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### Monitor in het belang van de vennootschap

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## Summary

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This book comprises an analysis of the function of the board of supervisory directors within corporations. This analysis is based on the study of relevant literature, interviews with supervisory directors and on the experiences of the author in his capacity of accountant (and with that, of advisor to various boards of managing and supervisory directors).

In *chapter one*, a description is given of the responsibilities and authorities of supervisory directors, based on the relevant legislation. In the Netherlands, the boards of managing and supervisory directors operate in a "two tier structure". This means that there is a formal segregation between the board of managing directors (also referred to as "management" or "executive board") on the one hand and the board of supervisory directors (also known as "supervisory board") on the other.

As defined by law, the function of a supervisory director is to use the best interest of the corporation as the basis of his actions and conduct. The responsibilities of the board of supervisory directors comprise the supervision of and the provision of advice to the board of managing directors. The best interest of the corporation is not necessarily synonymous to the best interest of the shareholders. What it actually constitutes has, however, never been formally defined. The concepts of supervision and provision of advice are in dire need of a clear definition.

For certain large corporations, the formation of a board of supervisory directors is legally required, and its authorities are defined by law. This is what is known as the large (structure) corporation rule. The members of the supervisory directory board of a large public corporation are appointed by the board of supervisory directors itself. The general meeting of shareholders and the works council are entitled to nominate candidates and to formally object to the appointment of candidates (controlled co-optation).

In *chapter two*, the issue of corporate governance is addressed. Here, corporate governance is to be interpreted as "the process of the influence exerted by interested parties on the business activities of companies both in terms of decision-making and the implementation of said decisions". The interests of various categories of stakeholders are discussed, as well as the limitations of the influence minority shareholders have on policy. Furthermore, the interests of suppliers of interest-bearing loans are discussed, as well as those of trade creditors, employees and other stakeholders.

An analysis of the function of the board of supervisory directors would be impossible without taking standards for governance into consideration. Such consideration is paid to this subject in *chapter three*, in which decision-making, implementation and accountability are addressed. Aspects which are discussed are risk policies, the weighing of long-term objectives against short-term goals, and the degree to which the interests of "weaker constituencies", such as employees and

suppliers in Third World countries, are considerations. Responsibilities with regard to environmental issues are also addressed.

In *chapter four*, the practical content of supervision is outlined. Firstly, the issue of internal controls is addressed. The function of supervisory directors is analyzed on the basis of the concepts of decision management and decision control (Fama and Jensen, 1983a). This analysis leads to a definition of the boundaries of the responsibilities and authorities of the board of supervisory directors. Secondly, methods of supervision are discussed, as well as the information requirements of the board of supervisory directors and the practical limitations to supervision.

Additionally, this chapter addresses possible conflicts of interest which could arise from other functions of certain supervisory directors, such as shareholder, supplier of credit and/or trade partner to the company. Finally, the factors which are crucial to the effectiveness of supervision by the board are outlined.

In *chapter five*, the questionnaire methodology is outlined. Phone interviews were conducted with 43 chairmen of supervisory directory boards of large companies. These interviewees have practical experience on several boards of supervisory directors. The supervisory directors interviewed for this examination represent 22 of the 25 major listed companies (ranked according to market capitalization), whereby the interviewee qualifies as "representative" if he is a member of the board of supervisory directors of one or more of these companies.

The theses posed to the interviewees concern the functions of a supervisory director. In considering their answers, the main criterion was to be what they considered to be best practice.

*Chapter six* focuses on the segregation of duties at top level. The segregation of duties as used by Fama and Jensen (1983a) turn out to be applicable to the segregation of duties between management and the supervisory directory board. According to the majority of the interviewees, supervisory directors are not to be involved on the executive side, nor with planning. As they say they restrict themselves to supervision and the provision of advice.

*Chapter seven* addresses possible conflicts of interest. The majority of interviewees do not consider the combined function of supervisory director/shareholder to be problematic. The combined functions of supervisory director/client and supervisory director/banker are rejected as being conflicting, albeit that many interviewees admit to condoning the latter type of functional combinations, given the degree of expertise among certain bankers. A proper segregation of duties within the bank is also advocated. (The interviewees also advocate a segregation of duties within institutional shareholders which are represented by a supervisory director.)

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From these answers, it can be deduced that the function of supervisory director is generally considered to be unsuitable for the representation of specific vested interests.

In *chapter eight*, the information requirements are discussed. The interviewees consider the supervisory directory board to be autonomous in the wording of its own information requirements. The interviewees unanimously consider information concerning risks and exposures to be part of these requirements, including an assessment of potential losses and damages.

In *chapter nine*, the limits to the function are addressed. The interviewees express that it is the function of the board of supervisory directors to supervise, but that the means required to do so are often unavailable. For instance, the interviewees generally comment on the problems of detecting and identifying inefficiencies. They also feel it is practically impossible to prevent the executive board from taking on commitments the company cannot keep.

The majority of the supervisory directors interviewed feel that they are obliged to see to it that the executive board does not misuse its position. The majority also agrees that the supervisory directors should see to it that management uses a system of internal controls aimed at the prevention of such abuse of position by employees.

*Chapter ten* discusses the weighing of interests. From this, it appears that supervisory directors particularly stress the importance of aspects such as continuity and the keeping of commitments by the company. The supervisory directors interviewed generally do not consider themselves to be the safekeepers of the shareholders' interests. Profitability and continuity do, however, rank high in their list of priorities. For most interviewees, forced lay-offs are considered to be a legitimate option if necessary for the improvement of profitability.

*Chapter eleven* concerns the social responsibilities of supervisory directors. Compliance to legislation and regulations and the preservation of continuity turn out to be the most important guidelines in this respect. However, several other considerations are mentioned. For instance, the interviewees may consider environmental pollution of Third World countries to be unacceptable, regardless of the quality of local legislation and law enforcement.

In *chapter twelve*, the option of interim resignation is discussed. From the answers, it can be deduced that supervisory directors will generally use this option as a last resort only. Staying on for the full term and thus using one's vote and efforts to influence the board's decisions seems to be the preferred option by far. The supervisory directory board clearly does not perceive its function to be the "hallmark" of the management board's conduct.

In *chapter thirteen*, the different interpretations of the function within various types of companies are summarized. Several comments by supervisory directors from Dutch systems are also included.

In *chapter fourteen*, the possible influence of a stock exchange listing on the supervisory director's interpretation of his function is briefly discussed. It appears from the questionnaire that interviewees with a more extensive experience in listed companies assign more importance to the interests of suppliers of capital than those with less experience in listed companies.

In *chapter fifteen*, the conclusions from the questionnaire are discussed. The consequences of the high degree of importance the supervisory directors assign to the interests of the suppliers of loan capital are discussed in more detail here. Additionally, this chapter includes some comments by the author on supervision within large (structure) corporations and, in particular, its potential benefits for suppliers of loan capital.