CORPORATE GOVERNANCE IN A NETWORKED AGE

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INTRODUCTION

We live in a networked and digital age. It is a brave new world with opportunities and challenges that have changed the way companies operate. In order to grow and excel, companies need to master four digital technologies when developing new, groundbreaking products and processes: cloud computing, big data, mobile, and social media.[1] For instance, decision-making processes need to be based on digital data, online footprints need to be increased,[2] and policies regarding the use of digital technologies need to be reconsidered and adjusted to the expectations of consumers.[3] Companies' products and services need to be redesigned with digital technologies in mind. Ignoring our networked age and the digital revolution is not an option, as it will accelerate the failure and decline of companies.

In particular, established companies that are publicly listed and have an impressive track record when it comes to innovation, global expansion, and building "monopoly" market shares might find it difficult to adapt to the fast-changing digital landscape.[4] The continuing decline of the average lifespan of an S&P 500 company

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1. Ravi Puri, *Cloud, Analytics, Mobile, and Social: Convergence Will Bring Even More Disruption*, FORBES: ORACLEVOICE (May 6, 2014, 12:12 PM), http://www.forbes.com/sites/oracle/2014/05/06/cloud-analytics-mobile-and-social-convergence-will-bring-even-more-disruption/.

2. Barry Libert, *Governance 2.0: The Future for Boards in the Age of Big Data*, CORP. SECRETARY (Oct. 16, 2013), http://www.corporatesecretary.com/articles/technology-social-media/12562/governance-20-future-boards-age-big-data/.

3. Timothy Morey et al., *Customer Data: Designing for Transparency and Trust*, HARV. BUS. REV., May 2015, at 97, 99–102.

4. *See* Barr Seitz, *Learning from Google's Digital Culture*, MCKINSEY & COMPANY (June 2015), http://www.mckinsey.com/insights/high_tech_telecoms_internet/learning_from_googles_digital_culture (interview with Jon Kaplan); Dave McClure, *Bubble, My Ass: Some Unicorns Might Be Overvalued, but All Dinosaurs Gonna Die*, MEDIUM: 500 HATS (Apr. 12, 2015), https://medium.com/500-hats/bubble-my-ass-some-unicorns-might-be-overvalued-but-all-dinosaurs-gonna-die-fb0ce311a7bd.

shows that it is becoming more of a challenge for these companies to grow and stay on top of market trends.[5] In contrast, the fast development of digital technologies has made it easier for startup companies to enter markets that, until now, have been dominated by the giants of this world.[6] Research by CB Insights, a data-driven business intelligence company, on emerging companies and disruptive technology trends confirms that many technology startup companies are attacking the distinct products and services of publicly traded giants.[7]

But why should we care about a company's failure to thrive or even survive in today's (and tomorrow's) environment? Big companies have always been disrupted and replaced by their disruptors, which will again be substituted by younger companies in the future.[8] Moreover, history is full of established companies that were once innovative leaders but have gradually become hugely successful as sales and marketing companies.[9] These companies usually end up stockpiling gigantic amounts of cash that will eventually be returned to the investors.[10] Also, companies that operate in more traditional sectors—e.g., travel and leisure, food, general retailing, and support services—are arguably less affected by disruptive technologies that have revolutionized the world as we know it. This was acknowledged by Steve Jobs during a 1995 interview in which he admits that a marketing and sales strategy works for companies (e.g., PepsiCo) that only make incremental improvements to existing products (e.g., a new sized bottle) every ten years or so.[11]

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5. INNOSIGHT, CREATIVE DESTRUCTION WHIPS THROUGH CORPORATE AMERICA 2 (2012), http://www.innosight.com/innovation-resources/strategy-innovation/upload/creative-destruction-whips-through-corporate-america_final2015.pdf.

6. Mark Suster, *Why Venture Capital Is So Much More Compelling Now*, BOTHSIDES OF THE TABLE (June 29, 2014), http://www.bothsidesofthetable.com/2014/06/29/why-venture-capital-is-so-much-more-compelling-now/.

7. *Disrupting Paychex: The HR Tech Startups That Are Unbundling Payroll, Insurance and SMB Services*, CB INSIGHTS (Apr. 26, 2015), https://www.cbinsights.com/blog/disrupting-paychex-adp/; *Disrupting Procter & Gamble: The Startups Unbundling P&G and the Consumer Packaged Goods Industry*, CB INSIGHTS (Mar. 27, 2015), https://www.cbinsights.com/blog/disrupting-procter-gamble-cpg-startups/.

8. *See* NATHAN FURR & JEFF DYER, THE INNOVATOR'S METHOD: BRINGING THE LEAN STARTUP INTO YOUR ORGANIZATION 221–28 (2014).

9. *Peter Thiel: Apple Is No Longer a Tech Company—and Neither Is Google*, STRICTLYVC, http://www.strictlyvc.com/2014/10/07/peter-thiel-apple-longer-tech-company-neither-google/ (last visited Sept. 1, 2015) (stating that Apple and Google have transformed from technology companies to successful marketing companies).

10. *Id.*

11. Steven Tweedie, *Here's Why Innovation Dies at Big Tech Companies, According to Steve Jobs*, BUS. INSIDER (Nov. 3, 2014, 11:10 AM),

But then again, the world has changed. We now live in a networked and digital age where companies must operate with a new set of principles and assumptions on how to become successful and competitive.[12] In today's business environment, every company has basically become a technology company.[13] This explains why smart companies increasingly attempt to become more agile, innovative, and responsive by restructuring the way they are organized.[14] Companies that are able to reinvent themselves by adopting an entrepreneurial, product-oriented spirit or by recapturing the "startup feel" are arguably best prepared for future opportunities and challenges.

How then are they doing this? Some companies have chosen to break up into two or more separate companies to better compete in a networked and digital environment.[15] Recent examples are the e-commerce company eBay and the information technology company Hewlett-Packard.[16] Other companies, such as the publicly traded conglomerate General Electric, attempt to replicate tried and tested decision-making processes that have proven successful in lean, high-growth startup firms.[17] All of these initiatives undoubtedly contribute to transforming corporate culture from a culture of bureaucracy to one more focused on innovation and entrepreneurship.

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http://www.businessinsider.com/steve-jobs-on-why-innovation-dies-at-tech-monopolies-2014-11.

12. *See* DON TAPSCOTT, THE DIGITAL ECONOMY, RETHINKING PROMISE AND PERIL IN THE AGE OF NETWORKED INTELLIGENCE 19–22 (2d ed. 2014).

13. Jon Bruner, *Every Company Is a Tech Company*, FORBES (May 13, 2014, 1:57 PM), http://www.forbes.com/sites/oreillymedia/2014/05/13/every-company-is-a-tech-company/.

14. Rex Huppke, *Psst: Be More Flexible. Pass It On*, CHI. TRIB. (Jan. 28, 2013), http://articles.chicagotribune.com/2013-01-28/business/ct-biz-0128-work-advice-huppke-20130128_1_companies-change-project.

15. Jerome M. Wendt, *Break Up or Make Up . . . Tech Companies Place Their Bets in 2014*, DCIG (Oct. 17, 2014), http://www.dcig.com/2014/10/break-up-or-make-up-tech-companies-place-their-bets-in-2014.html.

16. Julie Bort, *The HP Breakup Will Happen for Real in November—Here's Everything We Know About It*, BUS. INSIDER (Mar. 19, 2015, 12:30 PM), http://www.businessinsider.com/hp-breakup-scheduled-for-november-heres-everything-we-know-2015-3; Denise Roland, *eBay To Break Up into Two Separate Companies*, TELEGRAPH (Sept. 30, 2014, 12:19 PM), http://www.telegraph.co.uk/finance/newsbysector/mediatechnologyandtelecoms/digital-media/11130376/eBay-to-break-up-into-two-separate-companies.html.

17. Richard Clough, *General Electric Wants to Act Like a Startup*, BLOOMBERG BUS. (Aug. 7, 2014), http://www.bloomberg.com/bw/articles/2014-08-07/ge-taps-lean-startup-ideas-for-faster-cheaper-product-rollout; Carmel DeAmicis, *GE Tries to Innovate with Lean Startup Method, Invents Fridge. Points for Trying*, PANDO (Dec. 10, 2013), https://pando.com/2013/12/10/ge-tries-to-innovate-with-lean-startup-method-invents-fridge-points-for-trying/.

However, speaking from personal experience, when you are on the ground working for an established company with a significant market share, you should immediately recognize the other overriding considerations that need to take precedence in the event of a company failing to be responsive to economic headwinds and disruptive innovations. One of the main problems is that the regulatory environment has created a "nanny culture" in which the relationship among managers, directors, and investors is hierarchical and agency-based (as academics refer to it).[18] As a result of the nanny culture, shareholders and boards of directors tend to focus on controlling managerial misbehavior and monitoring the company's past performance and sustainability instead of actively contributing to it.[19]

When investors and directors are uninvolved or difficult to work with, managers can easily fall prey to risk-averse behavior by adopting a box-ticking mentality (often encouraged by conservative intermediaries, such as legal and other advisors). The latter is especially worrisome, as staying within the defined and accepted boundaries has traditionally paved the way to misaligned incentives that make it extremely difficult to recapture and maintain a focus on innovation, growth, and value creation.[20] Indeed, the nanny culture is characterized by a short-term mentality that often leads to stricter control mechanisms on corporate executives and demands for increased dividends and stock buybacks.[21] Thus, it should come as no surprise that corporate giants increasingly struggle with the competition from highly networked and agile startup companies.[22]

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18. The term "nanny culture" is derived from the term "nanny law professor," which was introduced by Professor Dale Oesterle on March 27, 2015 during his presentation at the *Wake Forest Law Review* 2015 Spring Symposium: "The Future of Financial Intermediation." For a further discussion of the concept, see Dale Oesterle, *Intermediaries in Internet Offerings: The Future Is Here,* 50 WAKE FOREST L. REV. 533, 540 (2015)

19. Didier Cossin, *Corporate Boardrooms Are in Need of Education*, FIN. TIMES (Jan. 9, 2012, 5:36 AM), http://www.ft.com/cms/s/2/796e749a-35ff-11e1-ae04-00144feabdc0.html#axzz3fmpoRrYs.

20. *Innovation Investment Decision Risk Aversion*, ALOPEX ON INNOVATION (June 20, 2013), http://alopexoninnovation.com/2013/06/20/innovation-investment-decision-risk-aversion/.

21. *See* Oesterle, *supra* note 18, at 540. *See generally* Steve Denning, *The Surprising Reasons Why America Lost Its Ability to Compete*, FORBES (Mar. 10, 2013, 2:29 PM), http://www.forbes.com/sites/stevedenning/2013/03/10/the-surprising-reasons-why-america-lost-its-ability-to-compete/ (describing management's short-term thinking and focus on shareholder value maximization).

22. Matthew Finnegan, *Insurance Giants Under Threat from Agile Startups, Says Forrester*, TECHWORLD (Dec. 18, 2014), http://www.techworld.com /news/startups/insurance-giants-under-threat-from-agile-startups-says-forrester-3591537/.

And yet, many established publicly listed companies have been able to maintain or return to the innovation model in the traditional form as a risk-takers and, most importantly, as innovators—despite the overregulated environment. How are they doing this? These innovative companies are, in essence, bringing the art of inventing innovative products and building pioneering businesses back to the forefront. The companies that are best in their class have created a "test-and-learn" culture by implementing a flat hierarchy and open communication.[23] Their organizations are built around passionate, often tech-savvy visionaries. Where it was once fashionable to be bold, these companies can now, with a modern twist, take both the networked age and the regulatory environment into account. The less creative and disruptive companies can only hope to replicate these innovative ways in a rapidly changing (digital) landscape where each will be forced to adapt or risk being exposed and shepherded out of the market. The ability for established companies to lurk in the background and ride the coattails of their previous success has come and gone. In a networked age, being innovative and adaptive is everything.

I. THE "NANNY DILEMMA" IN THE NETWORKED AGE

Successful companies are those that stand out from their competition in their approach to innovation.[24] To thrive and stay ahead of their competitors, these companies make research and development ("R&D") an integral part of their strategy and operations management and are able to deliver innovative products and/or services to meet customer demand.[25] To accelerate and scale innovation, these companies have also mastered the art of connecting, collaborating, cocreating, and codeveloping with external parties such as universities, venture capitalists, and other companies.[26] While this all sounds relatively straightforward, it quite often is not. It is a common refrain that big, successful companies quickly lose their entrepreneurial spirit across their life cycles, thereby becoming considerably less responsive to innovative and disruptive changes in the market.[27]

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23. *See* Joel Schectman, *Elon Musk on His Work and the Future*, NEWSWEEK (Nov. 18, 2010, 2:15 PM), http://www.newsweek.com/elon-musk-his-work-and-future-69867.

24. *See* Joseph A. McCahery & Erik P.M. Vermeulen, *Six Components of Corporate Governance that Cannot Be Ignored*, 160 EUR. COMPANY & FIN. L. REV. 160, 177–78 (2014).

25. *Id.*

26. EUROPEAN COMM'N, BOOSTING OPEN INNOVATION AND KNOWLEDGE TRANSFER IN THE EUROPEAN UNION 4 (2014), https://ec.europa.eu/research/innovation-union/pdf/b1_studies-b5_web-publication_mainreport-kt_oi.pdf.

27. Joseph A. McCahery, Erik P.M. Vermeulen & Masato Hisatake, *The Present and Future of Corporate Governance: A Refocus on Competitive Boards,*

There are three basic reasons for this. The first reason is outlined in "Steve Jobs: The Lost Interview," which compiles the most compelling quotes from the 1996 PBS documentary *Triumph of the Nerds: The Rise of Accidental Empires*.[28] In this documentary, Steve Jobs explains that successful companies—particularly the ones that had been able to build up a monopoly market share—are, in essence, run and managed by sales and marketing people.[29] The innovators (whom Steve Jobs refers to as "product people") are gradually pushed out of critical decision-making roles.[30] This gradual development in the life cycle of a company makes perfect sense from a short-term perspective. It is not the disruptive innovations and new products and processes, but the cost-effective sales and marketing strategies that make established companies more successful. Once these companies forget how to develop and introduce new breakthrough and game-changing technologies, their failure appears to be imminent and inevitable.

A second and related reason for the diminishing role of new innovations and disruptive products in shaping the future of established companies is that they generally find it increasingly difficult to recruit and retain talented employees (who often prefer to work for hotter startup companies).[31] Finally, even if "product people" are involved in the decision-making process, the R&D organizations tend to suffer from a "not-invented-here syndrome" that hinders the acceptance of innovations that are jointly developed with third parties or are created outside the company's innovation silos.[32] Clearly, if unchecked, this trend leads to companies merely focusing on incremental innovations based on existing technologies, eventually causing their demise.

In an era that is dominated by digital technology, shorter life cycles, and tech startups seeking to disrupt both "nontechnology" and "technology" giants, a corporate culture based on product-oriented processes and long-term thinking (which presupposes

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Investor Relations and Growth-Oriented Investors, 10 EUR. COMPANY & FIN. L. REV. 117, 140 (2013); Marc de Jong et al., *The Eight Essentials of Innovation*, MCKINSEY & COMPANY (Apr. 2015), http://www.mckinsey.com/insights/innovation/the_eight_essentials_of_innovation.

28. For the full interview, see STEVE JOBS: THE LOST INTERVIEW (Magnolia Pictures 2012).

29. Ryan Carey, *The Eight Greatest Quotes from Steve Jobs: The Lost Interview*, PASTE (Mar. 6, 2013, 9:04 AM), http://www.pastemagazine.com/blogs/lists/2013/03/the-eight-most-important-passages-from-steve-jobs-the-lost-interview.html.

30. *Id.*

31. Clair Cain Miller, *Google Grows, and Works to Retain Nimble Minds*, N.Y. TIMES (Nov. 28, 2010), http://www.nytimes.com/2010/11/29/technology/29google.html?_r=0.

32. Darrell Rigby & Chris Zook, *Open-Market Innovation*, HARV. BUS. REV., Oct. 2002, at 80, 82–83.

loyalty and mutual trust) is crucial to successfully navigate through tomorrow's opportunities. The critical question here is how to conceptualize the relationships among investors, managers, and employees. In today's publicly listed companies, these relationships are often agency based or hierarchical and encourage a short-term focus driven by employees, managers, and investors who do not commit to the company for the long haul.[33] It is this disconnect that is slowly but surely causing a shift in thinking about how to best structure the relationships among the various stakeholders in a company.

For instance, Reid Hoffman, cofounder of LinkedIn, has together with San Francisco-based entrepreneurs Ben Casnocha and Chris Yeh introduced a way to reframe the relationship between managers and employees in their book *The Alliance*.[34] The fact that lifetime employment is not sustainable in a networked age triggered the authors to come up with a model that would not only rebuild trust and loyalty but also would create incentives for employees to become more entrepreneurial and open to innovations.[35] The answer is the alliance-based relationship, which offers mutual benefits to the company and its employees.[36] This alliance between the company's managers and its employees is roughly built on three pillars.[37] The core pillar includes mechanisms that enable a company to hire employees for defined, but possibly successive, "tours of duty."[38] The second pillar focuses on the creation of the employees' networks outside the organization.[39] The final pillar includes the creation of an alumni network that enables companies to maintain long-term relationships with their former employees.[40] The employer-employee alliance can already be observed in startup communities, such as Silicon Valley, where the establishment of networks and connections is crucial to the success of both the companies and their employees.[41]

A less documented but similar trend can be observed in the relationship among managers, directors, and shareholders of a company. A new establishment of investors is emerging in which

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33. Tom Spencer, *Why Are Public Companies Too Short Term Focused?*, TOM SPENCER (Sept. 9, 2013), http://www.spencertom.com/2013/09/09/why-are-public-companies-too-short-term-focused/#.VaPlSJNVikp.

34. *See* REID HOFFMAN, BEN CASNOCHA & CHRIS YEH, THE ALLIANCE: MANAGING TALENT IN THE NETWORKED AGE 7–9 (2014).

35. *See id.*

36. *See id.*

37. Reid Hoffman et al., *Tours of Duty: The New Employer-Employee Compact*, HARV. BUS. REV., June 2013, at 49, 51.

38. *Id.* at 51–53.

39. *Id.* at 53–54.

40. *Id.* at 54–58.

41. *Id.* at 58.

investors are realizing that when they conceptualize the relationship between managers and shareholders as one of hierarchy, they create a short-term mentality within the company that usually leads to demands for increased dividends and stock buybacks.[42] Accepting these demands makes it extremely difficult for companies to recapture the focus on innovation and growth.[43] Consider Nokia and Blackberry, once viewed as tech champions until they became share buyback heavyweights.[44] Luckily, investors are increasingly interested in the question of what it is that causes companies to thrive and stay ahead of their competitors.[45] As they ask themselves how to architect and design their "portfolio" companies, they focus on board representation and business/growth strategy issues.[46]

It is exciting to see that the shifted focus towards collaborating with business executives is slowly but surely starting to become the norm of what is expected of active investors.[47] However, it is up to the CEO and other executives, as well as the board of directors, to make the investors work for the company (independently of the stage in the life cycle of a company). The best way to engage the investors is to frequently share information and communicate with them.[48] The information is not so much about annual and quarterly financial statements that focus on the past. Because, as we all know, past performance is not always indicative of future success. Instead, it is more effective to use metrics that are forward-looking and complement some of the more historical data that is available in the market.[49] Attributes that are critical for future performance

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42. Nick Hanauer, *Stock Buybacks Are Killing the American Economy*, ATLANTIC (Feb. 8, 2015), http://www.theatlantic.com/politics/archive/2015/02/kill-stock-buyback-to-save-the-american-economy/385259/.

43. Garry Tan, *Share Buybacks: Big Cos Say "We Don't Know What to Do with the Cash Anyway!" and Why It's Good for Startups*, GARRY'S POSTHAVEN (May 7, 2015, 6:38 PM), http://blog.garrytan.com/share-buybacks-big-cos-say-we-dont-know-what-to-do-with-the-cash-anyway-and-why-its-good-for-startups.

44. *See* Gerrit De Vynck, *Blackberry Plans Share Buyback To Offset Employee Incentives*, BLOOMBERG BUS., http://www.bloomberg.com/news/articles/2015-05-21/blackberry-planning-share-buyback-to-offset-employee-incentives (last updated May 22, 2015, 1:50 PM); *Share Buy-Back Program*, NOKIA (Sept. 15, 2011), http://phx.corporate-ir.net/phoenix.zhtml?c=107224&p=irol-sharebuyback.

45. Murray Newlands, *5 Things Investors Want to Know Before Signing a Check*, ENTREPRENEUR (June 5, 2014), http://www.entrepreneur.com/article/234536.

46. *Id.*

47. *See* Erik P.M. Vermeulen, *New Metrics for Corporate Governance: Shifting Strategies in an Aging IPO Market*, *in* THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE (Jeffrey N. Gordon & Wolf Georg-Ringe eds. forthcoming Feb. 2016).

48. McCahery & Vermeulen, *supra* note 24, at 188–91.

49. *Id.* at 191–95.

include customer satisfaction, employee engagement, and connections, collaborations, and cocreation activities, as well as the opportunities and challenges regarding the introduction of new products and processes, product innovations, and/or entering new markets.[50]

This collaborative model sounds great in theory, but it is still difficult to implement in practice, largely due to the existing patchwork of regulation and policy making in the area of corporate governance.[51] Consider the stringent agency-based rules and regulations that were introduced after the corporate failures and scandals during the early years of the twenty-first century, and then again in the wake of the most recent economic downturn.[52] The corporate governance reforms were mainly initiated to align the interests between managers and the often-passive investors by focusing on the independence and composition of the board of directors, the monitoring role of the board, auditing and remuneration processes, risk-management systems, and strict disclosure rules.[53] But if we believe that public-market investors are generally more concerned with a company's stock price and short-term performance, a strict adherence to a corporate governance framework that protects the "short-term" interests of investors may have the counterproductive effect of eroding long-term growth and innovation in listed companies.

Certainly, some of these new regulations have proven to be more effective than others (e.g., rules regarding disclosure and related-party transactions).[54] At the same time, however, the reform movements have spawned many cumbersome and costly rules that are unproductive (in terms of not being able to prevent more corporate failures) and occasionally destructive.[55] I do not refer to the direct compliance costs, which include fees paid to intermediaries, but to the adoption of a risk-averse nanny culture that is based on box ticking, an overemphasis on regulatory compliance, and short-term demands of investors. Clearly, the

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50. *See* Dominic Barton & Mark Wiseman, *Focusing Capital on the Long Term*, HARV. BUS. REV., Jan. 2014, at 44, 47–51.

51. *See* Guhan Subramanian, *Corporate Governance 2.0,* HARV. BUS. REV., Mar. 2015, at 96, 97–99.

52. Jonas V. Anderson, *Regulating Corporations the American Way: Why Exhaustive Rules and Just Deserts Are the Mainstay of U.S. Corporate Governance*, 57 DUKE L.J. 1081, 1082 (2008).

53. *See generally id.* (detailing U.S. regulations and reforms concerning corporate governance).

54. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, §§ 402–403, 116 Stat. 745, 784–88 (codified at 15 U.S.C. §§ 7261–7266 (2012)).

55. Yaron Brook, *The Government Did It*, FORBES (July 18, 2008, 11:30 AM), http://www.forbes.com/2008/07/18/fannie-freddie-regulation-oped-cx_yb_0718brook.html.

nanny culture is worse than the "sales and marketing culture" described by Steve Jobs in 1995. The nanny culture has only made it more difficult for the "product/technology-oriented" risk takers, innovators, and disruptors to influence the trajectory of established companies.

In order to get a better understanding of the nanny culture, consider the role of corporate governance intermediaries, such as corporate lawyers, accountants, auditors, and other advisors and consultants. These intermediaries are generally considered to be conservative, risk averse, and reluctant to think "out of the box."[56] They tend to recommend boilerplate standardized arrangements and compliance with one-size-fits-all "best practices" rather than offering their clients customized and more optimal organizational solutions.[57] It could, therefore, be argued that intermediaries only contribute to the nanny culture, and there are several reasons for this. First, there is a plethora of best practices in the area of corporate governance,[58] providing intermediaries with a feeling of supposed legal certainty and comfort. Consequently, these intermediaries generally recommend the adoption of these best practices when advising their clients about the organization of intra-firm relationships. Second, with relation to the first, intermediaries have usually invested considerable time and money in becoming familiar with these "best practices," making it difficult to recommend new and innovative solutions. Finally, promoting a new and innovative approach could, if it later does not bring about the coveted success, damage the professional reputation of intermediaries.

The challenge for companies (and their intermediaries) in a networked and digital age is to resolve the dilemma between the (overly) regulated environment and the need for speed in product and business-model innovation.[59] So how can they do this and, at the same time, avoid the nanny culture? The answer is both simple and straightforward; by learning from the world's most innovative companies. That is to say, those established and successful companies that have been able to implement a corporate governance system based upon mutual trust and loyalty and are flexible enough to act as the interface between what a company is today and what it needs to be in the future. This paper covers *Fast Company's* 2015

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56. Cristie Ford & David Hess, *Can Corporate Monitorships Improve Corporate Compliance?*, 34 J. CORP. L. 679, 729 (2009).

57. *Id.* at 723.

58. *Id.* at 714.

59. *See* Marc de Jong & Menno van Dijk, *Disrupting Beliefs: A New Approach to Business-Model Innovation*, MCKINSEY & COMPANY (July 2015), http://www.mckinsey.com/insights/innovation/disrupting_beliefs_a_new_approach_to_business-model_innovation.

and *Forbes'* 2014 lists of the *World's Most Innovative Companies.*[60] More specifically, it examines how they are structured and what we see happening within them. What is it that causes these particular companies to thrive and stay ahead of their competitors in today's environment? As we start to ask ourselves how to design and build these types of companies, we come across certain common themes, such as the importance of founder-CEOs,[61] board diversity (in terms of expertise),[62] collaborative investor-relation strategies that focus on non-financial metrics,[63] and a more fruitful interaction between the company's managers and investors.[64]

II. INNOVATIVE COMPANIES IN THE NETWORKED AGE

Highly innovative technology companies that consider an initial public offering ("IPO"), particularly if there has been a significant degree of hype surrounding the forthcoming listing (which has been the case for most digital technology and social media companies), tend to implement control-enhancing structures that give the founders a tight grip on the control over the newly listed companies' destiny over long time horizons.[65] For instance, these companies will often issue multiple voting shares to the founders to separate beneficial ownership (or cash-flow rights) from control rights (or voting rights), thus giving them voting control in excess of their minority stake in the company.[66] Clearly, there is something to the use of these structures. Not only do they help newly listed companies resist the short-term attitude of the stock market, but also more importantly, these structures protect companies against indifferent investors that have no real interest in the companies' businesses, do not care about the sectors they operate in, nor understand their technical and long-term prospects.

However, the 2014 IPO of the Chinese e-commerce company Alibaba showed again that the use of "control-enhancing" structures

60. *The World's Most Innovative Companies*, FORBES, http://forbes.com/innovative-companies/list [http://web.archive.org/web/20150202083408/http://forbes.com/innovative-companies/list] (last visited Sept. 1, 2015); *World's 50 Most Innovative Companies*, FAST COMPANY http://www.fastcompany.com/section/most-innovative-companies-2015 (last visited Sept. 1, 2015)

61. *See infra* Subpart II.A.

62. *See infra* Subpart II.B.

63. *See infra* Subpart II.C.

64. *See infra* Subpart II.C.

65. Joseph A. McCahery & Erik P.M. Vermeulen, *Business Growth and Firm Value Creation: The "Ignored" Third Dimension of Corporate Governance*, 2 J. SELF-GOVERNANCE & MGMT. ECON. 69, 73 (2014).

66. *Id.*

is not without controversy.[67] To be sure, Alibaba has not issued multiple voting shares but has implemented a "partnership structure" that gives a small group of managers (including Founder Jack Ma) the exclusive right to nominate the majority of the directors of the board.[68] Despite this controversial governance structure, Alibaba raised $25 billion at its IPO, making it the biggest IPO in the world.[69] Nevertheless, corporate governance experts continue to argue that investors should be careful, since control-enhancing structures are prone to severe agency problems that cannot be ignored.[70] First of all, these structures could seriously undermine the accountability of an owner/founder/CEO to the board of directors and the investors. Second, these structures could make the board of directors look like a "toothless" tiger because the controlling owner (who is often the founder), the CEO, and/or Chairman of the board have the ability to overrule any board decision. Finally, the lack of accountability could contribute to an increase of information asymmetries, which in turn may lead to corporate failure and a decrease in investor confidence.

It is not my intention to restart the discussion about control-enhancing mechanisms here.[71] This Article is more interested in the general governance structures of established companies that can still be viewed as the most innovative companies in the world. An obvious list that immediately comes to mind in this context is *Fast Company*'s *The World's 50 Most Innovative Companies*.[72] In order to be regarded as one of the most innovative companies, a company must excel in creativity, real-world impact, risk taking and execution. Unsurprisingly—and in light of what has been said so

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67. Lucian Bebchuk, *Alibaba's Governance Leaves Investors at a Disadvantage*, N.Y. TIMES: DEALBOOK (Sept. 16, 2014, 2:00 PM), http://dealbook.nytimes.com/2014/09/16/alibabas-governance-leaves-investors-at-a-disadvantage/.

68. Prudence Ho & Juro Osawa, *Alibaba Details Partnership Structure*, WALL STREET J.: MONEYBEAT (June 19, 2014, 12:18 AM), http://blogs.wsj.com/moneybeat/2014/06/19/alibaba-details-partnership-structure/.

69. Ryan Mac, *Alibaba Claims Title for Largest Global IPO Ever with Extra Share Sales*, FORBES (Sept. 22, 2014, 11:51 AM), http://www.forbes.com/sites/ryanmac/2014/09/22/alibaba-claims-title-for-largest-global-ipo-ever-with-extra-share-sales/.

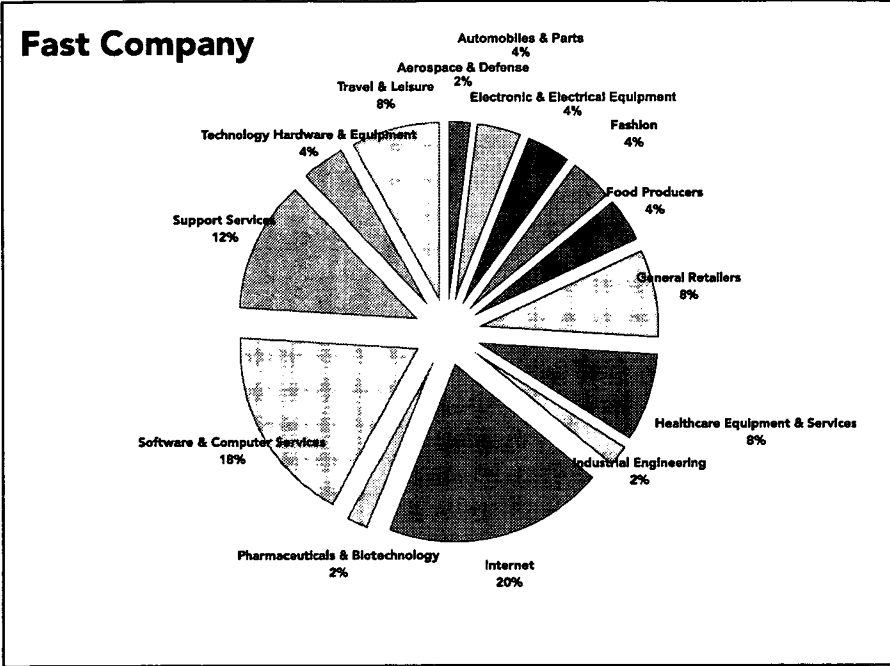
70. ERIK P.M. VERMEULEN, BENEFICIAL OWNERSHIP AND CONTROL: A COMPARATIVE STUDY 12 (2012), http://www.oecd.org/corporate/ca/corporategovernanceprinciples/50068886.pdf. *See generally* J. Thomas Connelly et al., *Form Versus Substance: The Effect of Ownership Structure and Corporate Governance on Firm Value in Thailand*, 36 J. BANKING & FIN. 1722 (2012) (providing empirical evidence that pyramid structures have a negative impact on firm value).

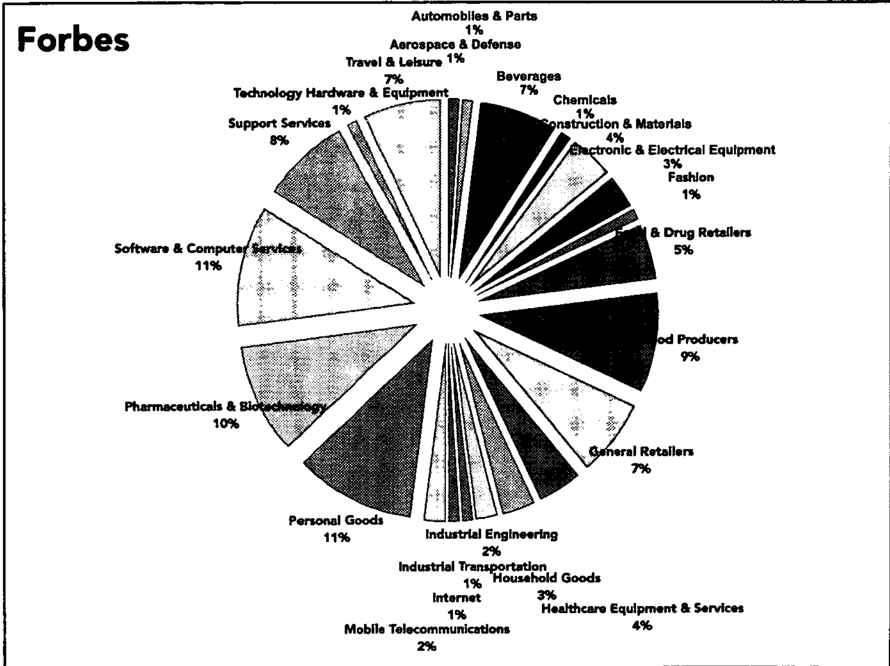
71. *See* Joseph McCahery & Erik Vermeulen, *Insider Trading*, 2013 ICGN Y.B. 60, 60 (2013).

72. FAST COMPANY *supra* note 60.

far—these companies have, for the most part, made it onto *Fast Company*'s list by demonstrating that they have begun to design, develop, and implement the four digital technologies (cloud computing, big data, mobile, and social media) in their business models in order to support their growth and sustainable development.

FIGURE 1: THE WORLD'S MOST INNOVATIVE COMPANIES (BY INDUSTRY)





What is more important here is that these highly innovative and entrepreneurial companies stand out by their "product-driven" culture. Note that in eighty percent of the companies that appear on the *Fast Company* 2015 list, the visionary, entrepreneurial, and passionate founders are still active as CEO, Chairman, or director. Another remarkable observation is that seventy-six percent of the companies on the list are private and nonlisted. What is perhaps even more important is that most of the listed companies (sixty-seven percent) have established structures that allow founders (or families) to run their companies as if they were private companies (recall the Alibaba example). These findings seem to indicate the importance of a flat hierarchy in highly innovative companies. This echoes themes in the literature on innovation and entrepreneurship about how the pace of innovation tends to be much faster in companies with looser organizational forms than in companies with more hierarchical structures where the seniority of the person proposing a particular idea determines the adopted solution.[73]

Unfortunately, however, with a vast majority of the companies being managed as private fiefdoms, it is clear that the *Fast Company* list does not provide an awful lot of information about how listed companies that were once viewed as winners can prolong their relevance. Here, the *Forbes* 2014 list of the *World's Most Innovative Companies* offers a solution.[74] In order to be included in the 2014 list, seven years of public financial data had to be available, which excluded private companies and companies with incomplete data.[75] Also important is that the companies on the *Forbes* list operate in a wider variety of industries (except within the oil and gas industry and the financial industry) than the companies on the *Fast Company* list.[76] The companies on the *Forbes* list include companies from North America, Europe, Asia, South America and Africa, whereas the *Fast Company* list companies are mostly located in the United States.[77]

Despite the fact that the *Forbes* list contains less "traditionally technology-oriented" companies (such as Internet and software companies) than the *Fast Company* list, the companies on the *Forbes* list are considered game-changing companies that continue

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73. *See* Mark Fenwick & Erik P.M. Vermeulen, *Alternatives to Silicon Valley: Building Your Global Business Anywhere* 8 (Lex Research Topics in Corp. Law & Econ., Working Paper No. 2015-2, 2015).

74. FORBES, *supra* note 60.

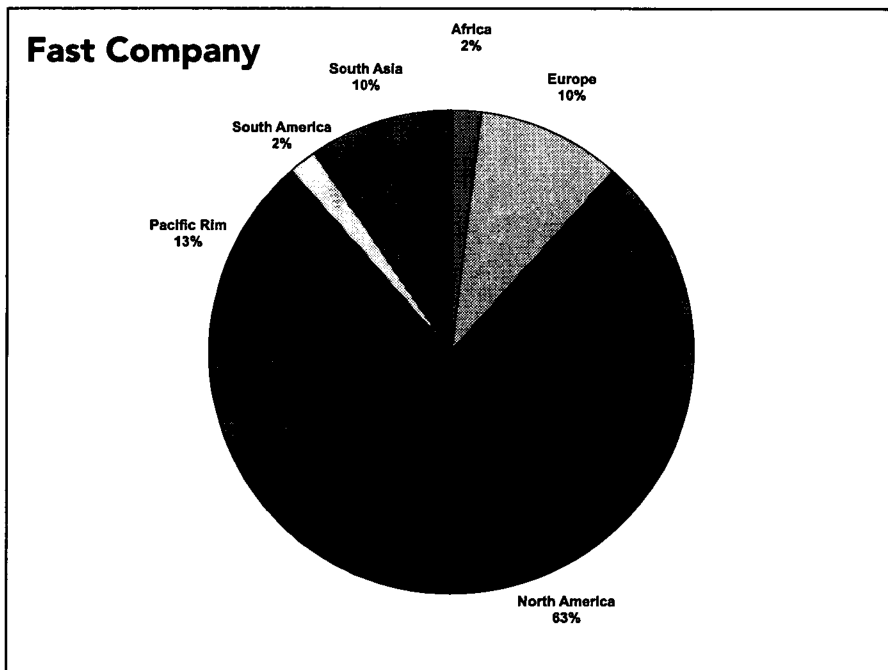
75. Jeff Dyer & Hal Gregersen, *About 'The Innovator's Method' Research*, FORBES (Aug 20, 2014, 9:40 AM), http://www.forbes.com/sites/innovatorsdna/2014/08/20/about-the-innovators-method-research/.

76. *Id.*; *see also* Joseph A. McCahery & Erik P.M. Vermeulen, *Understanding the Board of Directors After the Financial Crisis: Some Lessons for Europe*, 41 J. LAW & SOC'Y 121, 133 (2014).

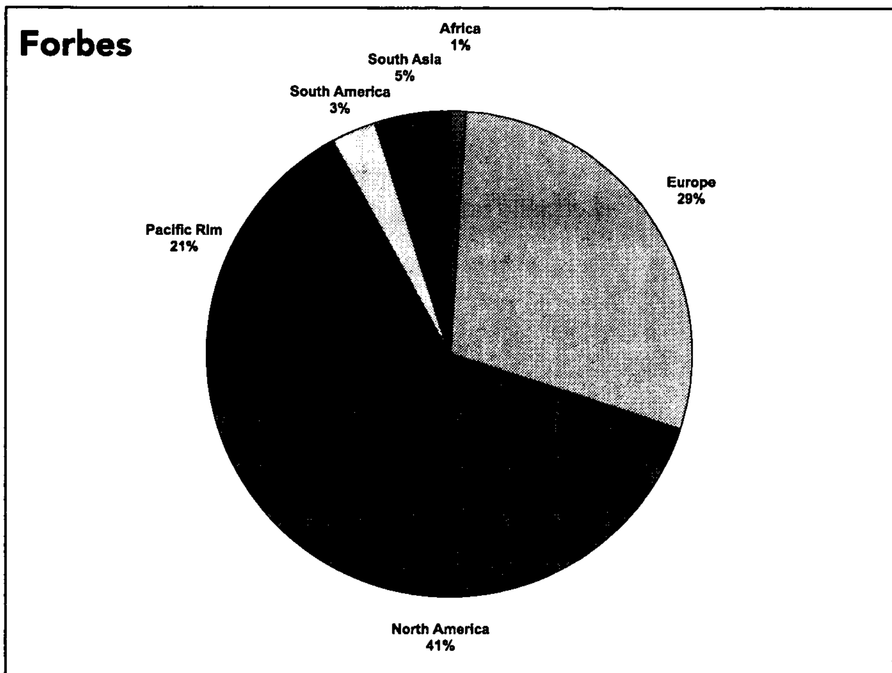
77. *See* Figure 2.

to be driven by innovation. *Forbes* has ranked the companies by their innovation premium, which could be defined as the difference between the market capitalization and the net present value of the cash flows generated by the company's existing products and processes.[78] The expectation that these companies will introduce the next big innovation explains the "innovation premium." The higher the expectation for the introduction of innovative products and/or processes, the higher the premium. Clearly, the innovation premium can often be explained by the companies' ability to adapt to the new digital and network realities. This should be no revelation, but if you need an example, consider hotel groups, such as Starwood Hotels and Marriott International, that try to win over the new generation of millennial travelers who are often described as "digital natives" by creating a technology-advanced experience in their hotels.[79]

FIGURE 2: THE WORLD'S MOST INNOVATIVE COMPANIES (BY REGION)



78. Dyer & Gregersen, *supra* note 75.
79. *See* Hugo Martin, *Hotel Giants Target Tech-Savvy Millennial Travelers*, L.A. TIMES (Mar. 28, 2015, 12:00 PM), http://www.latimes.com/business/la-fi-millennials-hotels-20150329-story.html.



In the next Parts, all 100 listed companies that appear in the *World's Most Innovative Companies* list are examined (this will avoid the so-called "selection bias"). This database is a starting point to find out more about the organization and governance structure of companies that have either higher-than-average growth potential or show a higher-than-average interest in product/process innovation. It is not my intention to explain all the variances in corporate governance structures/mechanisms within these companies, but rather to show that there are some general points of good practice that could provide companies with a competitive advantage. It appears that the most innovative companies have a visionary/founder-type CEO,[80] preserve the entrepreneurial spirit and product orientation in the board of directors,[81] and also have a responsible owner or established open communication with shareholders.[82] Another observation is that ownership and control structures appear to be firm specific and vary across life cycle stages, sectors, regions, countries, and cultures.[83] These structures are also dynamic in that they change over time according to evolving markets and shifting business strategies and practices.[84] What is interesting is that the use of multiple voting shares within

80. *See infra* Subpart II.A.
81. *See infra* Subpart II.B.
82. *See infra* Subpart II.C.
83. *See infra* Subpart II.C.
84. *See infra* Subpart II.C.

companies on the list often disappeared during the life cycle of the company, thereby making the discussions about these types of shares somewhat academic. This was only different in countries where these control-enhancing mechanisms are rather common (e.g., in the Scandinavian countries).

A. *The Chief Executive Officer*

When Marc Andreessen, cofounder of Netscape, announced the formation of a new venture capital firm with his partner Ben Horowitz in 2009, he wrote in a blog post that their new firm would be "hugely in favor of the founder who intends to be CEO."[85] The rationale behind their preference was that most of the successful technology companies of recent years were run by a founder for a long period of time, often decades. They referred not only to the usual suspects (e.g. Jeff Bezos at Amazon, Steve Jobs at Apple, Michael Dell at Dell, Bill Gates at Microsoft, and Larry Ellison at Oracle) but also to other companies that appear on the list of the *World's Most Innovative Companies* (e.g. Marc Benioff at Salesforce.com and Diane Green at VMware).[86]

Listening to *Steve Jobs: The Lost Interview*, it immediately becomes clear why Marc Andreessen and Ben Horowitz prefer founder-CEOs over professional ones in their portfolio companies. They acknowledge that professional CEOs are probably better placed and equipped to streamline the operational processes of existing products but generally are not able to do what it takes to succeed in a networked age: finding, developing, and scaling new products and solutions.[87] As a counterargument, one could immediately point out that in the traditional model of a professional CEO, product development and innovation are not ignored. At professionally managed startup companies, the founders are often still at the helm of innovation. Indeed, even after the CEO transition, founders often remain in key leadership roles, for example as Chief Technology Officer or Chief Innovation Officer.[88]

Still, in their new roles, the founders often lack the incentive to monitor the company closely and lead it for the long term. The reasons for this are simple: they are not personally exposed to the

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85. Marc Andreessen, *Introducing Our New Venture Capital Firm Andreessen Horowitz*, BLOG.PMARCA.COM (July 6, 2009), http://blog.pmarca.com/2009/07/06/introducing-our-new-venture-capital-firm-andreessen-horowitz/.

86. FORBES, *supra* note 60; *Why We Prefer Founding CEOs*, ANDREESSEN HOROWITZ: BEN'S BLOG (Apr. 28, 2010), http://www.bhorowitz.com/why_we_prefer_founding_ceos.

87. STEVE JOBS: THE LOST INTERVIEW, *supra* note 28.

88. *See* Niv Dror, *Marc Andreessen on Big Breakthrough Ideas and Courageous Entrepreneurs*, DATAFOX (Apr. 26, 2014), http://www.datafox.co/blog/2014/04/marc-andreessen-on-big-breakthrough-ideas-and-courageous-entrepreneurs/.

company's shareholders and other stakeholders anymore.[89] The downside of this is that the cost reduction and sales growth (instead of innovation and disruption) become the driving forces behind the future growth and development of companies. So, should we ignore operations, sales, and marketing in the networked age? No, of course not. But these skills and expertise should be built around a technology genius CEO. Mark Andreessen calls this management model the Mark Zuckerberg/Sheryl Sandberg partnership.[90] Mark Zuckerberg, the technology genius founder, is the CEO of Facebook while Sheryl Sandberg, the "high-powered business person with deep capabilities in sales, marketing, and operations," became the Chief Operations Officer.[91]

Clearly, not all founders have it in them to become successful and visionary CEOs. Additionally, an effective founder-CEO will retire and must be replaced at some point in a company's life cycle. Moreover, in family-controlled or corporate-controlled companies, it is quite often impossible to determine who the founders are (and whether they are still active). The question thus is: Who should be the new CEO and how should he or she run the company? This appears to be a difficult question to answer. Highly successful companies often lose their mojo and competitive advantages to other companies due to inappropriate CEO successions (which then lead to a more complicated exercise to reinvent or restructure a company in times of crisis).[92]

As a general rule, when a new CEO has to be appointed, an insider-executive who has grown up in the company or has spent a significant period of his or her career at the company increases the chances of a successful transformation.[93] In 2014, 78 of the 100 best-performing CEOs in the world were insiders.[94] These insiders

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89. Jose Miguel Mendoza, Christoph Van der Elst & Erik P.M. Vermeulen, *Entrepreneurship and Innovation: The Hidden Costs of Corporate Governance in Europe*, 7 S.C. J. INT'L L. & BUS. 1, 29 (2010) ("[Google's dual-class structure] gives controlling shareholders an incentive to monitor the firm closely and exposes the founders personally to the firm's public shareholders and other stakeholders.").

90. Bill Snyder, *Marc Andreessen: "I'm Biased Toward People Who Never Give Up"*, INC. (June 30, 2014), http://www.inc.com/bill-snyder/marc-andreesen-why-failure-is-overrated.html.

91. *Id.*

92. Stephen A. Miles, *Why So Many Companies Fail at CEO Succession Planning*, BLOOMBERG BUS. (June 23, 2011), http://www.bloomberg.com/bw/stories/2011-06-23/why-so-many-companies-fail-at-ceo-succession-planningbusinessweek-business-news-stock-market-and-financial-advice.

93. Greg Carrott, *The Five Essential Steps for Picking the Right CEO*, FORBES (Apr. 13, 2009, 6:20 PM), http://www.forbes.com/2009/04/13/ceo-search-executives-leadership-governance-choosing.html.

94. Adi Ignatius, *The Best-Performing CEOs in the World*, HARV. BUS. REV., Nov. 2014, at 47, 50–56.

usually show more compassion and commitment and, most importantly, pay more attention to the interests of employees and the existing corporate culture.[95] This is important, because if reorganization and restructuring activities interfere too heavily with the corporate culture, then they are likely to have a detrimental effect on the performance and growth prospects of a company. Obviously, the insider-CEO must have experience with developing and scaling new innovative and disrupting products and processes either within or outside the company.[96] It is usually preferred that he or she is a "product person," instead of a "business-oriented" person with expertise in sales, marketing, and operations.[97] Mark Leslie, serial entrepreneur and investor, makes the distinction between "opportunity-driven" and "operationally driven" leaders.[98]

That is not to say that outsider-CEOs will always fail. IBM is a clear and well-known example of a successful "outsider CEO transition." In 1993, after the company reported a loss of more than $8 billion, IBM was labeled as a dinosaur that was on the brink of extinction.[99] What could be done to successfully turn the company around? Although there was not a one-size-fits-all answer, a typical solution was to appoint an insider-CEO. IBM, however, decided to deviate from this "common procedure" and appointed Louis V. Gerstner Jr., who was recruited from outside IBM.[100] Besides going through the necessary and often dramatic reorganizations (such as reducing the workforce from approximately 370,000 employees in 1990 to a bit more than 220,000 employees in 1995), IBM's new CEO made a remarkable and often undervalued decision: he avoided splitting up the company and destroying the unique and valuable corporate culture, deciding instead to reposition IBM by connecting the different units, departments, and country organizations.[101]

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95. Steven Wheeler, *Why Your Next CEO Should Come from Inside*, STRATEGY+BUS. (Dec. 11, 2007), http://www.strategy-business.com/article/li00055?gko=9ef68.

96. *See* Joseph L. Bower, *The Most Successful CEOs Come from Within*, HARV. BUS. REV.: LEADERSHIP (Sept. 30, 2011), https://hbr.org/2011/09/most-successful-ceos.html.

97. Steve Denning, *Why Did IBM Survive?*, FORBES (July 10, 2011, 3:55 AM), http://www.forbes.com/sites/stevedenning/2011/07/10/why-did-ibm-survive/ (describing how incoming IBM CEO Lou Gerstner saved IBM by listening to and focusing on clients).

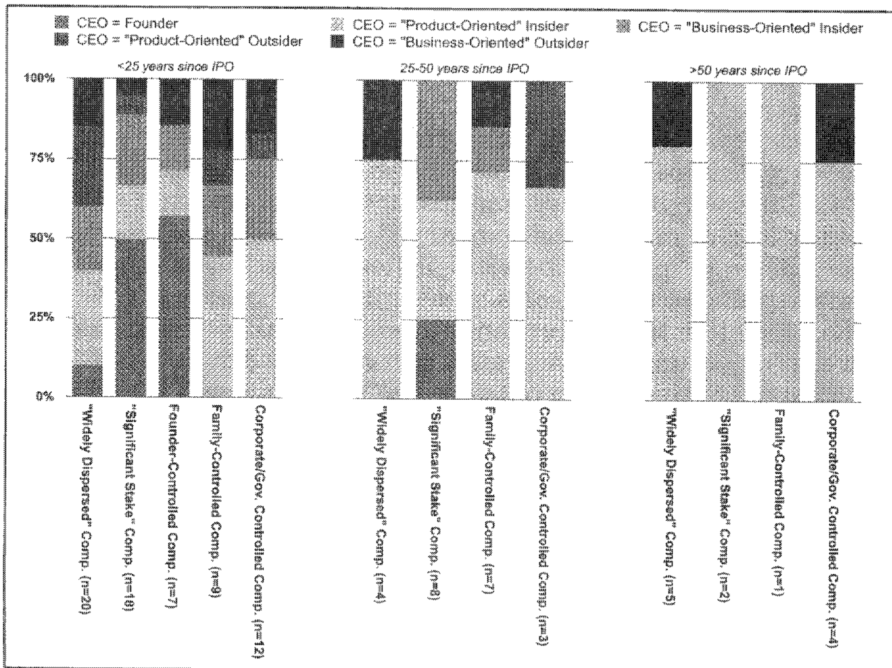
98. *See* Mark Leslie, *The Arc of Company Life—And How to Prolong It*, FIRST ROUND REVIEW, http://firstround.com/review/The-Arc-of-Company-Life-and-How-to-Prolong-It/ (last visited Sept. 1, 2015).

99. *Id.*

100. *Id.*

101. *See* Louis V. Gertner, Jr., WHO SAYS ELEPHANTS CAN'T DANCE?, LEADING A GREAT ENTERPRISE THROUGH DRAMATIC CHANGE 57–62 (2002).

FIGURE 3: WHO IS THE CHIEF EXECUTIVE OFFICER?



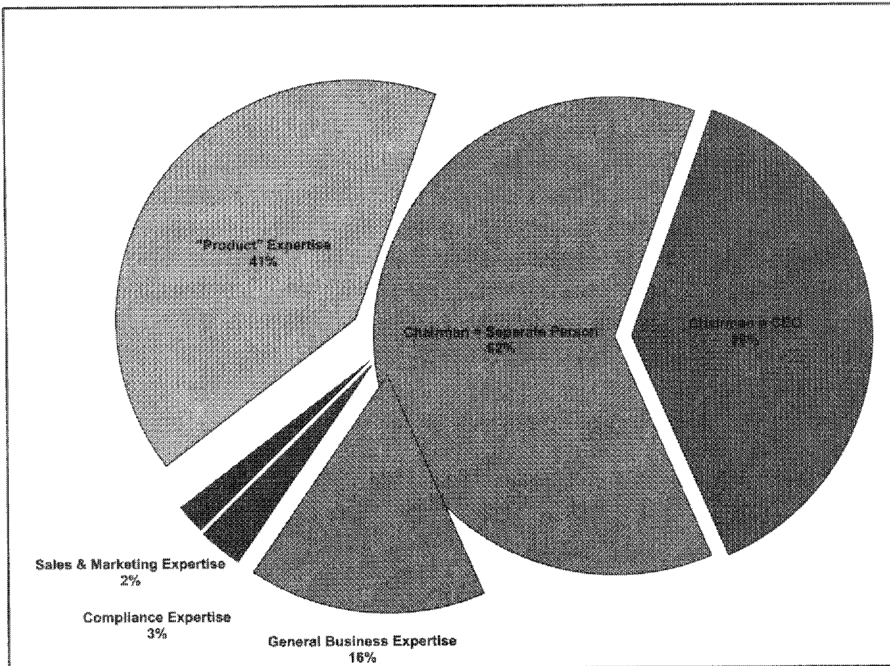
And there is more. So far, we have assumed that CEOs should be visionary, entrepreneurial, product oriented, and innovation minded. Executives with deep capabilities in operational, sales and marketing processes can be hired to assist them. This is often different in family-controlled and corporate-controlled companies. In these companies, the controlling owners—after having decided to become less active in the day-to-day management of the business—may prefer a "steward" or "governor" as the CEO.[102] The steward and governor-CEOs are not on a level playing field with the owners. They operate the business within the boundaries set by the owners. It would be interesting to see how the owners of controlled companies deal with CEO appointments across the life cycle of their companies. It is to be expected that corporate-owned companies will generally appoint a steward/governor-CEO. Family-owned companies that were, for whatever reason, forced to appoint a nonfamily CEO would likely be better off with a visionary CEO who replaces the owner when it comes to setting the strategy and future trajectories of the company.

To get a better understanding and appreciation of the identities and qualities of CEOs in established and mature companies (that

102. *See* Claudio Fernández-Aráoz et al., *Leadership Lessons from Great Family Businesses*, HARV. BUS. REV., Apr. 2015, at 82, 86.

have been successful in staying relevant in a fast-changing networked and digital environment), the respective biographies of the CEOs from the *Forbes' World's Most Innovative Companies* were collected from the companies' websites and supplemented by information that was collected by the *Financial Times* and *Morningstar*.[103] In order to ensure a level of comparability between firms, the information was broken down into three separate timeframes for when a company pursued its IPO (less than twenty-five years ago, twenty-five to fifty years ago, or more than fifty years ago). The list was also divided between companies with a widely dispersed ownership structure, companies with a significant shareholder (usually owners with a stake of approximately five percent but certainly less than fifty percent), and companies with a controlling shareholder structure (more than fifty percent of the voting rights). Interestingly enough, the list contains a healthy mix of companies in the described categories.

FIGURE 4: WHO IS THE CHAIRMAN OF THE BOARD OF DIRECTORS?



Just take a look at Figure 3 where founder-CEOs play an important role in companies that pursued an IPO less than twenty-

103. This information is available through the respective websites. *Markets Data*, FIN. TIMES, markets.ft.com (last visited Sept. 8, 2015); MORNINGSTAR www.morningstar.com (last visited Sept. 8, 2015).

five years ago.[104] In most cases, these founder-CEOs also had a controlling or significant stake in "their" company.[105] Though it may be a far cry to extrapolate a causal relationship between founder-CEOs and the company's innovation premium, the numbers indicate that there is some sort of correlation. Moreover, it may also come as no surprise that the use of the insider-CEO model increases with the age of the company (starting from its IPO).[106] Outsider-CEOs were only appointed in relatively few companies.[107] When insider-CEOs or outsider-CEOs were appointed in controlled companies, the CEO could be described as visionary and product oriented, working as an equal partner with the controlling owner.[108] Finally, "product CEOs" play a dominant role in most of the older *Forbes' World's Most Innovative Companies*.[109] Although we have to be careful in drawing any strong (one-size-fits-all) conclusions, it appears that the appointment of inside "product-CEOs" increases the chance of withstanding the test of time.

The research is also quite indicative when it comes to the question of whether the roles of chairman and CEO should be separated. Consistent with prior research that has analyzed different types of board structure in terms of the firm's risk oversight responsibility, the answer would be in the affirmative.[110] In practice, though, the one-person–CEO-chairman model might sometimes be the preferred way of working since it avoids disharmony, conflicts, and time-consuming ambiguous leadership issues. Nevertheless, Figure 4 indicates that the "separation of CEO and Chairman" model is the preferred model in the organizations of the "most innovative" companies.[111] Note that the Chairman is predominantly product oriented.[112] In fact, the "separation of CEO and Chairman" model appears to be extremely powerful if the founder, former CEO, or representative of the controlling shareholder takes the chairman's position, particularly when the

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104. *Supra* Figure 3; *see also* Ben Narasin & Michael Abbott, *The Importance of Founders*, TECHCRUNCH (May 11, 2015), http://techcrunch.com/2015/05/11/the-importance-of-founders/ (concluding that "founders are better CEOs than professionals" based on their success in IPOs and mergers and acquisitions from 1994 to 2014)

105. *See supra* Figure 3.

106. *See supra* Figure 3.

107. *See supra* Figure 3.

108. *See supra* Figure 3.

109. *See supra* Figure 3.

110. *See* Peter Whitehead, *Non-Executive Director: A Task for Which No One is Qualified*, FIN. TIMES (Apr. 10, 2013, 5:24 PM), http://www.ft.com/intl/cms/s/0/33ec6b3e-9099-11e2-a456-00144feabdc0.html#axzz3jgTpy9H2.

111. *See* Reid Hoffman, *If, Why, and How Founders Should Hire a "Professional" CEO*, REIDHOFFMAN.ORG (Jan. 21, 2013), http://reidhoffman.org/if-why-and-how-founders-should-hire-a-professional-ceo/.

112. *See supra* Figure 4.

company "ages" and founders begin to retire from active participation in management.[113]

B. The Board of Directors

The goal of this section is to underscore the importance of board composition and dynamics (particularly the role of independent board members with innovative and disruptive product-cycle experience and expertise) as key governance mechanisms that are often ignored in the corporate governance debate. While policymakers and regulators around the world have emphasized the need to increase the role of boards in the area of risk management and managerial oversight,[114] a first assessment of the boards of directors on the *Forbes Most Innovative Companies in the World* list indicates that boards can play a larger role in the creation of new products/processes (which eventually lead to a longer corporate life cycle) than initially thought.

Prior studies have established that there is generally no lack of growth-oriented spirit on the boards of venture-backed companies that are private or just completed their IPOs.[115] Lock-up periods, which prevent venture capitalist investors from exiting the company upon or immediately after the IPO, partially explain the position of venture capitalists on boards of newly listed companies.[116] Prior research also underscores the importance of having venture capitalists (with their specific focus on product cycles) on the boards of companies during the later stages of their life cycle.[117] Venture capitalists could assist a mature company's executive management with initiating open innovation strategies through which the company partners with smaller startups, universities, or other research institutions.[118] Certainly, these open innovation strategies,

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113. *See supra* Figure 4.

114. *See* Joseph A. McCahery, Erik P.M. Vermeulen & Masato Hisatake, *Understanding the Role of the Board of Directors: What Is the Right Balance Between Managerial Oversight and Value Creation?*, *in* 10 BOARDS OF DIRECTORS IN EUROPEAN COMPANIES: RESHAPING AND HARMONIZING THEIR ORGANIZATION AND DUTIES 301, 302 (Hanne S. Birkmose et al. eds., 2013).

115. *See* Natee Amornsiripanitch, Paul Gompers & Yuhai Xuan, More than Money: Venture Capitalists on Boards 24–25 (Mar. 1, 2015) (unpublished manuscript), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2586592.

116. Salim Chahine & Marc Georgen, *VC Board Representation and IPO Performance*, 38 J. OF BUS. FIN. & ACCT. 413, 426 (2011).

117. *See generally* Ugur Celikyur et al., *Venture Capitalists on Boards of Mature Public Companies*, 27 REV. FIN. STUD. 56 (2014) (finding that venture capitalist directors have a positive effect on innovation outcomes and investment policies at mature public firms in ways such as increases in R&D intensity and innovation outcomes, increases in mergers and acquisitions, and improvements in acquisitions that enhance firm value).

118. JANKE DITTMER, JOSEPH A. MCCAHERY & ERIK P.M. VERMEULEN, THE "NEW" VENTURE CAPITAL CYCLE AND THE ROLE OF GOVERNMENTS: THE EMERGENCE OF

that are increasingly viewed as a successful "healthy aging" model in the life cycle of listed companies,[119] may provide a possible explanation for the relatively high number of private investors and venture capitalists that were appointed on the boards of directors of the innovative companies on *Forbes'* list.[120]

As a remarkable example of the relationship between venture capital board members and "open innovation" initiatives, consider iFund, which is a $200 million investment initiative created by Kleiner Perkins Caufield & Byers (a renowned venture capital fund) in partnership with Apple.[121] The investment collaboration targets the development of applications, services, and components for Apple's iPhone, iPod Touch, and iPad.[122] What makes this example interesting is that, besides being a director at Apple, Al Gore is also a senior partner at Kleiner Perkins Caufield & Byers.[123] From the perspective of the increasing importance of corporate venturing activities (as a way to create a window to the global innovation market), it is only to be expected that the number of venture capital investors on the board of established publicly listed companies will increase in a networked and digital age.

Consistent with this expectation, an analysis of our sample clearly shows the importance of board diversity. Figure 5 presents evidence on board diversity in terms of expertise. Most companies in the sample have boards that consist not only of independent members with general management and global business experience and expertise (which is usually met by the presence of other CEOs, former CEOs, business consultants, and private equity investors), but also compliance-oriented members, such as accountants, auditors and lawyers. What is most important is that the boards have selected a number of individuals with substantive knowledge of products, product cycles, and innovation. Unsurprisingly, in the networked age, the technical experts outnumber the members that are experienced and skilled in "sales and marketing."[124]

COLLABORATIVE FUNDING MODELS AND PLATFORMS 24 (2014), http://www.dsf.nl/wp-content/uploads/2014/10/DSF-Policy-Paper-No-43-The-"New"-Venture-Capital-Cycle-and-the-Role-of-Governments.pdf.

119. Joseph A. McCahery & Erik P.M. Vermeulen, *Venture Capital Beyond the Financial Crisis: How Corporate Venturing Boosts New Entrepreneurial Clusters (and Assists Governments in Their Innovation Efforts)*, 5 CAP. MKTS. L.J. 471, 473 (2010).

120. *See infra* Figure 5.

121. *KPCB Doubles iFund to $200 Million*, KPCB (Mar. 31, 2010), http://www.kpcb.com/news/kpcb-doubles-ifund-to-200-million.

122. *Id.*

123. *Al Gore*, KPCB, http://www.kpcb.com/partner/al-gore (last visited Sept. 1, 2015).

124. *See infra* Figure 5.

A significant number of independent board members could thus be categorized as what Steve Jobs called "product people."[125] Who are they? Often such individuals were at the helm of product innovation or product development at companies that operate in similar markets or in the peripheries of a company's core business, whereas others hold academic positions, particularly in the area of biotech, medicine, and engineering. This is consistent with our intuitions that their presence can be invaluable in identifying issues and opportunities regarding disruptive innovations. More importantly, they are able to add vision and passion to the board of directors.[126] The evidence indicates that most companies realize that they operate in uncertain, fast-moving, and highly competitive markets. What is interesting in this respect is that the top fifty companies on the *Forbes* list have on average two "product-oriented" independent board members compared to one product-oriented board member in the bottom fifty companies.

Finally, what is noteworthy is that the composition of the board of directors is "fluid" and dynamic in nature. This is also reflected in Figure 5, which confirms that the composition of the board of directors is dependent on the ownership structure of the company.[127] A greater-than-average number of board members with specific product-cycle expertise can be found in companies that are characterized by a widely dispersed ownership structure. In "controlled" companies, managements' decisions regarding product innovation and development are usually challenged by the significant or controlling shareholders. This is only different in a founder-ownership structure.[128] The most important reason for this is that these companies often operate in the most volatile and unpredictable sectors, such as pharmaceuticals, biotechnology, and software.

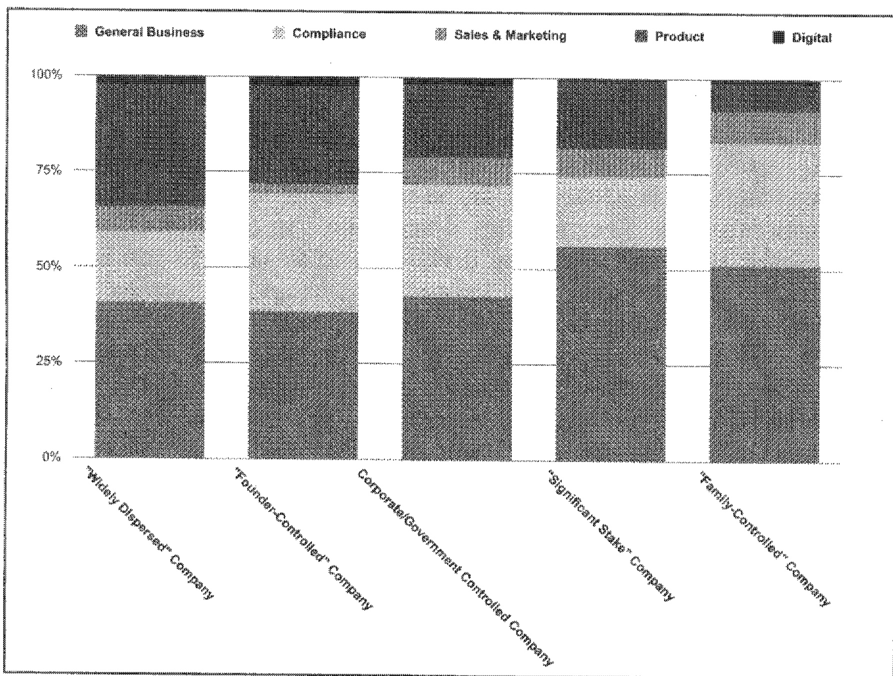
125. Tweedie, *supra* note 11.

126. Peter Whitehead, *Better Boards: Company Secretaries Give Their Views on Non-Executive Roles*, FIN. TIMES (June 19, 2013, 3:06 PM), http://www.ft.com/intl/cms/s/0/eae53020-cea4-11e2-8e16-00144feab7de.html#axzz3fmpoRrYs.

127. *See supra* Figure 5.

128. *See supra* Figure 5.

FIGURE 5: WHO ARE THE (INDEPENDENT) DIRECTORS?



Another observation in this regard is of the digital technology experts that were appointed to the boards of directors of some companies in our sample. Since their value-added contributions in the networked age is beyond any doubt, many more companies will predictably appoint "digital-technology people" onto boards of directors as a necessary step to deal with the digital challenges and opportunities in today's business environment. We have mentioned already the need for developing digital-centered business models for the design and production of new products and processes,[129] and we can also add the importance of connecting and communicating with shareholders by using digital technology.

C. *Investor Relations*

The recent financial crisis has led to a general belief that the benefits of controlling ownership structures outweigh the costs of private benefits of control that these owners expropriate from their companies (including the minority shareholders).[130] The argument is mainly based on the fact that controlled companies from fast-

129. *See supra* text accompanying notes 12–17.

130. *See* COLIN MAYER, FIRM COMMITMENT: WHY THE CORPORATION IS FAILING US AND HOW TO RESTORE TRUST IN IT 227 (2013).

growing markets, such as Samsung and the Tata group, have become serious competitors to their rivals in developed economies.[131] In fact, our sample indicates that there is a revival of controlling ownership structures on a global scale, with forty-three percent of the companies in the sample having a controlling owner. It has also become popular for founders, CEOs, families, or other companies to have a significant stake (of less than fifty percent). This structure can be found in 28 of the 100 observations.

Despite these observations, it would be too simplistic to draw conclusions about superior ownership and control structures from the sample. As noted, the drawback of the single-recipe approach is that it fails to recognize in general terms that one structure is unlikely to be more effective than another as it very much depends on a company's life stage and the sectors, regions, countries, and cultures it operates in. The *Forbes* sample confirms this view; investors (and other stakeholders) appear to appreciate diversity in ownership structures. The conclusion is that corporate ownership and control discussions should be segregated from discussions about the sustainable growth and innovation processes in listed companies.

What is important though is to look at the role of investors in dealing with the challenge of sustainable growth. Various studies suggest that the collaboration between corporate boards, management, and shareholders can promote economic growth and increase the value of the firm.[132] If direct engagement indeed promotes better governance and firm value, then the relationship between the parties can be enhanced by the quality of the communications and, as a result, add value to the firm. There is much we can learn from the companies in our sample.

In practice, different repertoires of engagement with investors can be observed and then roughly be split into three distinct and separate categories. On one end of the spectrum, there are companies that just comply with the respective minimum rules and regulations regarding the interaction and communication with minority investors. They organize annual shareholder meetings, respect the shareholders' legal rights, and provide investors with the mandatory quarterly and annual reports. The compliance-based

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131. *See id.* at 195–97; Jungah Lee, *Samsung's First Family Struggles to Keep Grip on Company*, BLOOMBERG BUS. (July 23, 2014, 2:53 AM), http://www.bloomberg.com/news/articles/2014-07-22/inside-the-lee-family-s-struggle-to-keep-grip-on-samsung.

132. SUNEELA JAIN ET AL., THE CONFERENCE BOARD GOVERNANCE CENTER WHITE PAPER: WHAT IS THE OPTIMAL BALANCE IN THE RELATIVE ROLES OF MANAGEMENT, DIRECTORS, AND INVESTORS IN THE GOVERNANCE OF PUBLIC CORPORATIONS? 3 (2014), http://tcbblogs.org/public_html/wp-content/uploads (select "The Conference Board Governance Center White Paper.pdf").

interactions with investors are characterized by a "check-the-box" attitude, which usually results in boilerplate statements and presentations about corporate governance and the company's past performance and growth opportunities. These approaches are usually the norm in firms, which operate in the shadow of the innovative and disruptive companies.

On the other end, some companies go beyond the strict compliance of these rules and adopt a more integrated approach to the communication and presentation of information. These companies are usually characterized by the owners, founders or visionary (and often charismatic) CEOs who position themselves as "managing partners"/dominant leaders of a "corporate partnership." They will explain in detail how they are going to propel "their" company towards value creation in the short, medium, and long term. As a real partner, they also admit operational mistakes and challenges.

An ultimate and well-documented example of a company that has a "partnership" attitude is Warren Buffet's Berkshire Hathaway.[133] It could be argued that the companies in our sample (who have made it explicit that they are managed for the long term rather than on a quarter-to-quarter cycle) have emulated, intentionally or not, some of Berkshire's practices—e.g., an inclusive and collaborative management style (in which the company's shareholders and stakeholders are viewed as a community or an ecosystem rather than a company), a thrifty corporate culture, and a conservative dividend policy (the shareholders of Berkshire have not received any dividend since 1967).[134] Interestingly in this regard is that companies with a more conservative dividend policy generally have a higher "innovation premium."[135]

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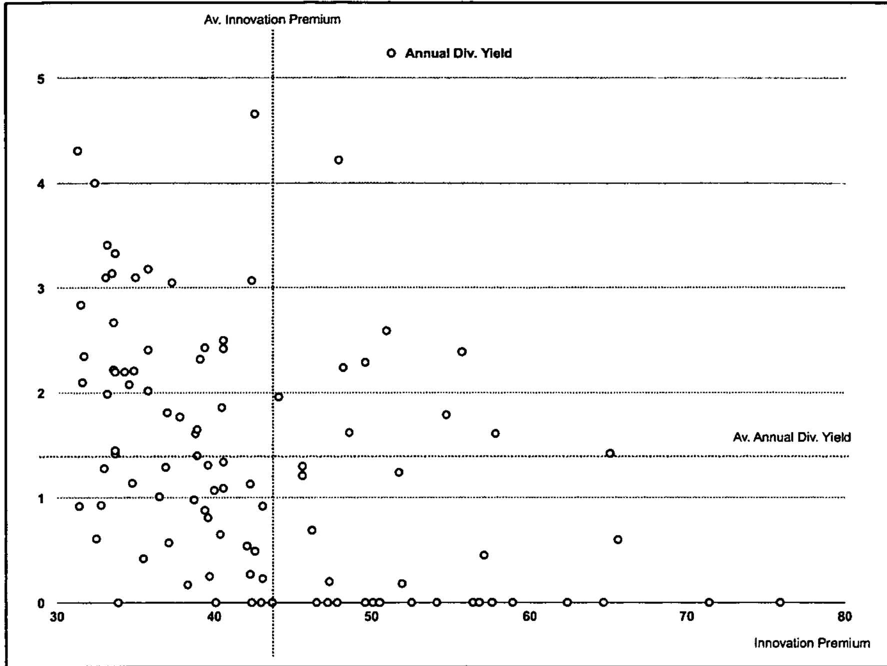
133. *See* LAWRENCE A. CUNNINGHAM, BERKSHIRE BEYOND BUFFET, THE ENDURING VALUE OF VALUES 36–41 (2014); Lawrence A. Cunningham, *Berkshire's Disintermediation*, 50 WAKE FOREST L. REV. 509, 511 (2015).

134. CUNNINGHAM, *supra* note 133 at 36–41, 45–58, 208.

135. *See* Figure 6.

FIGURE 6: ANNUAL DIVIDEND YIELD *VERSUS* INNOVATION PREMIUM



There are also companies that waver between these two extremes, as evidenced by the sample. In fact, the majority of companies fall within this category. There are several examples of effective and sometimes innovative investor relations strategies that companies in the sample have established. First, we see that they implement an engagement strategy that builds strong relationships with customers, business partners, and employees but also enhances the value of the relationship with investors. Salesforce's Dreamforce, a conference that offers learning and networking opportunities as well as inspiration for customers by bringing together leaders and pioneers from the industry, is one example of such an event.[136]

Second, many companies take investor relations strategies seriously and establish a more frequent and timely dialogue with investors. Greater focus on making it easier for firms to disclose vital information to investors promises to result in better coordination of the branding and strategy dimensions of the firm. For example, attending investor conferences organized by the

136. Alex Konrad, *Dreamforce Recap: As Benioff Remained Master Showman, Wave and Lightning Look To Shine*, FORBES (Oct. 17, 2014, 1:59 PM), http://www.forbes.com/sites/alexkonrad/2014/10/17/dreamforce-recap-salesforce-analytics/.

company itself or investment banks may help to stimulate more widespread interest in the firm. Investor conferences are generally attractive for companies seeking to generate trading volume and/or boost the stock price performance, but also to engage in an interactive discussion with investors about the introduction of new products, product innovations and/or entering new markets.

Three potential benefits of investor conferences can be identified when analyzing the investor-relations strategies of the companies in our sample. First, the most important aspect of engagement may be connecting with leading institutional investors across the globe to explain and discuss growth strategies (and invite input). These discussions assist the managers and the board of directors in making better decisions and avoiding tunnel vision. Second, a similar focus is on identifying opportunities and getting a better sense of their peers and competitors that often attract the same investors. Finally, (pro)active engagement helps companies in identifying expertise gaps on the board and executive teams.

TABLE 1: INNOVATIVE "INVESTOR RELATIONS" STRATEGIES

	Virtual Annual Report	Product-oriented investor relations website	Average number of investor relations events (2014)	Median number of investor relations events (2014)
Widely Dispersed	24%	48%	5	4
Significant Stake	18%	18%	3	1
Founder-Controlled	14%	0%	2	0
Family-Controlled	25%	38%	8	2
Corporate/Government Controlled	25%	20%	7	1

Third, companies appear to become more and more entrepreneurial and innovative when it comes to their communications and interactions with investors. They use digital technology, social media, and online solutions to maximize investor-relations outcomes. For instance, our sample shows the emergence of "virtual and interactive annual reports," which offer a clear,

visually attractive, and compelling way for disseminating information to investors.[137] Clearly, companies that have embraced a dynamic and interactive means of communication significantly improve their visibility towards investors and other stakeholders. The interactive websites clearly show how the company's strategy, governance, past performance, and prospects interrelate and eventually lead to growth and the creation of value. What is also interesting is that the investor relations websites are becoming more focused on products, processes, and innovation rather than on financial results. Expectedly, companies with widely dispersed shareholders are most innovative in their investor relations approach.

Finally, the sample shows that in order to effectively target investors (particularly retail investors), six companies[138] have introduced "investor relations applications" for mobile use, which can be downloaded for free from investor relations websites. These applications provide direct access to quarterly results, annual reports, and global-responsibility documents. They also, and more interestingly, offer financial news, international press releases, and investor relations activities. Lastly, social media is used by some companies to provide the market with information in a much faster and accurate way, giving the investors the opportunity to make better-informed investment decisions. Clearly, the use of social media will only increase in the networked age.

TYING UP LOOSE ENDS

In a networked age, being innovative and adaptive is everything. It has been acknowledged that in order to survive and grow, companies must operate with a new set of principles and assumptions on how to be successful and competitive. Consider the growing number of technology startup companies that are doing something that once seemed unthinkable: challenging and disrupting corporate giants. Even the behemoths that operate in industries that traditionally were not viewed as technology industries have not been spared. With the rise of digital technologies, they must also be agile, innovative, and, more importantly, act as responsive technology companies.

The result is that more and more companies, encouraged by financial intermediaries, opt to go down the "break up" route in an attempt to become more agile and capitalize on faster-growing businesses. There is something to splitting up or selling off certain parts of the business. The newly formed companies, ideally, will be

137. *See supra* Table 1.

138. These companies are: (1) Luxottica Group, (2) Danone, (3) Hindustan Unilever, (4) Diageo, (5) Jeronimo Martins, and (6) Colgate-Palmolive.

able to better focus on their respective core competencies. Still, there are problems with expecting too much from the reorganization efforts. The assumption that "broken-up" companies are better able to recapture the entrepreneurial spirit, become more responsive to disruptive innovations, and retain talented employees is questionable. In order to become entrepreneurial, more fundamental changes are needed.

This is where intermediaries, such as lawyers, accountants, and auditors, should play a larger and more important role. Unfortunately, though, they often see it as their main job to guide their corporate clients through the patchwork of formal rules and regulations that conceptualized the relationship amongst managers, directors, and shareholders as one of hierarchy. As a result, they have helped create a nanny culture that is characterized by bureaucracy as well as risk-averse and short-term behavior. For instance, they tend to overestimate the relevance of the formal control rights allocated to the annual general meeting of shareholders. They also spend too much time and energy on quarterly reporting. Their cookie-cutter, one-size-fits-all straitjacket approach to the duties, tasks, and the composition of the board of directors often turns the directors into unproductive and irrelevant watchdogs who at times are destructive to innovation and business growth.

It is fair to say that the governance structures of companies that have long lost the start-up feel need facelifts. Luckily, there are a number of innovative companies that have taken it upon themselves to design governance practices that will make them better innovators. These practices, which encourage loyalty and mutual trust, can be categorized into three groups: (1) the appointment of founder-CEOs or professional CEOs who act like founders (knowledgeable, innovative, courageous, and not threatened by technologists), (2) the importance of board diversity (in terms of technical and product/process-cycle expertise), and (3) the establishment of investor-relations strategies that focus on a collaborative interaction between the company's executives, board of directors, and investors.

Unfortunately, we see that these practices are too often (still) discounted as irrelevant traits of corporate governance. This is unfortunate, as an analysis of the organizational structures of *Fast Company*'s and *Forbes' Most Innovative Companies of the World* indicates that these practices are (at least somewhat) correlated to the innovation potential of companies. It can only be expected that these practices will become more and more valuable to companies, intermediaries, and investors who are looking to continue to propel global innovation forward.