RESTORING TRUST IN CORPORATE GOVERNANCE: SIX ESSENTIAL TASKS FOR BOARDS OF DIRECTORS AND SENIOR EXECUTIVES

CED Statement Aims to Focus Directors and Executives on Governance Essentials in this Time of Economic Turmoil and Change

Washington, D.C. January 25, 2010 – If American business leaders are to restore public confidence in how companies are run, boards of directors must discharge six essential, closely interrelated tasks. That is the message of a new policy brief, Restoring Trust in Corporate Governance: The Six Essential Tasks of Boards of Directors and Business Leaders, from the Committee for Economic Development (CED). The brief was written by Ben W. Heineman, Jr., CED Trustee and former Vice President and General Counsel for General Electric Corporation, with the consultation and advice from the CED’s Subcommittee on Corporate Governance.

“These tasks require a redefinition of corporate mission and CEO role,” said Heineman, “to make fundamental the balance of risk-taking with risk management and the fusion of high performance with high integrity. They are essential to restoration of trust in corporate governance but, more importantly, to make credible corporate accountability—the profound issue underlying corporate governance. This is not a “nice to do.” Regardless of the outcomes of regulatory debates, it is profoundly in the self-interest of private sector leadership energetically to implement the six “must do’s” in order to answer powerfully the legitimate criticisms of board and senior executive decision-making in recent years. The six tasks are:

1) A redefinition of the mission of the company—and the role of the board of directors and the CEO to create durable value for shareholders and other stakeholders through sustained economic performance, sound risk management and high integrity. The most basic purpose of the corporation is for leaders to find a sound balance between risk-taking (innovation and creativity) and risk-management (financial and operational discipline) and to fuse this high performance with high integrity. High integrity means a commitment to law, ethics and values in order to attain affirmative benefits inside the company, in the marketplace and in global society, but also to reduce legal, ethical, reputational, public policy and country risk. The emphasis on short-term maximization of shareholder value should be reduced significantly

2) A revamped internal leadership training process. Such a process should be built on these integrated essentials of performance, risk and integrity—and on a culture in which all are honored and exemplified. Corporate education and training for potential leaders must be broadened and transformed; growth assignments must include diverse roles involving risk and integrity issues, not just making the numbers in different environments.

3) A refocused CEO selection process. This most important board function should flow from a revised leadership development process and seek a broader set of skills appropriate to a redefined mission. The board of directors should explicitly articulate a redefined role when seeking a new CEO.
4) A restatement of fundamental but operational measurements for performance, risk and integrity.
These metrics should express the near, medium and long-term corporate goals across all three dimensions in both financial and non-financial terms—with primary focus on clear steps that create value of sustainable value for shareholders and other stakeholders, such as employees and customers, essential to the company’s well-being. These performance, risk and integrity operational goals not only should guide internal actions but should be articulated annually in a public and transparent way so that external constituencies can assess accountability against clear standards.

5) A revision of compensation for the CEO and other senior executives.
Such a revision for top business leaders —and for other employees with significant impact on the corporation—must be based on real actions measured against those restated operational performance, risk and integrity objectives. Although top business leadership will receive substantial annual cash compensation, a significant proportion of compensation in any particular year will be variable cash and variable equity which will be paid out or held back over time as objectives are met, exceeded or missed.

6) A re-alignment of the board’s fundamental oversight function.
Boards often complain of two much complexity in their jobs. They should cut through the clutter and focus primarily on those high priority performance, risk and integrity operational objectives which are central to attainment of corporate mission and to assessing the fundamental actions on which executive compensation, over time, is based.

This Policy Brief seeks to address the crisis in confidence about business’ ability to govern itself and to be accountable in the wake of the Great Recession which was caused, in party, by poor business decision-making and excessive and poorly structured corporate compensation. These developments, combined with a constant media barrage of stories about business problems, have driven public confidence in business to a very low ebb. Cries for more regulation of business are coming from many quarters.

This Policy Brief is released when necessary, spirited and extensive regulatory debates are taking place on the safety and soundness of the financial system and on governance issues applicable to all publicly held companies (e.g. disclosure on compensation and risk; enhanced shareholder role). But the Policy Brief purposely focuses exclusively on private sector self-determination, not public sector regulation. The reason for this approach is straightforward: a deep-seated belief that, whatever the outcome of the many public inquiries and varied public policy debates, only the leadership of corporations—boards of directors and senior executives—can make the complex decisions that will yield sustainable, durable creation of value with sound risk management and high integrity. Because this role of corporate decision-making is enduring and critical to our nation’s economic well-being, the Policy Brief encourages corporations to focus on these essentials, which are fundamental regardless of policy outcomes, as we move across the business landscape altered by the Great Recession.

Directors in particular should put highest priority on these six tasks in defining a “right-sized” board role going forward. This will require focused intensity. But, the CEO and other senior company executives must also make these tasks the core of their leadership and management efforts as they “govern” the company on a day-to-day basis. If boards do their most fundamental tasks—define the mission of the corporation to include risk and integrity and choose the right CEO and senior executives according to that mission --then directors should be able to act as constructive critics with business leaders and forge a powerful board/executive partnership to direct the destiny of publicly held corporations.

Restoring Trust in Corporate Governance: The Six Essential Tasks of Boards of Directors and Business Leaders has been endorsed by three leading policy organizations: the Hills Program on Governance at the Center for Strategic and International Studies; the Millstein Center for Corporate Governance and Performance at the Yale School of Management; and, the Caux Round Table.
“The CED statement is a high cut above recent recommendations coming in the wake of the 2008 collapse of credit markets. Others talk about the need for American business to regain public trust, but this set of recommendations is an actual plan. It can work. Better yet, it is based on values – stewardship and responsibility – and knows how the right values can be grown inside a corporation. The CED has given us an action agenda to improve American capitalism. The Caux Round Table fully supports the proposal,” said Stephen B. Young, Global Executive Director, Caux Round Table.

“Business leaders may refer to these six fundamental tasks, but not be fully committed to using them for their board of directors. I believe these tasks can effectively check short-termism, greed and corruption and restore financial discipline, law, ethics and values,” said Roderick Hills, CED Trustee and former Chairman of the Securities and Exchange Commission.

“A relentless focus on the six fundamental tasks is an important guide to creation of sustainable shareholder and stakeholder value. Moreover, developing appropriate executive compensation---the governance topic generating the most public heat today --- can only flow from definition of corporate mission and articulation of related operational goals and measurements,” said Ira Millstein, Partner at Weil Gotshal in New York City.

Restoring Trust in Corporate Governance: The Six Essential Tasks of Boards of Directors and Business Leaders continues CED’s work on corporate governance issues. A PDF of the brief and more information about CED’s work on this issue can be found at www.ced.org.

CED is a non-profit, non-partisan organization of more than 200 business leaders and university presidents. Since 1942, its research and policy programs have addressed many of the nation’s most pressing economic and social issues, including education reform, workforce competitiveness, campaign finance, health care, and global trade and finance. CED promotes policies to produce increased productivity and living standards, greater and more equal opportunity for every citizen, and an improved quality of life for all.