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Crisis in Trust: The CEO Perspective

by Chris Trimble T'96

It gives CEOs little pleasure to revisit the events of the past year. Several of their peers were indicted for fraud. The U.S. Congress passed sweeping new governance legislation. And the public reported a lower level of trust in corporations than they have in decades. In a recent speech, Russ Lewis, CEO of The New York Times Company, reflected on just how bad the situation has become: “My loving 87-year-old mother...and my unfailingly supportive 94-year-old father...no longer brag about me to the clerks at the Lake Worth, Florida, Publix supermarket.”

Under the outrageously high expectations of the recent stock market bubble, several CEOs gave in to temptation. They met the expectations through deceit and dishonesty. “It reads like Greek tragedy,” commented Michael Dolan, CEO of Young & Rubicam. As people rise from nearly nothing to incredible heights, core values are at risk, he explained.

Perhaps core values are squeezed out by ego and hubris. Favoring bland effectiveness to celebrity in a CEO, Eric Bourdais de Charbonniere, chairman of Michelin, added, “When you see the CEO in the ‘People’ column [of the newspaper], you sell the stock.”

On March 11, 2003, 10 CEOs and senior executives gathered for the second annual CEO Leadership Summit to exchange insights on the current state of affairs. Sponsored by Tuck’s William F.

Ahtmeyer Center for Global Leadership, the event took place in the Wall Street offices of Goldman Sachs. In addition to Lewis, Dolan, and Bourdais de Charbonniere, John Thornton, president and co-COO of Goldman Sachs; Bill Ahtmeyer, managing partner of The Parthenon Group; Peter Francis, CEO of J.M. Huber; Robert Louis-Dreyfus, president and CEO of Louis Dreyfus Communications, former CEO of Saatchi & Saatchi, and former president of the executive board of Adidas; Paul Danos, dean of the Tuck School; Dick Harrington, CEO of the Thomson Corporation; and David Shaffer, CEO of Thomson Financial, all participated in the discussion moderated by Professor Vijay Govindarajan, director of the Center for Global Leadership.

By the end of the discussion, one thing was abundantly clear—all participants are anxious to restore the reputation of the CEO. Already, the group has taken numerous actions within their companies to do so. They are talking more frequently about core mission, values, and purpose. They have redoubled their efforts to communicate fully and completely with investors, the board, employees, and the public. They are spending much more time ensuring compliance with reporting regulations and thinking more about the intent of the regulations, as opposed to the specific requirements. Finally, they have installed new procedures to ensure personal accountability, requiring dozens of

employees to attest to the accuracy of internal financial reports with a signature.

Nonetheless, this group of CEOs wants more assurance. They want better systems of governance that minimize the probability that the events of the past year can ever be repeated. Of particular concern is the effectiveness of boards of directors. Where were the boards at Enron, WorldCom, Adelphia, and Tyco? Why didn't they act to prevent such brazen dishonesty?

Indeed. But companies that are diligently working to improve the capability of their boards are finding it extremely challenging. First, qualified board members are hard to find. And the few that are qualified are now substantially less interested in taking on new directorship responsibilities than they used to be. The job appears much more demanding today, and the risks of being associated with inappropriate or illegal behavior appear much greater.

In one sense, it is a positive sign that candidates are taking the job so seriously. At the same time, especially when the necessary qualifications of a board member are considered, one wonders how board positions can ever be filled. Directors must have stature, a proven track record, and expertise in a variety of areas.

Among the most important areas of expertise are financial reporting requirements, interpretation of financial statements, and the legalities of corporate governance. In these areas, the screening mechanisms appear ineffective. Corporations often turn to headhunting firms to find new board members. And, as Shaffer pointed out, "The headhunters screen now, but they do it imperfectly. Their screening just means that the

candidate has a nice résumé." Speculating on what might make for a better system, participants debated the merits of having a public accreditation system for board members and considered the accreditation system for judges in the United States as a possible analogue. The press could also have a role, by instituting a rating system for board members. Although such a system would also be imperfect, it is likely better than nothing.

Boards need other types of expertise, including deep familiarity with the industries in which the corporations that they direct are competing. But standards for what it means for a director to be "independent" are rising, as are expectations for the proportion of independent directors. Exclude all officers of a company, all customers, and all suppliers, and it is easy to see that industry expertise becomes much harder to come by.

In Dolan's view, what matters most in board members is their willingness to take a position of strong dissent—to go so far as to vocally and publicly resign when they genuinely believe the company is doing something it shouldn't do. This may be a reasonable expectation in a clear case of misbehavior, but boards more often face issues that are not black and white, such as voting on approval of a major acquisition. This is where industry expertise really pays off. Without it, board members are at a disadvantage to the CEOs they supervise. Without becoming full-time employees, they cannot possibly have as much information. As Thornton pointed out, "It is hard to stand up and be a pain unless you really know the business." Otherwise, it is natural to defer to the presumably much more informed judgment of the CEO.

While expertise in financial reporting, in governance, and in a specific industry may be difficult to find, corporations have generally succeeded in attracting board candidates with a high level of general business knowledge. Often, several members of boards have past or ongoing experience as CEOs. And many corporations are now looking for other specific areas of expertise that can have a positive impact on the company. Harrington commented on how Thomson is transforming its board: “Most people would say that we have had the ‘Who’s Who?’ list in Canada as our board. Now we are bringing in different individuals, like a venture capitalist, an educator, et cetera, to round out our board.”

But more than smarts is necessary. As Achtmeyer pointed out, “Look at the board of Enron. It was a very high-quality board. The issue is not whether board members are smart. Finding people who have sufficient time and commitment is what is really tough.”

Already, board members have to invest significant time just to get through the substantial volume of information that they receive before each meeting. With today’s heightened sensitivities, the burden is only getting worse. And it is not uncommon for board members to simultaneously serve on more than one board while holding down the post of CEO in their own company. There are only 24 hours in each day.

Even if a company succeeds in attracting a board that contains the requisite expertise and level of commitment, ensuring that the board acts effectively as a team is another challenge. One problem is that board members, after decades of success in their given business, have become quite unaccustomed to saying “I don’t understand” when confronted with

an unfamiliar situation. Doing so in front of peers that they are just getting to know may be particularly uncomfortable. Danos even wondered, “Are you unethical if you remain silent when there is something discussed that you just don’t understand?” Danos went on to note that the complexity of the operations at Enron were such that few PhDs could have understood them, given the time constraints typical for a board member.

Another problem is that strong dissent is often discouraged by the implicit standards of social interaction developed by boards. As Thornton noted, boards must be understood as social groups that develop their own dynamics. Too often, boards are overly polite, developing what Thornton described as a “stylized candor.” Developing real discussion, real debate, and a healthy tension in the boardroom can be extremely difficult.

Creating this kind of boardroom environment may be impossible without sufficient separation between the directors and the full-time executives of the company. None of the participants at the summit argued against ending the common practice of having the same person serve simultaneously as chairman and CEO, a situation Thornton called “the ultimate conflict of interest.” Not only must the chairman be independent, but the chief executive must be willing to leave the room to allow the board to discuss his or her personal performance. According to Achtmeyer, “If you are willing to do that, a lot of things change.”

If one of the more important functions of the board is to put a halt to any misbehavior, they must somehow be connected to the *right* information. As Francis noted, “Unless you hire the board members full-time, which would be like having 12 more CEOs, they will

not ever have enough information to snuff out everything in the company. It is just not going to happen. In the end, it is going to happen because someone tells them the truth.” Louis-Dreyfus has instituted a system to help ensure that board members do get the information they need: “We have two different people, one a retired judge and the other a retired policeman, and any employee can go to them if he thinks there has been some miscarriage, dishonesty, bribery, or something like that.”

Finally, a board can only be effective if it has a balanced sense of its overall objectives. Nominally, boards represent shareholders singularly. But, Harrington pointed out, shareholders want more than financial performance. “You have to have a purpose, and making money can’t be the only purpose. It has to be one of the purposes. There are a lot of social obligations as well.”

This likely has implications for board memberships. As Lewis pointed out, it is one thing to have a formal written statement of purpose and values—quite another to ensure that everyone actually lives by those values. Commenting that some direct representation for employees on the board may be sensible, Lewis observed: “Financials speak for themselves, but to figure out whether you are living up to your values...I don’t think the shareholders can tell you that. I’m not even sure that the customers can tell you that. But the people who work for you probably have a clear opinion as to whether or not you are a good, honest, value-driven guy.” Bourdais de Charbonniere and Louis-Dreyfus, both experienced with employee representation on boards in Europe, gave a mixed review of its effectiveness. In addition to employee representation, it may become more common to find

judges or ethicists on boards to ensure that corporations live by their values.

To wrap up the summit, participants were asked to offer advice for new CEOs that they wouldn’t have given one year ago. The major themes: ensuring board independence and communicating more openly and thoroughly with everyone, especially the board, employees, and investors. Achtmeyer advised finding a few people at each level who will be honest with you—no matter what the circumstance. Lewis emphasized the importance of knowledge and integrity at the position of CFO. Thornton’s advice: “You are now a public figure, in the most profound sense of the term.”

The Center for Global Leadership will host the third annual CEO Leadership Summit in March 2004.