Chris Mumford & Thomas Mielke analyse HVS's 2008 European Corporate Governance Report and offer some advice on how to improve your score

Board sports

The past year has seen the worlds of business and finance come under intense scrutiny from the general public. Outrage over perceived excessive bonuses and pension pots has now resulted in governments beginning to step in and attempt to regulate executive pay. The emphasis going forward is on linking incentives to performance over three or so years, rather than rewarding quick, short-term results which potentially damage corporate and public value over the longer term.

Regulators' focus, however, should not purely be on the headline numbers involved but should also look at how pay packages are determined and who sets them. It is a company's board of directors which ultimately decides on the remuneration of the top key executives as part of their corporate governance responsibilities.

In most of today's publicly listed companies, ownership is separated from the management and it is the role of the corporate governance control systems to align the incentives of executives with those of the company's shareholders. Since the Enron scandal, corporate governance has become a much greater topic of debate and the banking crisis and subsequent recession have shown it to be ever more worthy of scrutiny.

In the 2008 corporate governance survey of the European hotel industry, HVS Executive Search has reviewed 21 European publicly listed companies.

Based on information available in the public domain and provided through interviews, companies were scored on their performance in four key categories:

- Size, makeup and independence of the board
- Committee structure and effectiveness
- Presence of interlocks, insider participation and related transactions
- Commitment to pay-for-performance for executive and director pay.

Overall, it was encouraging to note that more and more companies (approximately 50%) have a senior independent director sitting on their board – a non-executive director, whose responsibilities include the review of the performance of the chairman, who acts as a point of contact for shareholders and stakeholders, and who typically also presides over the nomination committee. However, a third of the companies still do not separate the roles of chairman and chief executive officer.

It is widely agreed that the board of directors should have an uneven number of members. Experts typically recommend anything between five and 11 members

European Corporate Governance 2008

Rank	Company	Size & makeUp	Committee structure	Interlock & insider participation	Pay for performance	Total
1	Rezidor Hotel Group	67%	77%	100%	100%	86%
2	InterContinental Hotel Group	67%	92%	100%	80%	85%
3	Whitbread	67%	69%	100%	100%	84%
3	Accor Corporation N/A	50%	85%	100%	100%	84%
4	Fuller, Smith & Turner	33%	69%	100%	100%	76%
5	TUI Hotels	25%	77%	100%	100%	75%
5	Millennium & Copthorne Hotels	75%	85%	100%	40%	75%
6	NH Hoteles	50%	85%	100%	60%	74%
7	MWB – Malmaison	67%	77%	100%	40%	71%
8	Club Méditerranée	33%	62%	100%	80%	69%
9	Euro Disney	67%	46%	100%	60%	68%
9	Societe Des Bains De Mer	75%	77%	100%	20%	68%
10	Pierre & Vacances	58%	54%	100%	40%	63%
11	International Hotel Investments	33%	54%	100%	60%	62%
12	Peel Hotels	33%	54%	100%	40%	57%
12	Sonae Capital	33%	54%	100%	40%	57%
13	Danubius Hotels	50%	54%	100%	20%	56%
14	Sol Melia Hotels & Resorts	25%	85%	50%	60%	55%
15	Orco Property Group	42%	46%	100%	20%	52%
16	Park Plaza Hotels	25%	23%	100%	20%	42%
17	Maypole Group	42%	8%	100%	10%	40%

It is generally accepted that these positions should be held by two individuals, with the chairman ideally being an outsider (someone who does not have any ties to the company other than sitting on its board) – yet, within our sample group, 11 chairmen were insiders.

Board size & makeup

It is widely agreed that the board of directors should have an uneven number of members. The size will usually depend upon the complexity of the corporation, with experts typically recommending anything between five and 11 members.

The ruling principal for this guideline is that an odd number facilitates the decision-making process, whereas the limit in size avoids complications in arranging board meetings with all of its members being present. Of the surveyed companies, most reported a board appropriate to the size of the company, but only 48% had an uneven number of board members.

Seventy six per cent of the companies had a board of directors where the number of independent executives was at least equal to or greater than the number of non-independent executives. This is a reassuring finding, as it should establish greater objectivity in the decision-making process and favourably support the corporate governance control systems.

Additionally, companies were scored on the length of term of their board members. Ideally, directors should stand for re-election on a yearly basis, which allows regular review of the performance of each member and thereby maximises the efficiency and effectiveness of the board as such.

Out of the 21 companies, five received maximum scores. However, some of the board activities refer to long-term objectives, which justifies scoring those companies with a tenure for their board members of up to three years with "fair".

In the 2008 study, 11 companies – or 52% – received such a mark.

Committee structure

Next to the board of directors, committees represent a significant part of the corporate governance control systems.

They are set in place to review the company's financial performance and the adherence of the board of directors to the corporate governance guidelines.

Additionally, these committees are established to evaluate the remuneration of the executives and to appoint new board members. Experts therefore recommend the set-up of four separate committees: Audit, Corporate Governance, Remuneration and Nomination.

In this category, companies were not only given marks for the mere existence of the individual committees, but also on the committee setup (whether or not any committee included an insider) and the frequency of meetings of the board of directors and its individual committees.

In the 2008 study, only one company had all four committees in place. However, it should be noted that most other companies have delegated the responsibilities of the Corporate Governance Committee to the Nomination Committee.

- 57% of audit committees met at least once every quarter, up from 52% in 2007
- 48% of the remuneration committees met more than twice within the past year, up from 26% in 2007
- Nomination committees met on average 1.5 times during the last year, a reduction on 2007
- Average board meeting attendance rate was 93%, up from 86% in 2007.

It is interesting to note the impact of the economic crisis on board behaviour. Not only have boards met more often, as one would expect during times of trouble, but they have also spent more time than in previous years defining the rewards of the executive team. It is also perhaps a sign of a desire to maintain stability among a company's decision-makers that nomination committees met fewer times in 2008.

The InterContinental Hotels Group achieved nearly top marks in the Committee Structure category (92%), and was closely followed by the Spanish companies Sol Meliá and NH Hotels, as well as Accor and Millennium & Copthorne Hotels, which all achieved 85%.

The average score was 63%.

Interlocks & insider participation

In the past, board interlocks (you sit on my board and I'll sit on yours) have caused serious headaches to investors and stakeholders. The board of directors of numerous large corporations showed an inappropriate overlap in membership, which was either based on business affairs (eg banking relationship) or shared social backgrounds (eg family/friends).

Due to these close links between board executives, the control systems of corporate governance were nullified; the board of directors was almost considered a "social club" rather than a controlling body.

However, times have changed and it is encouraging to note that board interlocks were not existent in HVS' 2008 Corporate Governance study.

Insider participation, rarely encountered these days, refers to a situation in which a board member, or his or her firm, engages in business activities with the company.

As this could lead to insider deals and/or preferred 'partnerships', which result unfavourably for the company's shareholders, such behaviour is actively discouraged.

Radisson Royal, Moscow. The Rezidor Group achieved one of the top scores in the Pay-for-performance category

Pay-for-performance

As initially mentioned in this report, executive compensation continues to stir debate. It has also been established that one cannot analyse the subject of corporate governance without examining remuneration practices.

This study, therefore, evaluated the transparency of information available on directors' remuneration and scored companies on the way they compensate both their executive and their non-executive directors.

While the reporting rules on the disclosure of executive compensation do vary from one European country to another, companies would act in their shareholders' best interests if they volunteered all information on remuneration practices rather than disclosing only the bare required minimum, as per the UK and USA.

Five companies achieved top scores in the pay-for-performance category – Accor, Fuller's, Smith & Turner, the Rezidor Hotel Group, TUI and Whitbread.

Maximum points were awarded to companies whose non-executive directors' compensation package included a moderate annual director fee, an additional fee for committee membership or for being a committee chairman, as well as some form of ownership (eg shares or stock options).

Not only have boards met more often, they have also spent more time than in previous years defining the rewards of the executive team. It is also perhaps a sign of a desire to maintain stability among a company's decision-makers that the Nomination Committee met fewer times in 2008

Result

Coming first in the 2008 HVS Corporate Governance study was the Rezidor Hotel Group, which achieved an overall score of 86%. The InterContinental Hotels Group was first runner-up, scoring just 1% below the winner. Both Accor and Whitbread ranked third with a total mark of 84%. Average score for the Top 10 was 78%, indicating that companies across the sector have committed themselves to good corporate governance.

Following this rather challenging past financial year, a number of hotel companies have recently revised the makeup and structure of their supervisory board. These changes will take effect in next year's study.

Also, while some companies dropped out of this year's report (eg The Real Hotel Company), it could very well be that the list of publicly listed hotel companies will expand again in the near future.

The recent past has seen a trend for going private but, with the current difficulties in raising capital, it will be interesting to observe, going forward, whether more companies will contemplate going public, such as Hyatt and Las Vegas Sands Macau.

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2008 HVS Corporate Governance Study key facts

- **50% of companies have a senior independent director sitting on their board**
- **76% of companies had a board of directors where the number of independent executives was at least equal to or greater than the number of non-independents executives**
- **Average board meeting attendance rate was 93% (2007: 86%)**
- **57% of audit committees met at least once every quarter (2007: 52%)**
- **48% of the renumeration committees met more than twice within the past year (2007: 26%).**

Sample: 21 hotel companies