

4th EU-Asia Corporate
Governance Dialogue
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Role of the Board of Directors

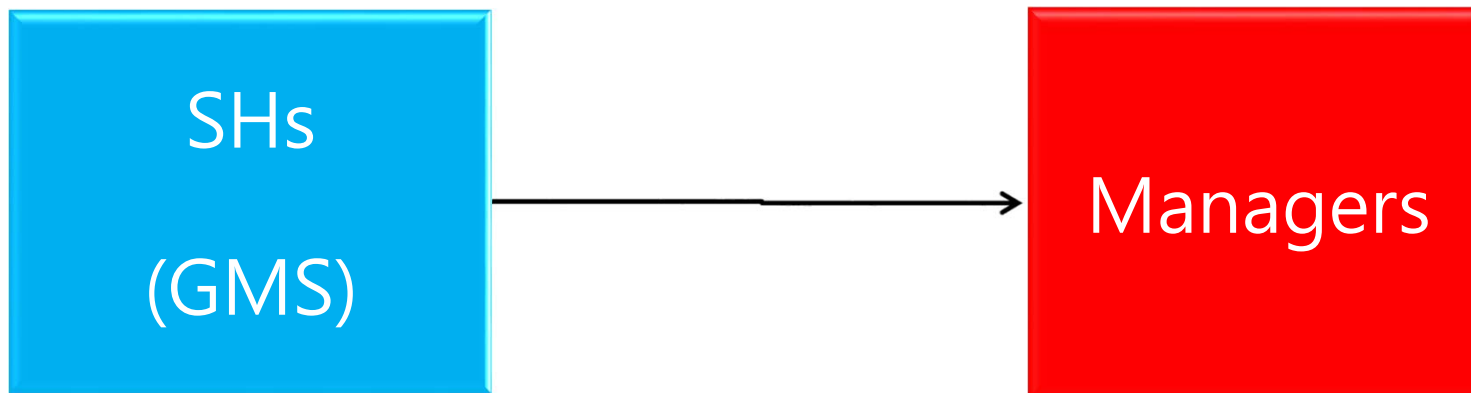
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Overview

- Basic theory
- Law
- Problem and solutions

Theory: starting point

- Managers and investors are two essential elements of a firm



Theory: is the BOD necessary?

- Investors need to monitor performance of managers
- As long as investors can effectively monitor the performance of managers, they don't need a corporate organ like the board of directors(BOD)
- Investors, however, are often unable to perform the monitoring function effectively (eg lack of incentive) – need for BOD

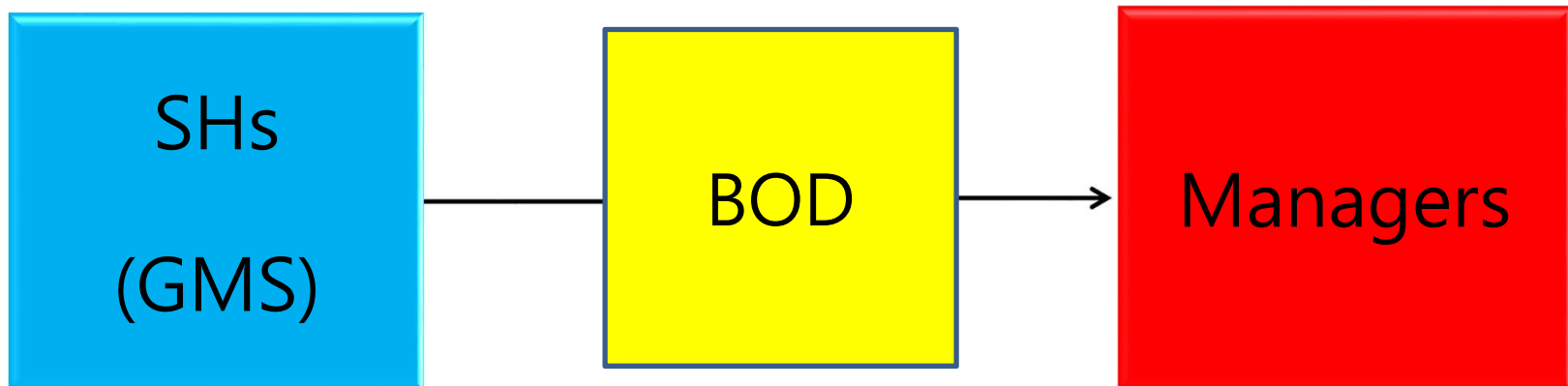
Theory: a BOD as an option

- One potential solution is to allow investors to appoint their representatives (=directors) who can monitor managers for them
- This is the route that Norway took in the past
- In such a voluntary regime, what kind of firms adopt a BOD? - the more the number of SHs and the larger the firm size, the more likely is the firm to have a BOD

Theory: problem with an optional BOD?

- Corporate statutes in most jurisdictions now require a corporation to have a BOD
- Q: What's the problem with the "private ordering" approach Norway took?
- A: Investors may be unable (or unwilling) to install a BOD even when it is in the interest of the investors as a whole to have one – collective action or agency problem;

Theory: BOD as a mandatory corporate organ



Theory: the most essential function of the BOD?

- Various functions the BOD is expected to perform
 - - decision-making (working board)
 - - monitoring (monitoring board)
 - - hiring and firing, compensation
 - - advising managers
 - - advocating the firm's interest in relation to the government and others (quasi-lobbyists)

Theory: the most essential function of the BOD?

- Various functions of the BOD
 - - decision-making (working board)
 - - **monitoring (monitoring board)**
 - - hiring and firing, compensation
 - - advisory role
 - - quasi-lobbyists

Theory: need for independent directors

- In order to perform the monitoring function effectively, directors need to be independent from managers
- Many jurisdictions now require a listed firm to appoint at least some independent directors – another statutory intervention

Law: BOD's statutory power

- Although the exact scope varies, the BOD power is extensive at least under the statutes
- Under the Korean statutes, for example, the BOD has the power to determine "the affairs of the corporation" (Article 393(1))
- "corporate affairs" may be interpreted so broadly as to include potentially almost all decisions of the corporation – not only "monitoring" but also "managing"

Problem with the expansive power of the BOD?

- Intervention by the BOD may prove counterproductive when:
 - - directors (independent directors in particular) lack information and expertise
 - - founder-manager (eg. Steve Jobs)
- Q: Could Samsung Electronics or Hyundai Motors have still emerged even if their BOD had been dominated by independent directors?

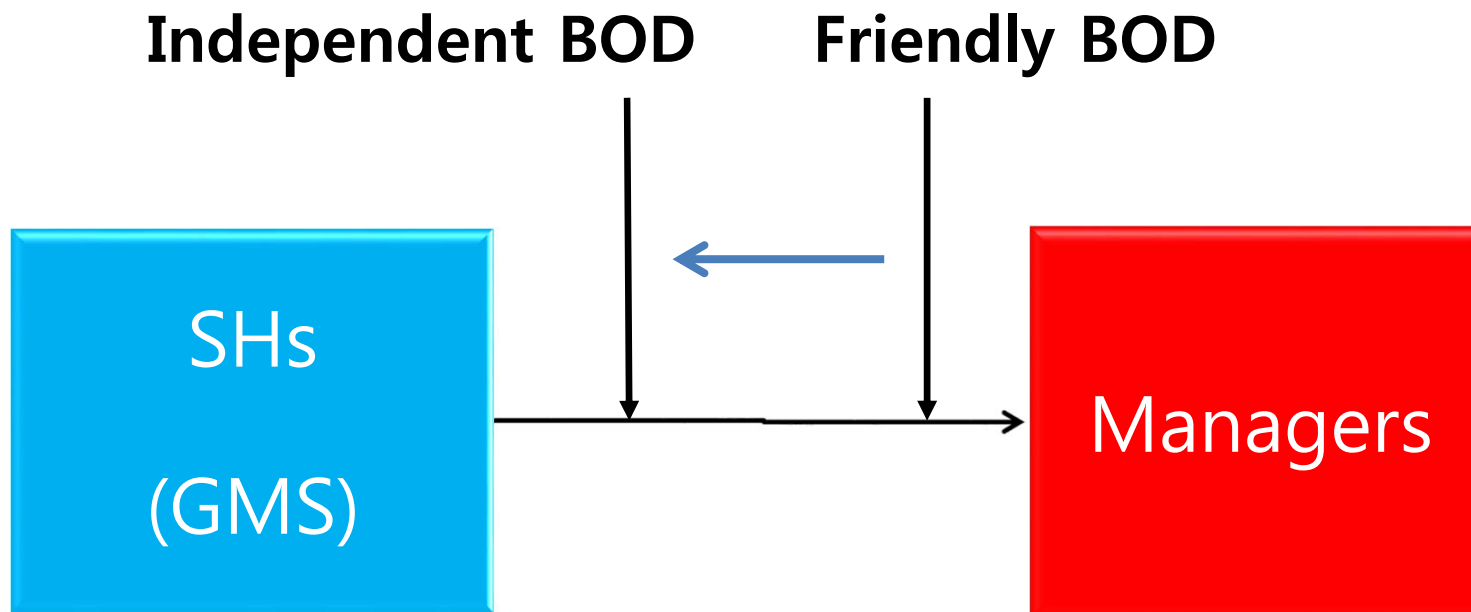
Possible solutions?

- Managers: appoint only inside or friendly directors (eg., Korea, Japan) - weakening monitoring function
- BOD: delegate decision-making power to managers (eg. US) – directors may sometimes want to intervene
- Law: remove the management decision-making power of the BOD by law and have the BOD focus on monitoring: (German supervisory board, Art. 111(4) of AG)

Choice b/w US and German approach

- German approach seems more clear-cut as the management and monitoring functions are formally separated
- Q: Can the BOD still perform the monitoring function adequately even in the absence of decision-making power?

Challenge of policy-makers in countries with one-tier board



Q: How to make the BOD more independent while not making it more interventionist?

Business judgment rule

- Delegation should be liberally allowed
- Directors should be protected from legal liability for an unsuccessful business project by the business judgment rule - if they are not well protected, they will be compelled to intervene in advance
- Judges in some civil law jurisdictions often hold directors liable on substantive grounds

Thank you!