any lan-

guage differences be addressed? Will discussions and documents be in a language that all directors are fluent in? Will discussions and/or documents need to be specially translated for some directors?

■ Who can enforce director duties or bring actions for breach? What courts are such actions heard in, and how competent are they to deal with sophisticated issues?

■ What controls and procedures are in place to give directors reasonable assurance that the company complies with laws and regulations in all of the jurisdictions in which it operates?

■ Does the company have adequate D&O insurance coverage with a reputable carrier and appropriate indemnification provisions? Are there any unusual exceptions or exclusions that apply?

■ Does the company have a strong internal legal team with a leader who has a respected position in the senior executive team?

■ What systems are in place to ensure that directors can take a deep dive into underlying information as necessary?

■ Are high-quality advisors in place related to legal and financial obligations, and are those advisors fluent in the language, requirements, and culture of both the jurisdictions in which the company operates and the home jurisdictions of global directors, such that they can help to bridge gaps in understanding?

■ Are there any significant differences in cultural and ethical expectations that could lead to misunderstandings or disagreements among directors and/or as between members of the board and management?

■ What is the tenor within the company and in its primary jurisdictions of operations with respect to ethics and integrity?

■ Are there any special circumstances, for example, related to a controlling shareholder or sovereign wealth fund, that may impact the ability of independent directors to have meaningful influence?

■ Under what circumstances have directors left the board?

■ What is the board's reputation for effective governance? What specific governance challenges has it faced, and how has it handled them?

■ Do I have the time, attention, and capacity to serve as a prudent fiduciary in circumstances that likely present significant travel demands, potential language barriers, and cultural challenges? **D**

Holly J. Gregory is a partner in Sidley Austin's New York office and co-head of the firm's global corporate governance and executive compensation practice. She is the incoming chair of the American Bar Association's Corporate Governance Committee. Also contributing to this article was Sara N. Shouse, associate in the securities group in Sidley's New York office.

This article has been prepared for informational purposes only and does not constitute legal advice.