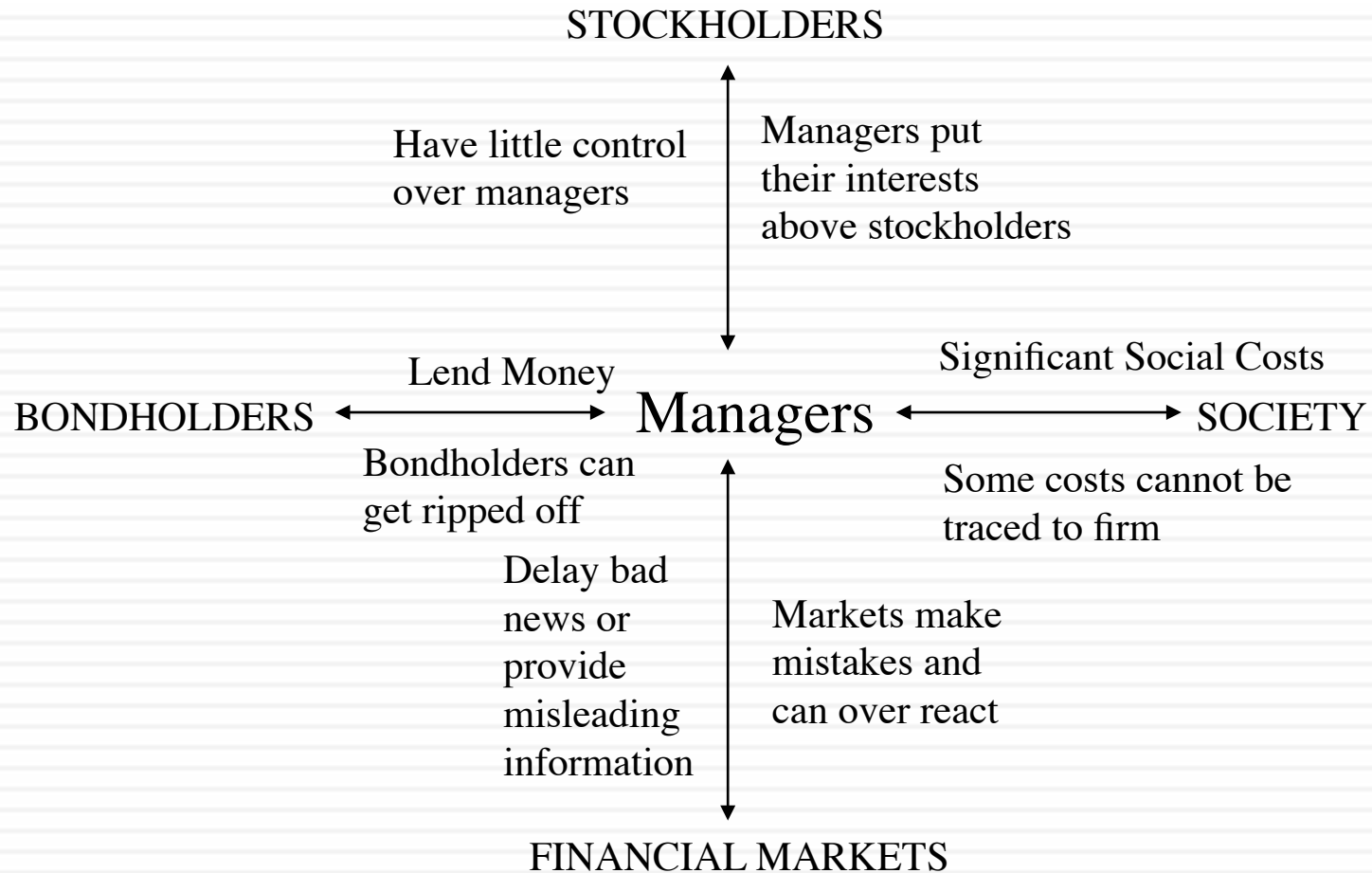


What can go wrong?

7



I. Stockholder Interests vs. Management Interests

8

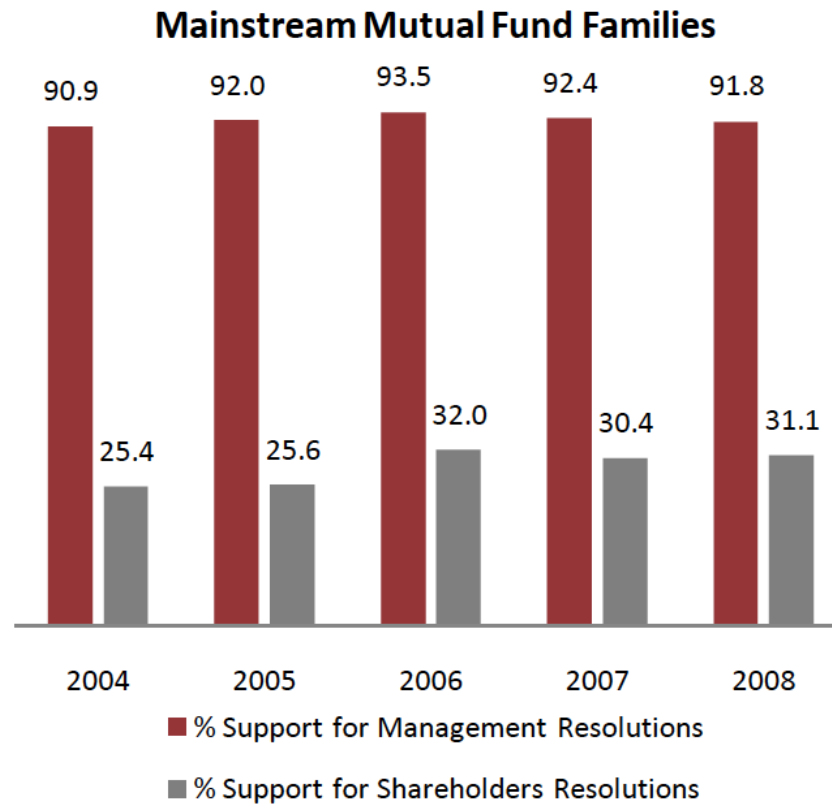
- In theory: The stockholders have significant control over management. The two mechanisms for disciplining management are the annual meeting and the board of directors. Specifically, we assume that
 - Stockholders who are dissatisfied with managers can not only express their disapproval at the annual meeting, but can use their voting power at the meeting to keep managers in check.
 - The board of directors plays its true role of representing stockholders and acting as a check on management.
- In Practice: Neither mechanism is as effective in disciplining management as theory posits.

The Annual Meeting as a disciplinary venue

9

- The power of stockholders to act at annual meetings is diluted by three factors
 - Most small stockholders do not go to meetings because the cost of going to the meeting exceeds the value of their holdings.
 - Incumbent management starts off with a clear advantage when it comes to the exercise of proxies. Proxies that are not voted becomes votes for incumbent management.
 - For large stockholders, the path of least resistance, when confronted by managers that they do not like, is to vote with their feet.
- Annual meetings are also tightly scripted and controlled events, making it difficult for outsiders and rebels to bring up issues that are not to the management's liking.

And institutional investors go along with incumbent managers...



Board of Directors as a disciplinary mechanism

11

- Directors are paid well: In 2010, the median board member at a Fortune 500 company was paid \$212,512, with 54% coming in stock and the remaining 46% in cash. If a board member was a non-executive chair, he or she received about \$150,000 more in compensation.
- Spend more time on their directorial duties than they used to: A board member worked, on average, about 227.5 hours a year (and that is being generous), or 4.4 hours a week, according to the National Associate of Corporate Directors. Of this, about 24 hours a year are for board meetings. Those numbers are up from what they were a decade ago.
- Even those hours are not very productive: While the time spent on being a director has gone up, a significant portion of that time was spent on making sure that they are legally protected (regulations & lawsuits).
- And they have many loyalties: Many directors serve on three or more boards, and some are full time chief executives of other companies.

The CEO often hand-picks directors..

12

- CEOs pick directors: A 1992 survey by Korn/Ferry revealed that 74% of companies relied on recommendations from the CEO to come up with new directors and only 16% used an outside search firm. While that number has changed in recent years, CEOs still determine who sits on their boards. While more companies have outsiders involved in picking directors now, CEOs exercise significant influence over the process.
- Directors don't have big equity stakes: Directors often hold only token stakes in their companies. Most directors in companies today still receive more compensation as directors than they gain from their stockholdings. While share ownership is up among directors today, they usually get these shares from the firm (rather than buy them).
- And some directors are CEOs of other firms: Many directors are themselves CEOs of other firms. Worse still, there are cases where CEOs sit on each other's boards.

Directors lack the expertise (and the willingness) to ask the necessary tough questions..

13

- Robert's Rules of Order? In most boards, the CEO continues to be the chair. Not surprisingly, the CEO sets the agenda, chairs the meeting and controls the information provided to directors.
- Be a team player? The search for consensus overwhelms any attempts at confrontation.
- The CEO as authority figure: Studies of social psychology have noted that loyalty is hardwired into human behavior. While this loyalty is an important tool in building up organizations, it can also lead people to suppress internal ethical standards if they conflict with loyalty to an authority figure. In a board meeting, the CEO generally becomes the authority figure.

The worst board ever? The Disney Experience - 1997

14

Reveta F. Bowers 1,5
Head of School
Center for Early Education

Roy E. Disney 3
Vice Chairman
The Walt Disney Company

Michael D. Eisner 3
Chairman and Chief Executive Officer
The Walt Disney Company

Stanley P. Gold 4,5
President and Chief Executive Officer
Shamrock Holdings, Inc.

Sanford M. Litvack
Senior Executive Vice President
and Chief of Corporate Operations
The Walt Disney Company

Ignacio E. Lozano, Jr. 1,2,4
Editor-in-Chief, LA OPINION

George J. Mitchell 5
Special Counsel
Verner, Liipfert, Bernard, McPherson
and Hand

Thomas S. Murphy
Former Chairman
Capital Cities/ABC, Inc.

Richard A. Nunis
Chairman
Walt Disney Attractions

Leo J. O'Donovan, S.J.
President
Georgetown University

Michael S. Ovitz 3
President
The Walt Disney Company

Sidney Poitier 2,4
Chief Executive Officer
Verdon-Cedric Productions

Irwin E. Russell 2,4
Attorney at Law

Robert A.M. Stern
Senior Partner Productions

E. Cardon Walker 1
Former Chairman and Chief Executive Officer
The Walt Disney Company

Raymond L. Watson 1,2,3
Vice Chairman
The Irvine Company

Gary L. Wilson 5
Co-Chairman
Northwest Airlines Corporation

1 Member of Audit Review Committee
2 Member of Compensation Committee
3 Member of Executive Committee
4 Member of Executive Performance Plan Committee
5 Member of Nominating Committee

The Calpers Tests for Independent Boards

15

- Calpers, the California Employees Pension fund, suggested three tests in 1997 of an independent board:
 - ▣ Are a majority of the directors outside directors?
 - ▣ Is the chairman of the board independent of the company (and not the CEO of the company)?
 - ▣ Are the compensation and audit committees composed entirely of outsiders?
- Disney was the only S&P 500 company to fail all three tests.

Business Week piles on... The Worst Boards in 1997..

16

THE WORST BOARDS OF DIRECTORS												
EN RANK	OVERALL SCORE	SURVEY SCORE	ANALYSIS SCORE	DETAILS	BOARD PERFORMANCE POLL				GOVERNANCE GUIDELINE ANALYSIS			
					SHAREHOLDER ACCOUNTABILITY	BOARD QUALITY	BOARD INDEPENDENCE	CORPORATE PERFORMANCE	SHAREHOLDER ACCOUNTABILITY	BOARD QUALITY	BOARD INDEPENDENCE	
1. DISNEY	10.3	1.8	8.5	Investors decry board for conflicts; many directors own little if any stock	3.3	4.3	2.0	5.8	-0.4	2.8	2.2	
2. AT&T	10.9	-16.6	27.5	Investors scorn board for failing to control succession, not ousting CEO	3.0	4.2	3.5	2.8	2.0	5.2	7.4	
3. H.J. HEINZ	15.4	-1.1	16.5	Longtime CEO dominates insider-filled board; resists investor calls for change	2.8	3.7	2.0	4.7	4.4	6.0	1.4	
4. ARCHER DANIELS MIDLAND	16.8	-12.2	29.0	Board changes fail to satisfy investors, who say directors still lack independence	2.3	2.1	1.3	3.5	5.6	7.6	5.0	
5. DOW JONES	21.1	1.6	19.5	Investors disenchanted with performance; weakest attendance record of any board	2.6	4.6	2.8	2.6	6.0	0.0	5.8	
6. DILLARD'S	22.0	5.0	17.0	Board loaded with insiders; lacks an outsider with retail expertise or CEO	2.0	3.0	2.0	3.5	6.4	3.2	2.0	
7. ROLLINS INTERNATIONAL	22.7	1.7	21.0	Board dominated by family members and insiders; lacks nominating panel	1.0	1.0	0.0	2.0	4.0	7.6	4.4	
8. OCCIDENTAL PETROLEUM	24.0	-1.5	25.5	Investors outraged over \$95 million payout to CEO by cozy, aging board	1.3	2.0	1.1	2.0	2.8	6.0	5.8	
9. OGDEN	27.2	4.2	23.0	Board has three consultants and a lawyer who do business with company	2.0	1.5	2.0	2.5	2.0	8.4	4.0	
10. MAXXAM	28.3	4.3	24.5	Tiny board with little business experience dominated by CEO	1.5	2.0	1.0	3.5	3.6	2.0	6.0	

Application Test: Who's on board?

17

- Look at the board of directors for your firm.
 - How many of the directors are inside directors (Employees of the firm, ex-managers)?
 - Is there any information on how independent the directors in the firm are from the managers?
- Are there any external measures of the quality of corporate governance of your firm?
 - Yahoo! Finance now reports on a corporate governance score for firms, where it ranks firms against the rest of the market and against their sectors.
- Is there tangible evidence that your board acts independently of management?
 - Check news stories to see if there are actions that the CEO has wanted to take that the board has stopped him or her from taking or at least slowed him or her down.

So, what next? When the cat is idle, the mice will play

18

- When managers do not fear stockholders, they will often put their interests over stockholder interests
 - Greenmail: The (managers of) target of a hostile takeover buy out the potential acquirer's existing stake, at a price much greater than the price paid by the raider, in return for the signing of a 'standstill' agreement.
 - Golden Parachutes: Provisions in employment contracts, that allows for the payment of a lump-sum or cash flows over a period, if managers covered by these contracts lose their jobs in a takeover.
 - Poison Pills: A security, the rights or cashflows on which are triggered by an outside event, generally a hostile takeover, is called a poison pill.
 - Shark Repellents: Anti-takeover amendments are also aimed at dissuading hostile takeovers, but differ on one very important count. They require the assent of stockholders to be instituted.
 - Overpaying on takeovers: Acquisitions often are driven by management interests rather than stockholder interests.

No stockholder approval needed..... Stockholder Approval needed

Overpaying on takeovers

19

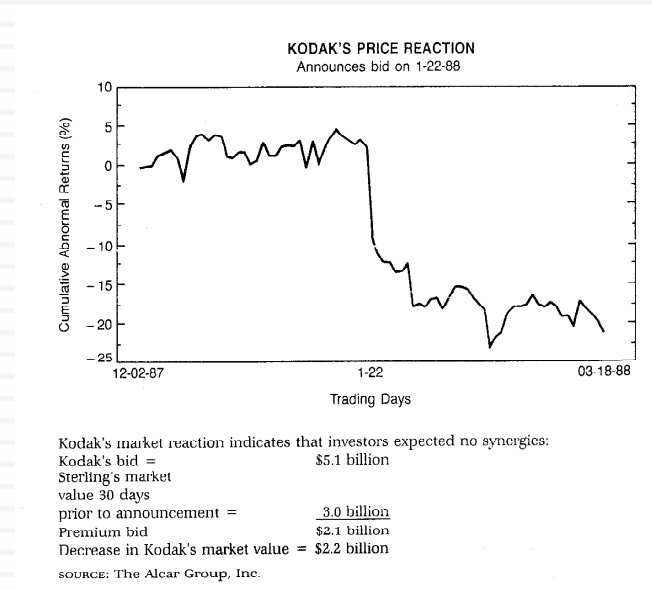
- The quickest and perhaps the most decisive way to impoverish stockholders is to overpay on a takeover.
- The stockholders in acquiring firms do not seem to share the enthusiasm of the managers in these firms. Stock prices of bidding firms decline on the takeover announcements a significant proportion of the time.
- Many mergers do not work, as evidenced by a number of measures.
 - The profitability of merged firms relative to their peer groups, does not increase significantly after mergers.
 - An even more damning indictment is that a large number of mergers are reversed within a few years, which is a clear admission that the acquisitions did not work.

A case study in value destruction: Eastman Kodak & Sterling Drugs

Kodak enters bidding war

- In late 1987, Eastman Kodak entered into a bidding war with Hoffman La Roche for Sterling Drugs, a pharmaceutical company.
- The bidding war started with Sterling Drugs trading at about \$40/share.
- At \$72/share, Hoffman dropped out of the bidding war, but Kodak kept bidding.
- At \$89.50/share, Kodak won and claimed potential synergies explained the premium.

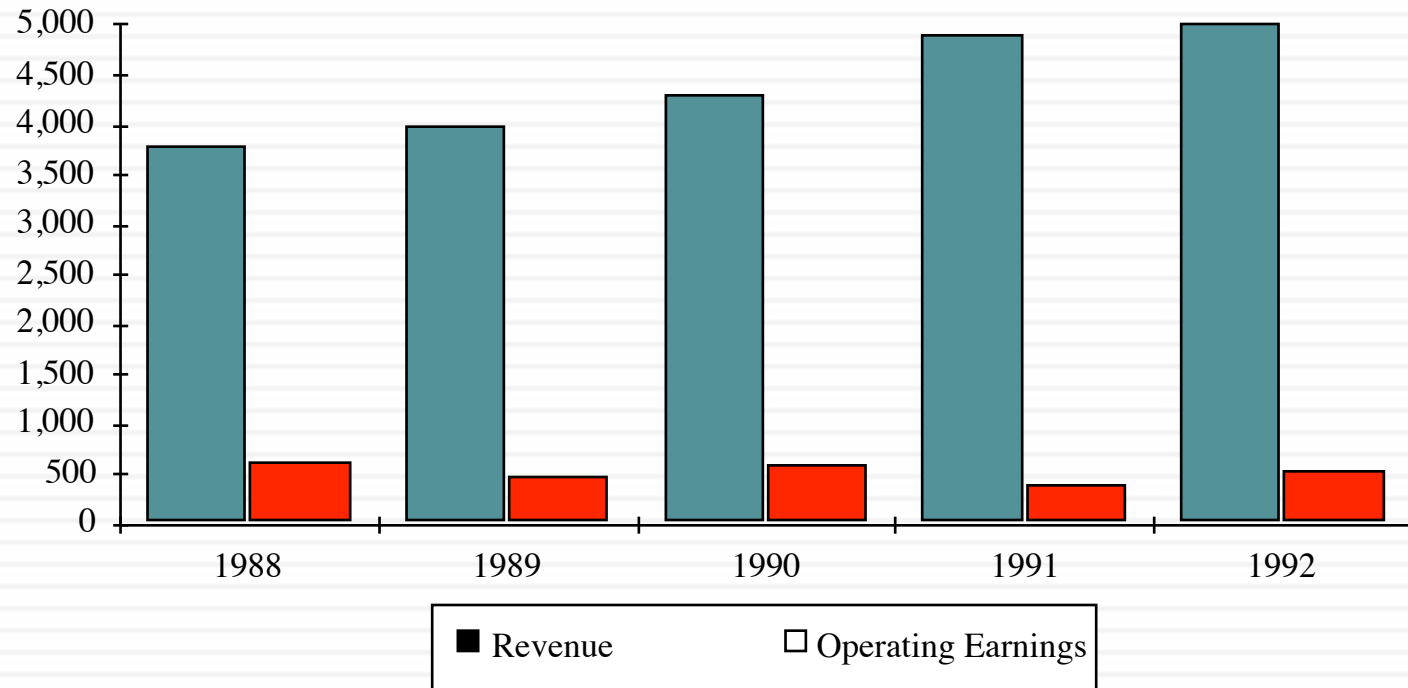
Kodak wins!!!!



Earnings and Revenues at Sterling Drugs

21

Sterling Drug under Eastman Kodak: Where is the synergy?

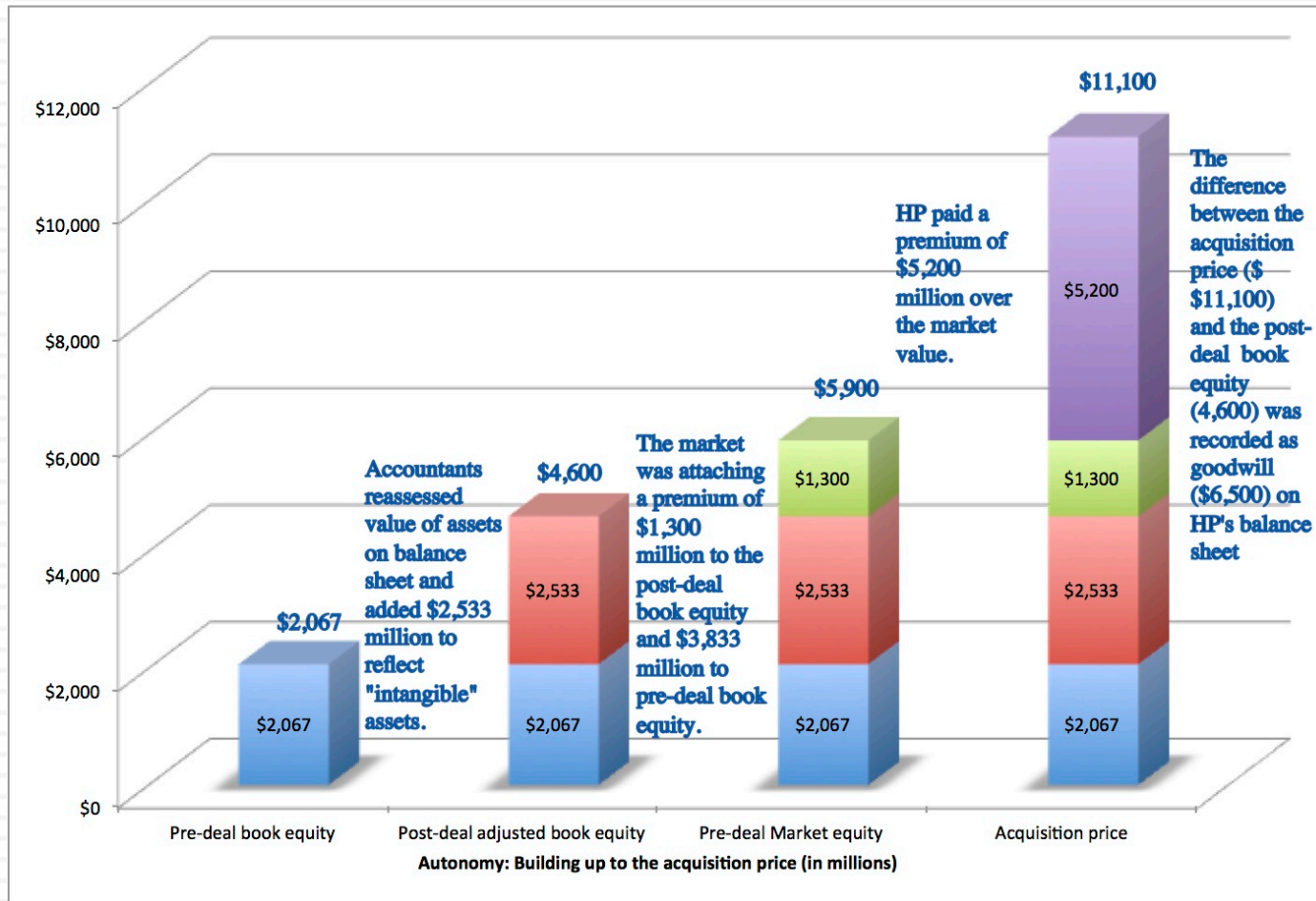


Kodak Says Drug Unit Is Not for Sale ... but...

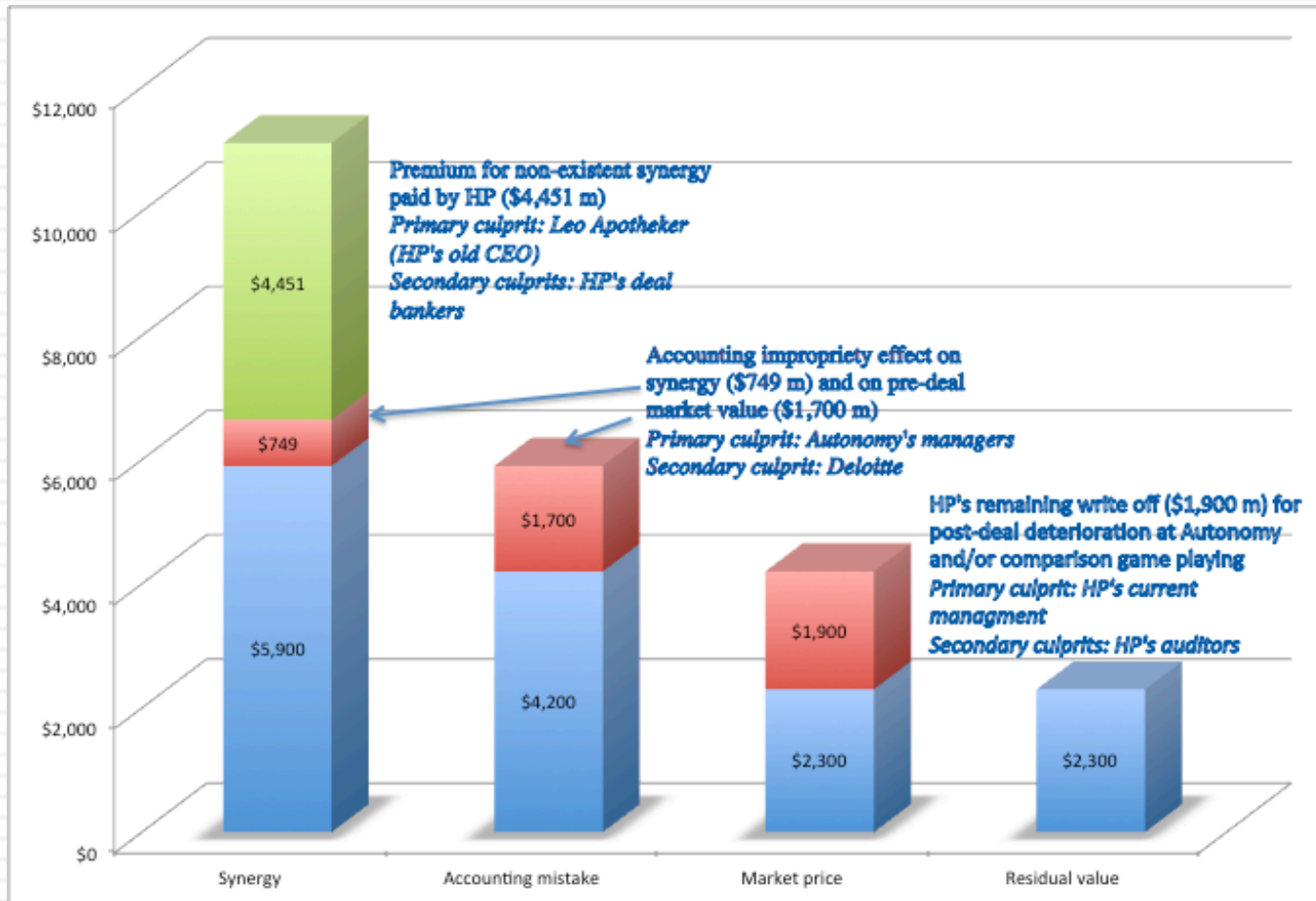
22

- An article in the NY Times in August of 1993 suggested that Kodak was eager to shed its drug unit.
 - In response, Eastman Kodak officials say they have no plans to sell Kodak's Sterling Winthrop drug unit.
 - Louis Mattis, Chairman of Sterling Winthrop, dismissed the rumors as “massive speculation, which flies in the face of the stated intent of Kodak that it is committed to be in the health business.”
- A few months later...Taking a stride out of the drug business, Eastman Kodak said that the Sanofi Group, a French pharmaceutical company, agreed to buy the prescription drug business of Sterling Winthrop for \$1.68 billion.
 - Shares of Eastman Kodak rose 75 cents yesterday, closing at \$47.50 on the New York Stock Exchange.
 - Samuel D. Isaly an analyst , said the announcement was “very good for Sanofi and very good for Kodak.”
 - “When the divestitures are complete, Kodak will be entirely focused on imaging,” said George M. C. Fisher, the company's chief executive.
 - The rest of the Sterling Winthrop was sold to Smithkline for \$2.9 billion.

The connection to corporate governance: HP buys Autonomy... and explains the premium



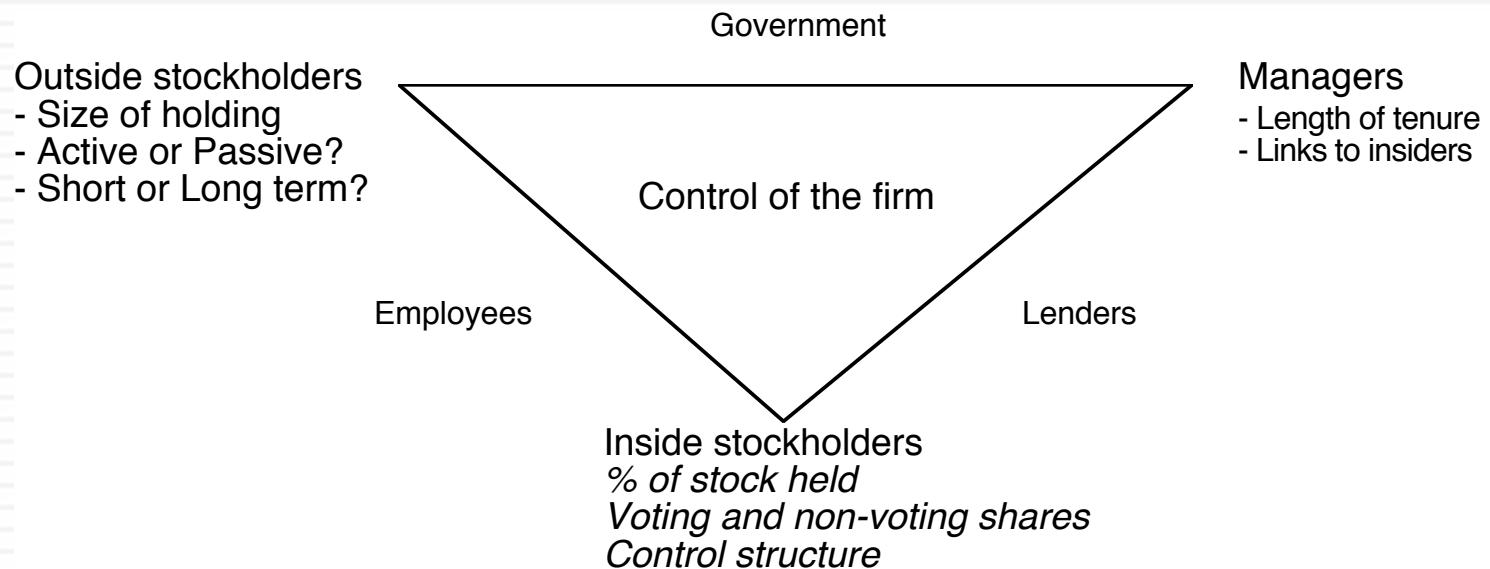
A year later... HP admits a mistake...and explains it...



Application Test: Who owns/runs your firm?

25

- Look at: Bloomberg printout HDS for your firm
- Who are the top stockholders in your firm?
- What are the potential conflicts of interests that you see emerging from this stockholding structure?



Case 1: Splintering of Stockholders

Disney's top stockholders in 2003

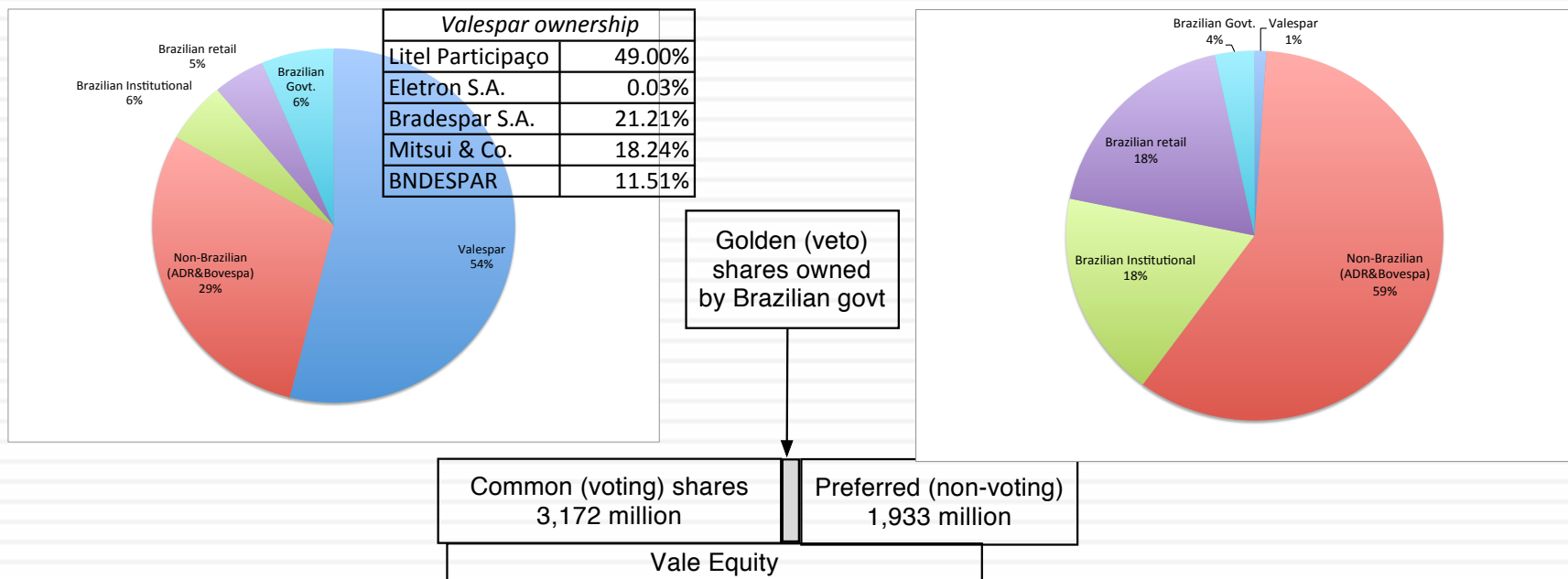
<HELP> for explanation. dgp Equity HDS
 Enter #<GD> to select aggregate portfolio and see detailed information

001189658224-000		HOLDINGS SEARCH		CUSIP 25468710	
DIS	US	DISNEY (WALT) CO	Page 1 / 100		
Holder name	Portfolio Name	Source	Held	Outstd	Percent Latest Filing Change Date
1 BARCLAYS GLOBAL	BARCLAYS BANK PLC	13F	83,630M	4.095	1,750M 09/02
2 CITIGROUP INC	CITIGROUP INCORPORAT	13F	62,857M	3.078	4,811M 09/02
3 FIDELITY MANAGM	FIDELITY MANAGEMENT	13F	56,125M	2.748	5,992M 09/02
4 STATE STREET	STATE STREET CORPORA	13F	54,635M	2.675	2,239M 09/02
5 SOUTHEASTRN ASST	SOUTHEASTERN ASSET M	13F	47,333M	2.318	14,604M 09/02
6 ST FARM MU AUTO	STATE FARM MUTUAL AU	13F	41,938M	2.054	120,599 09/02
7 VANGUARD GROUP	VANGUARD GROUP INC	13F	34,721M	1.700	-83,839 09/02
8 MELLON BANK N A	MELLON BANK CORP	13F	32,693M	1.601	957,489 09/02
9 PUTNAM INVEST	PUTNAM INVESTMENT MA	13F	28,153M	1.379	-11,468M 09/02
10 LORD ABBETT & CO	LORD ABBETT & CO	13F	24,541M	1.202	5,385M 09/02
11 MONTAG CALDWELL	MONTAG & CALDWELL IN	13F	24,466M	1.198	-11,373M 09/02
12 DEUTSCHE BANK AK	DEUTSCHE BANK AG	13F	23,239M	1.138	-5,002M 09/02
13 MORGAN STANLEY	MORGAN STANLEY	13F	19,655M	0.962	3,482M 09/02
14 PRICE T ROWE	T ROWE PRICE ASSOCIA	13F	19,133M	0.937	2,925M 09/02
15 ROY EDWARD DISNE	n/a	PROXY	17,547M	0.859	-126,710 12/01
16 AWA FINANCIAL	ALLIANCE CAPITAL MAN	13F	14,283M	0.699	69,353 09/02
17 JP MORGAN CHASE	JP MORGAN CHASE & CO	13F	14,209M	0.696	-462,791 09/02
Sub-totals for current page:			599,159M	29.340	

* Money market directory info available. Select portfolio, then hit IP<GD>.
 Australia 61 2 8777 8600 Brazil 55 11 3048 4506 Europe 44 20 7330 7500 Germany 49 69 306410
 Hong Kong 852 2577 6000 Japan 81 3 3201 0906 Singapore 65 212 3900 U.S. 1 212 318 2000 Copyright 2002 Bloomberg L.P.
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Case 2: Voting versus Non-voting Shares & Golden Shares: Vale



Vale has eleven members on its board of directors, ten of whom were nominated by Valepar and the board was chaired by Don Conrado, the CEO of Valepar.

Case 3: Cross and Pyramid Holdings

Tata Motor's top stockholders in 2013

TTMT IN Equity 25) Settings 99) Feedback Holdings: Current

Tata Motors Ltd ISIN INE155A01022

1) Current 2) Historical 3) Matrix 4) Ownership 5) Transactions 6) Options

Search Name -- 21) Save 22) Delete 3) Saved Search 24) Refine Search

Text Search Holder Group All Holders 20) Export

Holder Name	Portfolio Name	Source	Opt	Amt Held	% Out	Latest Chg	File Dt
1. TATA SONS LTD	n/a	Co File		702,333.345	26.07	0	09/30/13
2. CITIBANK NA	n/a	20F		446,246.135	16.56	0	06/30/12
3. LIFE INSURANCE CORP OF I	n/a	Co File		168,754.477	6.26	-119,728,333	09/30/13
4. TATA STEEL LTD	n/a	Co File		147,810.695	5.49	0	09/30/13
5. CAPITAL GROUP COMPANIES	n/a	ULT-AGG		97,689.911	3.63	-877,871	09/30/13
6. TATA INDUSTPIES LTD	n/a	Co File		68,436.485	2.54	0	09/30/13
7. VANGUARD GROUP INC	n/a	ULT-AGG		41,285.983	1.53	4,535,434	09/30/13
8. PRUDENTIAL PLC	n/a	ULT-AGG		34,080.063	1.26	147,814	09/30/13
9. GIC PRIVATE LIMITED	n/a	ULT-AGG		30,428.428	1.13	0	09/30/13
10. WILLIAM BLAIR & COMPANY	WILLIAM BLAIR & COMP	13F		30,093.943	1.12	3,997,149	06/30/13
11. JPMORGAN CHASE & CO	n/a	ULT-AGG		24,918.852	0.92	-2,157,750	08/31/13
12. SCHRODER INVESTMENT MGMT	Multiple Portfolios	MF-AGG		19,136.665	0.71	2,578,904	06/30/13
13. BLACKROCK	n/a	ULT-AGG		14,100.725	0.52	-265,173	10/31/13
14. NORGES BANK	Multiple Portfolios	MF-AGG		10,762.579	0.40	0	12/31/12
15. T ROWE PRICE ASSOCIATES	Multiple Portfolios	MF-AGG		10,056.366	0.37	324,353	09/30/13
16. TATA INVESTMENT CORP LTD	n/a	Co File		10,025.000	0.37	0	09/30/13
17. SBI LIFE INSURANCE CO LTD	Multiple Portfolios	MF-AGG		9,256.170	0.34	-151,323	09/30/13
18. ALLIANZ ASSET MANAGEMENT	n/a	ULT-AGG		8,129.923	0.30	2,071,551	09/30/13

% Out 76.19 Zoom - 100%

Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
 Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2013 Bloomberg Finance L.P.
 SN 636136 EST GMT-5:00 G627-2830-0 04-Nov-2013 12:31:34