On Boards of Directors:

Power, Reality, Incentives and Value Creation

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1. Introducing the elephant in the room

The issues of corporate governance, in general, and Boards of Directors, in particular, are fields of thought where it is always difficult to generalize. Indeed, there are many different types of companies depending on their ownership structure, from large listed companies with atomized capital and a free-reigning management team to companies where there is hardly an agency problem because a majority shareholder is also the CEO, or family businesses with different branches and non-family CEOs in which no member of the Board holds a significant stake in the business. All these Boards have commonalities, but there are also significant differences among them. There are also big differences between the business culture in the Anglo-Saxon world and that of continental Europe or Asia. It is therefore inevitable that some of these thoughts, which I understand apply to most Boards, will leave out particular cases.

The ultimate power of the business lies in its owners, but in companies in which ownership and management are separate, a Shareholders' Meeting held only once a year is clearly insufficient to oversee and judge the state of affairs of the business, so shareholders consider it appropriate to establish a delegated governing body in order to maintain such control throughout the year. This is the origin of the Board of Directors, in which the supposed representatives of the shareholders meet more frequently and have access to a greater level of information, even though in this process a subtle yet substantial change has taken place: in the Shareholders' Meeting, the strength of the vote is solely determined by the percentage held by each shareholder, and each shareholder limits his liability to his stake; in the Board of Directors, on the other hand, one man equals one vote, so the director acquires a great deal of power. At the same time, under Spanish law he is liable for collective decisions, responding even with his own net worth (unless he has explicitly voted against).

Yogi Berra said that "in theory there is no difference between theory and practice, but in practice there is", and Spanish Professor Dalmacio Negro describes the present times as "a rationalist era inclined to despise reality" in his book *La Ley de Hierro de la Oligarquia*. Undoubtedly, the question of corporate governance is a blatant example of contempt for reality in which theory and regulations cling to legalisms that have little to do with the always stubborn reality, because reality is so complex that it often escapes pigeonholing and closed definitions. For example, in theory the Board of Directors has all the authority in the world; in practice this is usually not the case. How many proposals from the management are overturned by the Board? In theory it is the Board of Directors who chooses the CEO, but then it is the CEO who chooses the Board members. How many Boards of Directors fire their CEOs? The issue becomes even more entangled. There is an immutable rule that states that authority and responsibility must always go hand in hand: if I am responsible for results, I must have the authority to influence those results, and if I have the authority to change reality, I must take responsibility for the results of my decisions. When this rule is broken, bad things usually happen. Take the case of the politician or the bureaucrat who, endowed with enormous authority and protected behind the shadow of the State and an endless tangle of rules, and whose actions or omissions can ruin an individual, a business or a whole country, has, however, no legal or economic responsibility whatsoever. He is not responsible for the consequences of his decisions. He can screw it up and yet go away unscathed, a fact that doesn't exactly encourage responsible behavior. At the other extreme we find the figure of the

Board's director who, despite often lacking real authority, is legally responsible for everything, signs the firm's accounts and may be obliged to personally respond for others' misdeeds.

In such an environment in which Corporate Governance literature stands completely detached from reality, the academic world and the endless body of corporate governance regulation do not usually emphasize the most relevant figure in the Board, which is the individual who holds the power, which I will call the power-holder. He's definitely the elephant in the room. As a power structure, it seems natural to apply to the world of business the Oligarchy Iron Law (so well developed by Professor Negro), which states that in any organization and under any system of government (democracy definitely included, in spite of its name), power is always held by a handful of people. Napoleon, a true expert on power, went even further: "large assemblies are boiled down to cliques, and cliques are boiled down to just one person". And the writer and philosopher Ayn Rand, in her novel The Fountainhead, makes a perhaps excessively stark definition of a Board of Directors: "one or two ambitious men - and a lot of ballast". Power, in short, tends to be concentrated in one person and, in the case of the Board of Directors, we will simply call that person the power-holder. This brings us to the fundamental principle of Corporate Governance: the Board of Directors will work if the power-holder wants it to work, and it will not work if the power-holder does not want it to work, and generally the power-holder does not want it to work.

In this short essay we will develop several concepts around this figure. We will start with the agency problem, the biggest challenge facing any Board of Directors, and then emphasize the difficulties actually faced by Boards in operating effectively as a team, such as incentive systems, the regulator's blunders in establishing rigid categories of board members and canonizing the (supposedly) independent board member, and the challenge of avoiding groupthink. Finally, we will comment on those areas in which the Board, despite all these obstacles, might add great value to the business.

2. The agency problem, conflicts of interest and asymmetric risks

In most large companies ownership and management are separate and shareholders feel the need to oversee and monitor the managers. Why? Because of the agency problem, that is, the potential conflict of interest between the two. Since Michael Jensen coined this term in 1974, this conflict of interest is so documented and is so obvious that it is hard to believe that it is still politically incorrect to mention it. Jensen defined an agency relationship as one "in which one or more persons (the principals) hired another (the agent) to perform a service that included delegating some decision-making authority to the agent", and stated in velvety fashion that "there are good reasons to believe that the agent will not always act in the interest of the principal". The principal, therefore, will seek to establish systems of supervision and incentives to limit the potential damage caused by this divergence of interests. The agency costs will be the sum of the supervision costs, the cost of incentives and the loss of value which, despite the foregoing, the principal suffers when the agent chooses his interests in the event of conflict.

As always happens with issues regarding the immutable human nature, the agency problem is not exactly new. Some 2,000 years ago, Jesus walked around the small towns of Israel talking in parables so that the people could understand His message with stories familiar to their daily lives. You might remember one of these parables: "A good shepherd lays down his life for the sheep. A hired man, who is not a shepherd and whose sheep are not his own, sees a wolf coming and leaves the sheep and runs away, and the wolf catches and scatters them. This is because he works for pay and has no concern for the sheep" (John 10, 11-13). The parable of the dishonest steward (Luke, 16, 1-8) is another example of the fragility of the agent's fiduciary duty. Indeed, management has its own interests, which often clash head-on with the shareholders' interests. First of all, obviously, shareholders pay and managers get paid. Managers will want to get paid more and shareholders will be interested in paying less. Secondly, the shareholder has financial downside risk, that is, he can lose his net worth if the business performs badly or even goes bankrupt. That's not the case for the manager: his downside risk is professional (due to the loss of his job, usually temporary) and reputational (even more ephemeral than the previous one), but in any case his reward-risk map is usually completely asymmetrical: if he wins, he wins a lot, if he loses, he doesn't lose much. The manager hardly loses his net worth, he doesn't get ruined. What's more, in many cases he manages to eliminate such risk with oversized pension plans, ironclad contracts or golden parachutes that almost make him wish he were fired.

As Herbert Allen, the very discreet founder and Chairman of Allen & Co, recalled, the real partner is the one who shares downside risk with you. Indeed, sharing downside risk is the fundamental alignment of interests that can reduce agency risk. Already in 1700 B.C. the Hammurabi Code ensured that the quality of construction was excellent with an expeditious incentive system: "If a bricklayer builds a house to a man and does not consolidate his work well and the house he has just made collapses and kills the owner of the house, that bricklayer will be executed. If a son of the owner of the house dies, let them execute a son of that bricklayer". It was quite simple: the bricklayer shared downside risk. When the king was the one who personally led his troops into combat and personally charged in the frontline, he thought twice before declaring war. It is decidedly not the same as declaring war from the

armchair of a presidential palace thousands of miles away from the battlefield. When the king personally financed the wars, he carefully analyzed all possible scenarios from the point of view of prudence. That's quite different from recruiting the youth under coercion with a minimum wage that doesn't even come from the pockets of whoever sends them to kill and die. Another example is that of ship captains, who should be the last to abandon ship if it sinks, or airplane pilots. Would you be equally comfortable travelling by boat or airplane if the person responsible for steering the ship or piloting the airplane were on land using remote controls while sipping coffee? Undoubtedly, sharing the downside reduces risk. Shockingly, "modern" compensation systems, instead of correcting the asymmetry, aggravate it. An obvious case is the widespread stock options' schemes that became fashionable with the bull market of the 80s and 90s. Let's make it clear that I firmly believe in the incentive power of generously sharing the profits that can be attributed to extraordinary individual action (the share price largely escapes such requirement), but I also believe in the fairness of sharing the losses; I advocate sharing success, but also failure; reward, but also risk. A good director helps reduce the agency problem, not aggravate it. He thus defends the shareholders' interests and not the managers', even when the power-holder belongs to the management.

The agency problem between shareholders and managers has another component of asymmetry in addition to the asymmetry of risk and reward: the asymmetry of information. Indeed, managers have much more information on the business than the Board of Directors or the shareholders. The job of a good director, in this case, is to remain unintimidated by the superior knowledge of the management on the business, to demand the necessary information to be able to make a decision and to trust his common sense and his own experience, always applying a light coat of the healthy varnish of skepticism. The quality of the reporting to the Board, the sending of thorough information well in advance of meetings and the proportional time allocation in the meetings according to the importance of the issue under discussion are all essential tools that help mitigate the inevitable asymmetry of information.

Unity is strength. The more atomized the capital, the less power the shareholders will have to effectively supervise the management. In fact, Michael Porter, the famous Harvard's Corporate Strategy specialist, wrote that "the natural instinct of many managers is to seek fragmented property in order to preserve their independence from owners in decision-making". In this sense, the last decades have produced what I call "the death of the owner". Large listed companies lack relevant shareholders and have an enormously fragmented capital and, even worse, these shareholders have become transient shareholders. In Porter's own words, "p*erhaps the most basic weakness in the American system is transient ownership, in which institutional agents are drawn to current earnings, unwilling to invest in understanding the fundamental prospects of companies, are unable and unwilling to work with companies to build long-term earning power".* The existence of short-term shareholders raises an interesting question: Which shareholders does the Board represent? Because decisions that are good for some shareholders may be bad for others. The common rhetoric on corporate governance assumes that shareholders have long-term interests in the business, but we see that this is increasingly false. With a large part of the shareholders focused on the short term, the Board should behave as if the shareholders it represents were long-term shareholders. Interestingly,

this fiction would make the Board an independent third party in corporate governance, apart from both managers and shareholders.

The death of the owner (due to the atomization of capital and the current short-termism) is correlated with the absurd increase in CEO compensation, which in the USA has moved up from approximately 20 times the average salary of their workers (in 1960) to maybe 360 times today, creating even the weird (and overvalued) figure of the celebrity CEO. Given that American businesses are not managed today more efficiently than they were 60 years ago (ROAs, for example, have fallen very significantly) and that CEO compensation, adjusted for size and sector, exhibits a negative correlation with subsequent profitability for the shareholder (according to a 2009 paper by Cooper, Gulen et al., the more the CEO is paid, the worse the share performance in the subsequent five years), I would suggest that in the correlation between the death of the owner and the abuse of CEO pay (if I may use such a expression) there seems to be an underlying cause-effect relationship: basically the CEOs have multiplied by 13 times the salary they pay to themselves because there was no countervailing power to stop them, no clear owner or no champion to defend the smaller, dispersed owners' interests. Thus, many of today's CEOs have the economic reward of yesterday's business owners without having taken their risk. Although this is a fundamentally North American phenomenon, the hyperinflation of executive compensation also affects Europe and Spain to varying degrees, especially in (but not limited to) large cap companies where there are no significant shareholders (large banks, utilities, etc.).

3. Are independent directors really that independent?

As usually happens when the regulator develops a messianic vocation, regulation creates a politically correct, virtual reality plagued with stereotypes, commonplaces and rather crude simplifications that pigeonholes reality and is unable to reflect the complexity of the real world, the truth of power dynamics and the psychology of the human being. Strangely enough, the regulator is believed to possess a supreme intelligence and an embedded righteousness with which he deigns to order the world for the rest of us, mere mortals. Indeed, regulation and reality walk parallel and distinct paths. Frequently, regulation just serves for bureaucrats and politicians to increase their arbitrary power and for eventual responsibilities to be quickly purged according to a legalistic application of the law (establishing rigid cause-effect relationships so often alien to truth, justice and common sense). Such gap between regulation and reality implies that strict compliance with the letter of the law is not synonymous at all with good corporate governance practices.

Regulation first distinguishes between internal and external directors, something indisputable: the former are part of the management team and the latter are not. Then, the Spanish regulator goes astray by creating three types of directors: the independent director, the shareholder-director (a relevant shareholder himself or a representative) and the executive director. Miguel Angel Gallo, emeritus professor at IESE University, who gave me the best definition of strategy I have ever heard (I will mention it later), proposes in his interesting book *El Poder en la Empresa* a classification of directors in four different types: directors whose main asset is a name with pomp and splendor; yes-men (who always say yes to power-holder); contact-makers (people with contacts, especially ex politicians); and independents.

But let's get back to our regulation. The rule makes it clear: the good ones are the independent directors, shareholder-directors are always suspicious of malfeasance and the executives are just inevitable. In order to define that nice fellow called the independent director, the Spanish law engages in a negative definition (stating what it is not) that, faithful to the tiresome tradition of Spanish lawmakers, tries to be utterly exhaustive. I'd be more sober. When Rhett Butler (Clark Gable) in the movie *Gone with the Wind* decides to leave the manipulative Scarlett O'Hara (Vivian Leigh) for good, she makes one last desperate attempt to convince him, on the very threshold of her house, not to leave her: "*If you go, where shall I go, what shall I do?*" Unmoved, Clark Gable replies: "*Frankly my dear, I don't give a damn*" before turning on his heels and disappearing into the fog. The truly independent director is the one who is able to withstand, unmoved, attempts at persuading or pressuring him to vote yes and is able to say: "frankly, dear, I don't give a damn", before moving on with his decision.

From whom is the "independent" director independent? The legislator, focused on listed companies with few significant shareholders, has wanted the independent to be the champion defending the "floating capital", the small shareholders or the not-so-small shareholders who come and go and, above all, to be independent of that suspicious shareholder-directors. But what problems does the independent director face? First of all, the independent is almost never independent from he who appoints him, obviously, and it is the power-holder who does that, and he is usually an executive. Therefore, what the figure of the independent director has created is an increase in the power of the executives on the Boards

and a strange demonization, possibly of ideological origin, of the relevant shareholder's representatives, that is, of the business owners (evil capitalists, perhaps?), so that the majority of Boards are far from being balanced or from satisfactorily fulfilling their duty of oversight. I've barely met any independent directors who really were. In fact, yes-men abound. Some are amateur independents, who openly show their submission to the power-holder, and others are serial independents, true Board professionals who sit on many different Boards and who, under a well-worked dialectical layer and irreproachable forms, are capable of beginning by expressing their opposition to a business operation presented by the management team with apparent objectivity only to finish, as if by magic and fifteen minutes later, voting in favor of it with renewed enthusiasm. Secondly, the independent director receives a salary, sometimes a high enough one. How will he say "frankly my dear, I don't give a damn" to what may be his main source of income or social prestige? In my opinion, there are two types of truly independent directors: the guy who has the right temperament, a set of values full of virtues and specific circumstances, that is to say, a very particular personal profile and, more generally, the shareholder who bears downside risk, defends his assets and takes decisions that, right or wrong, seek to increase the value of his net worth. By this I do not mean, logically, that such a director is magically free from errors of judgment or that, on occasions, he may act in self-harming ways to the point of damaging the business and himself; all I say is that he has an obvious rational incentive to defend the interests of shareholders, since they coincide with his own. The shareholder-director does not owe his appointment to the power-holder or the CEO, but to his shareholding, and will endeavor not to jeopardize the dividend, the principal or the increase in value of his shares, and of course he will not do so in exchange for his salary as a director or for the social status that accompanies it. A good director, therefore, represents himself as a shareholder or represents shareholders in general, but never the management team or the power-holder.

Which percentage of the proposals made by the management team is rejected by the Board of Directors? Of course that figure shouldn't be too high, since the relationship between management and Board must be cooperative (at arm's length) and not antagonistic, but possibly the real figure is close to zero. The reason is very simple: to say no is more difficult than to say yes (to our children, to our wives and also to the power-holder); to bring good news is better than to bring bad news. Since the dawn of time, it has been human nature to mistreat those who carry bad news, and what worse news than to know that I, the power-holder, can be wrong, and on top of that to be communicated to me in public! Plutarch, in his Parallel Lives of Cimon and Luculus (100 A.D.) narrates the war waged by the legions of the Roman consul Lucius Licinius Luculus against the Armenian king, Tigranes, who had refused to hand over Mitidrates, king of Ponto (and at that time his father-in-law) to Rome (Mitidrates had sought asylum in Armenia). Quite naïvely, Tigranes maintained the confidence that his refusal was not going to lead to an attack from Rome, as threatened, so Plutarch tells us that "the first who announced the coming of Luculus, he cut off his head so that no one else spoke to him again a word, but remained in the greatest ignorance not listening but the language of flattery". Shakespeare, in Anthony and Cleopatra (1606) shows us a scene in which a messenger brings Cleopatra the unhappy news that her beloved Mark Anthony has married Octavia. Cleopatra rides in anger and hales him up and down: "*Horrible villain! I'll spurn thine eyes*

like balls before me; I'll unhair thy head. Thou shalt be whipped with wire, and stewed in brine, smarting in lingering pickle". We cannot help but smile with the messenger's calmed response: "*Gracious madam: I, that do bring the news, made not the match*".

The good director is the one who knows how to say "no" for the right reasons and calmly affirm: "I think you are wrong because these are the facts and this is my logical reasoning" – and vote in consequence (so many directors say they don't like something and then vote for it).

When commenting about independent directors, the regulator mentions in passing that they must have "diversity of knowledge and experience". However, one of the most common mistakes of the power-holder who seeks to create a Board in good faith is to create a Noah's Ark-type of Board which resembles the palette of a painter with all the colors: the lawyer, the banker, the engineer, the woman or the foreigner. Naturally it is essential that the director be knowledgeable and experienced in business affairs, and that he also know about human nature, power dynamics and teamwork, but the fundamental criterion when choosing a director is that he have the right character and show a handful of virtues, as we will see later. The Book of Ben Sira (written ca 180 b. C), one of the five books of wisdom of the Old Testament, gives us some good warning and a few clues: "*Every counselor points out a way, but some counsel ways of their own. Watch out when one offers advice, find out first of all what he wants, for he also may be thinking of himself. Seek no advice from a woman about her rival, from a coward about war, from a merchant about business, from a buyer about value, from a miser about generosity, from a worthless worker about his work, from a seasonal laborer about the harvest. Instead, associate with a religious person, who you know keeps the commandments, who is like-minded with yourself and will grieve for you if you fail*" (37, 7-12). The power-holder will succeed if he looks for the wise and loyal director, but not loyal to him, but to the truth and to the shareholders, and will do well if he also looks for qualities that can be complementary to his own. If every now and then good expert advice is needed for specific purposes, the business might always hire outside consultants on an *ad hoc*, temporary basis.

4. Incentives, personal values and groupthink

We have mentioned some features of a good director. However, being human nature what it is, we cannot demand heroic behavior from him. The director's incentive system must help his virtues and not undermine them. In the case of the shareholder-director, the fundamental incentive is that his own assets are at stake, like the rest of the shareholders. He has, as we have seen, downside risk, and personal virtues aside, he will support decisions and behaviors that, to the best of his knowledge and understanding, lead to an increase in the value of the business and, therefore, of his participation. But there are very important incentives that affect all directors and that can help make the Board work fine or, on the contrary, make sure it doesn't work at all. And here we go again with the fundamental rule of corporate governance: the Board will work if the power-holder wants it to work, and it will not work if the power-holder does not want it to work, and generally the power-holder does not want it to work. Indeed, for the Board to work, the power-holder will have to give up part of his power in the name of the business interests. Personal values come into play here, since, as in any field of life, there is room in the Boards of Directors for virtues: humility, courage, serenity, magnanimity, patience, prudence, justice, kindness and respect for the truth. In fact, the sincere quest for truth and not the sophist confrontation that seeks to achieve only a pyrrhic dialectical victory is one of the key traits of a good Board. The power-holder must respond with his virtues and with a correct incentive system that promotes the deployment of virtues by the directors. The first incentive is that every Board member should feel absolutely free to express any opinion. The freedom of speech must be completely real and go well beyond an attitude of grumbling acceptance: the power-holder shall encourage contrary opinion, openly rewarding it instead of bitterly punishing it, and in order to achieve this he will often have to fight against himself, since the character traits that have helped him achieve his position as power-holder are often antithetical to what is required for chairing a well-run Board.

The incentive system will also have to face the threat of "groupthink" developed by Yale psychologist Irving Janis in his famous 1972 book., in which he tried to answer why groups of intelligent people made stupid decisions, particularly in the political and military realm (such as the complete failure of the U.S. government in Bay of Pigs, Cuba), but later applied to the civilian and business world as well. Janis called such decision-making disease "groupthink", a disease that had several symptoms. If the power-holder wants the Board to work, he'd better know these symptoms and fight them. I'll mention three:

- an illusion of invulnerability, which leads the group to take extraordinary risks, to overestimate its capabilities, to undervalue its competitors and to disregard warning signals;

- a strong pressure on any member of the group who expresses doubts or questions the validity of the arguments put forward by the majority;

- a self-censorship attitude by members who may have doubts about the consensus position, who will minimize their doubts or remain silent to avoid being lynched.

Decisions taken under groupthink atmospheres also have a number of features that are often indicative of a decision poorly framed, discussed and taken. These ill-taken decisions stem

from a flawed decision-making process in which the group has not defined its objectives well, has narrowed the number of possible alternatives, refuses to reconsider its decision when new negative data not originally taken into consideration appear, carries out poor research from independent sources (and, when it does so, applies a confirmation bias valuing only the information that supports its thesis and despising the opposite), and finally makes a very poor analysis of the risks assumed and the obstacles that may be encountered in the execution of its plans, which leads the group to disregard contingency plans.

How can the power-holder mitigate groupthink? Janis proposes several remedies, the main one being that the leader encourage the freedom of debate (even creating the figure of the devil's advocate), accepting and spurring criticism of his own judgments and avoiding exposing with total clarity his own opinions at the beginning so as not to condition those of others. This incentive system has its limitations. For instance, if a Board director depends for a living on his director's compensation or on the contacts he makes, or if his position on the Board is key to his self-image or the maintenance of his social status, he will never risk losing it, regardless of the good faith with which the power-holder can act. And, on the other hand, if the Board finds itself immersed in a power struggle (often when the authority of the power-holder has been weakened by serious errors of judgment or when he has disappeared without a clear successor, creating a power vacuum), or personal philias and phobias develop, emotionality will prevent the Board's effective functioning no matter how good the incentive system is, because such systems are designed, by definition, for rational behavior.

Everything said about the incentives for the director applies to the incentives of the power-holder himself. In this sense, the best power-holder is the relevant, knowledgeable shareholder whose interest as shareholder overshadows any other interest that may tempt him, and who possesses sufficient self-confidence, humility and nobility to voluntarily humble himself and share his power for the common good of all shareholders, including himself, and of the business as a whole.

5. How can the Board add value in the real world?

After putting forth all the natural obstacles to the proper functioning of the Board of Directors, it would seem that I show severe skepticism to the point of considering it impossible for a Board to add value to the business. That's not the case: accepting that there are inevitable limits to the real effectiveness of Boards, I believe that a good Board can be an extraordinary asset for a business and that it is indeed a great loss for society as a whole that the vast majority of Boards are mostly ineffective. The Board can add value in the five main fields indicated by the first Spanish corporate governance report set forth by the CNMV (the Spanish SEC) in 1998, much better than subsequent reports, as "the core of the non-delegable powers of the Board of Directors":

a) Approval of the general business strategy: it is as funny as it is realistic that the report talks about approving, not deciding, not even discussing. Much has been written about corporate strategy. No doubt, the word strategy is cool and attractive. Comparisons have even been made with military strategy from Sun-Tzu to Von Clausewitz, which speaks volumes of the Napoleonic fantasies of some CEOs (and the heated imagination of many consultants) rather than of any hint of serious similarity between business competition and war. The best theoretical definition of business strategy, in my opinion, was given with the simplicity of genius by Michael Porter in a well-known HBR article: "*Strategy is about being different*". Strategy is about making the business different from the competition, either by cost advantages or by product differentiation as perceived by the customer. In short, strategy is anything that makes it difficult for competitors to compete against us. However, the best practical definition of strategy was given to me by Miguel Angel Gallo, mentioned before. He calls it The Three Ps: "*Personal Preferences of the Power-holder"*. Therefore, the Board will hardly change what the power-holder and the management team have previously understood as the right corporate strategy (which, on the other hand, does not usually have much to do with strategy). Rather, the Board may finetune, shape, limit and question some aspects of it. It is a limited task, no doubt, but essential if it succeeds in proposing a rational and well-defined decision-making process, setting out the problem and the objectives well, contemplating all the alternatives and their consequences, leaving room for the obstacles and the luck factor and avoiding the common practice of underestimating competitors. The Board can also be very useful in helping the management focus on the long term, protecting the Business from the short termism epidemic we are living today. Finally, it can curb the tendency towards action of those in power, a phenomenon well documented in psychological literature, and encourage the necessary pause for reflection. This is particularly useful in a society like ours that confuses being busy with doing something useful.
b) Appointment, compensation and, where appropriate, dismissal of the top executives: this is undoubtedly an essential role of the Board. It is true that if the power-holder is the CEO, it will be difficult for the "independent" directors to vote in favor of removing the person who appointed them. The definition of the compensation scheme for the management is a very important part of the role of

the Board, which, as we have already mentioned, must avoid the pay abuse and mediocre performance that usually occurs when executives do not have shareholders’ counter-power (as Montesquieu recalled in The Spirit of Laws, "it is an eternal experience that every man with authority abuses it"). It must also establish an incentive system that takes into account both reward and risk, establishing the fundamental variables that will drive management to fight for the long-term interests of the shareholder and focusing on objective metrics that cannot be easily manipulated by the recipients themselves (accounting can be so deceitful!). In order to achieve this, the Board’ Appointments and Compensation Committee will do a better job if it thinks for itself rather than hiring the typical consulting firms whose real clients, let us not forget, are usually the executives, not the shareholders (consulting and private aviation are two examples of very lucrative business models in which the beneficiary of the service - the executive - is different from the person who pays for it - the shareholder).

Finally, where appropriate, the firing of senior management in order to safeguard shareholders' interests is one of the Board's main missions, and the belief that this may happen, or better yet, the existence of some precedent, is one of the best incentives for the Board to obtain the respect it deserves from management.

c) Oversight and evaluation of the management team: as we have said in depth, the Board's primary mission is to fight the agency problem, and in this field it can do a great deal of work. Obviously, if the chief executive is always present at Board meetings, it will be difficult for the Board to openly evaluate or freely discuss his performance. The agency problem is particularly acute in corporate M&A deals, where the management team's interest lies more in the fact that size matters (by testosterone and because sooner or later a bigger size will be reflected in their compensation) than in shareholder’s profitability. In this sense, the empirical evidence is overwhelming: the vast majority of mergers & acquisitions harm the acquiring business. In particular, auctions that make assets particularly expensive and incite power struggles between alpha males should be avoided: only purchases made at a low valuation have any chance of being profitable for the shareholder (forget about synergies, as evident in Excel spreadsheets as non-existent in reality, but nevertheless, a fetish word for consultants and investment banks). The smoking gun of the agency problem is the coinage of the expression "hostile” takeover bid. Wait a moment: hostile to whom? Generally not to the shareholders of the acquired business, who are usually offered an attractive premium over market value and who can always oppose it with their votes. Undoubtedly hostile to the management team of the acquiree, whose members see their jobs endangered (how many corporate operations have been successfully completed exclusively by the integration agreement offered to the other management team!) and hostile, almost always, to the interests of the acquirer's shareholders.

d) Identification of the business's main risks and implementation and monitoring of the appropriate internal control and information systems: the Board represents the shareholders, who provide the capital and bear downside risk. Too often, the

agency problem leads managers to force shareholders to take disproportionate risks by applying the principle "heads I win, tails I don't lose much". In this sense, the work of the Board is crucial, particularly in limiting financial risk, being aware that in debt ratios EBITDA or cash generation vary: today they exist, tomorrow, who knows, while debt remains constant. Dividends discipline capital allocation policies and are therefore unpleasant for the management team, which prefers the arbitrariness of buybacks, unfortunately made fashionable in the last two decades by Warren Buffett. In the U.S., the buyback fad, actually intended to mitigate shareholders' dilution by the exercising of executives' rich stock options and to effortlessly increase earnings per share so that market expectations are met, has distorted balance sheets by inflating ROEs, has dangerously indebted companies and has squandered shareholders' money by buying mostly when the share price was expensive and stopping buying when it fell (in the 2008 crash buybacks were reduced to virtually zero just at the time when they would have been most useful in creating shareholder value).

The last risk that the Board can help mitigate is what I call "dependency risk". Actually, when drawing up the business risks' map, the Board should identify the person, product, market, customer or supplier considered indispensable, not in order to pamper and perpetuate them as such, but so that they cease to be so. As an extraordinary businessman and friend of mine (who started from scratch nearly half a century ago at age 18 and now has roughly a one billion revenue business) used to say, if a manager becomes indispensable, you have to start warning him he might get fired.

e) Setting of the information and communication policies for shareholders, markets and public opinion: Indeed, any exercise of transparency that attenuates information asymmetry and facilitates informed decision-making by shareholders is good, and it is the role of the Board, as representative of shareholders, to ensure this.

6. Conclusion

Corporate Governance is a sea plagued by reefs, a very complex issue to which political correctness and the messianic vocation of compulsive regulators have done much disservice by turning theory and practice, rule and reality into watertight, completely separate compartments. In this sense, the ubiquitous agency problem has been neglected at the same time that the difficulties encountered by the power-holder to fight against himself when choosing the right directors and setting an appropriate incentive system for them has been underestimated. Despite the skeptical fundamental principle of Corporate Governance (the Board of Directors will work if the power-holder wants it to work, and it will not work if the power-holder does not want it to work, and generally the power-holder does not want it to work), the Board can be a very powerful weapon for the business and even become a competitive advantage, but this requires an interesting exercise of values and virtues on the part of both the power-holder and the directors.

Dear power-holder: your Board of Directors can be a social meeting of flatterers where the all-too-common "you scratch my back, I'll scratch yours" prevails or a primary weapon for the defense of the shareholders' interests and the long-term success of the business, allowing it to continue offering the goods and services demanded by society at the most competitive prices possible, thus exercising its social value par excellence. To do so, the Board must focus on its role as a hard and effective supervisor of management by providing value in helping management with their usually very poor capital allocation skills, identifying and controlling risks for rational decision-making and avoiding the puerile and harmful arrogance to which we human beings are so prone to when we exercise power. And in order to do so, directors must be well chosen and should have the freedom to say: "you're wrong”. It's all up to you, dear power-holder. I trust that, for the sake of society as a whole, of the business and its shareholders and yourself, you will take the right path. Good luck.

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