THE CORPORATE GOVERNANCE ALLIANCE DIGEST

October 21, 2010

To receive your own complimentary copy of the Corporate Governance Alliance Digest, go to http://www.thevaluealliance.com/cga_newsletter_signup.htm.

Published by:
Eleanor Bloxham, CEO of The Value Alliance and Corporate Governance Alliance, an independent firm providing board evaluation, education, information and advisory services, and John M. Nash, President Emeritus of the National Association of Corporate Directors.

Links to articles cited are at the end of the Digest.

Keywords: economy, strategy, compensation, BP, BIS, risk, metrics, regulatory policy, proxy access.

If you are a director or a general counsel, **please join me in Columbus November 17 at the Fall Directors' Corporate Governance Exchange** (half day, complimentary) hosted by Jones Day along with Chartis and Russell Reynolds Associates for a chance to mingle and meet with your peers and discuss ways to enhance your board's performance. Easy in and out same day if you are in locales like New York or Chicago. Meet peers from different locations.
For a brochure and to register, click here. http://www.thevaluealliance.com/colcdx.htm

Metaphors, Analogies, Comparisons and Contrasts:
Are you standing still or moving to where the puck is going?

By Eleanor Bloxham

Perhaps you remember reading John Milton's *On His Blindness*. In that sonnet, Milton mourned that his life was over, that what mattered most to him, his writing, had been snuffed out with his blindness.

It was a poem of hand-wringing, of standing still, ending with the famous line: "They also serve who only stand and wait."

As it turns out, of course, he did not stop -- and over the next 20 plus years was very prolific, producing, among other works, the epic poems *Paradise Lost* and *Paradise Regained*.

Is there an analogy here?

There is a blindness today, an uncertainty, a sense of mourning, that, for some, leads to hand wringing and complaints – and for others provides a new sense of motivation pulling them to see in a new way.

Everyone seems to have their Chilean miner theme these days.

What was uplifting in the tale was **those that could act and rescue did so** – they did not wring their hands.

And those that could but stand and wait used that time to purpose – to form a brotherhood of cooperation – and a plan for when they would be set free. Some created a physical transformation; others a mental and spiritual one. Some by action and others by example.

This has everything to do with directorship today as we see directors having to make this choice. Directors continue to ask questions about their role and question their own abilities to make a meaningful difference, to speak up – or not - and make their voices heard.

Which companies will have directors that wring their hands – and which will have directors that take this time to determine how, through long-term corporate strategies, they can solve the powerful new problems our world faces? Which companies will have the oversight of directors that realize their tremendous power to make a difference to economies and their people by the work they do shaping the future agendas of their firms – and who will allow disabling blindness and complaints to envelop them?

Entrepreneurs constantly must answer the question: what problem does my product/service solve? Looking for the next opportunity? Just think of a problem. For inspiration, think Google Car. Then consider whether you have the right management to enact a bigger vision and what you must do to align all that you say and do (including pay) with that performance.

BP, Banks and Risk

> *BP enacted a self-imposed moratorium on all its metrics, save those tied to safety and risk. Will bank boards follow suit?*

"Bonuses for the fourth quarter for BP staff will be based solely on how employees perform in terms of safety and risk management, Bob Dudley, the UK oil group's new chief executive, has told staff. The move **will affect all of the company's employees around the world** … the fourth quarter's performance would be measured "solely according to each business's progress in reducing operational risks and achieving excellent safety and compliance standards'." (*BP links bonuses to safety performance,* Sylvia Pfeifer, Financial Times, October 18)[1]

Bravo! We should cheer for any organization and board which takes on the difficult issue of compensation. For BP, the question will be how to sustain this.

This action by BP stands in contrast to bank efforts to address risk in their development of metrics and in their development of pay practices, according to a report of the Bank for International Settlements.

As of October 2010, **effective implementation by banks** of principles "**ensuring that remuneration is effectively aligned with risk and performance** … an essential element for reducing incentives that may arise from the design of remuneration schemes and that can lead to excessive risk taking… **has not been achieved.**"[2]

These sentiments, by the Bank of International Settlements, on an issue fundamental to the health of our world's economies echo similar comments by the US Federal Reserve in June which one year ago asked US banks to immediately implement such measures.

It is not that the implementation requirements are new or that work by the banks is *that* difficult – or should be. In an article I wrote that was published by a dozen or so banking associations earlier this year, I outlined how to approach the implementation – the concepts aren't new -- they are based on implementations I did successfully approximately 15 years ago.

See also http://www.thevaluealliance.com/PDF/CGADigest030910.pdf for a discussion on capital and risk.

What will regulators do? Will they wring their hands – or will they use traffic enforcement techniques - set up a speed trap to pull over as many as they can in order to cause traffic to flow safely, as required by law?

The Government's Role

> Some companies are looking for *more* government or regulatory guidance on the national level.

For example, we haven't had a national energy policy -- but some are looking for it. "'If we had a national policy and knew what the rules were, we could take action,' says Kelly, CEO of Xcel Energy and chairman of the Edison Electric Institute, the association of shareholder-owned electric utilities." (*Uncertain of future regulation, businesses are paralyzed*, Geoff Colvin, October 20, Fortune)[3].

Despite those desires, however, Xcel isn't standing still. "Xcel Energy Inc. has awarded a solar energy project to Eastern New Mexico University in Portales that is expected to offset nearly half of the energy needs on campus over a 20-year period." (*Xcel awards solar project to NM University,* October 13, AP via Bloomberg Businessweek)[4]

"Doctors told state regulators Thursday that Xcel Energy Inc.'s plan to switch some of its coal-fired power plants to run on natural gas would mean cleaner air to breathe, but those with ties to the coal industry said it would cost jobs." (*Doctors, miners weigh in on Xcel natural gas plan*, Catherine Tsai, September 24, AP via Bloomberg Businessweek)[5]

> Corporate executives who understand the relationship to economic growth are concerned about high unemployment.

"Some of America's most influential economists and Coca-Cola CEO Muhtar Kent say the U.S. government needs to spend more money to stimulate the economy until unemployment drops from the current 9.6% to pre-recession levels of around 6% ...'In the US, the consumer is still confused; there's still high unemployment and companies continue to deleverage,' Kent told The Financial Times. He added that government 'is the only entity that can borrow and should borrow and support and generate incentives for innovation and entrepreneurial spirit.'" (*The case for more government spending*, Nin-Hai Tseng, October 21, CNN Money Fortune)[6]

"The top 1 percent of Chinese families now own 41.4 percent of the wealth, a figure similar to that in the US, where the top 1 percent control 40 percent of all the country's wealth..."

"The current Gini coefficient of inequality in China is 0.47, its highest in the last 60 years. When China began its reform and opening-up in 1978 the Gini ratio was just 0.18 percent..."

"The number of people falling below the poverty line last year was also the largest since the US Census started tracking poverty 51 years ago."

"About 14.3 percent, or 44 million Americans, were living below the poverty line in 2009..."

"In China, the swiftly widening income gap has time and again sounded alarm. World Bank Chief Economist Justin Yifu Lin has **warned that narrowing the income gap is the biggest challenge facing the country**..."

"In both countries, this **extreme concentration of wealth and income is accused of hurting the economies**." (*Income gap, a woe for China and US*, Zhang Xiang, October 12, China Daily)[7]

On the US Financial Reform Bill (Dodd Frank), please see our July Digest.

http://www.thevaluealliance.com/PDF/CGADigest073110.pdf.

We are seeing others echo our advice therein. "As the lawyers focus on ensuring these details are carried out, it's important for board members to **vigilantly keep in mind the key strategic and governance issues and use this as an opportunity to achieve great practice --** and avoid the trap of a too narrow compliance focus which plagued some boards during the implementation of 404 of Sarbanes-Oxley as advisors took over the conversation."

> It is also important for directors to continue to focus on the long term – and not allow short term investors to dictate the agenda.

If you have read (or attended) the proceedings of the Harvard Law School Proxy Access Roundtable in January (Lucian A. Bebchuk and Scott Hirst, Editors, Discussion Paper No. 661, 01/2010)[8], you will likely agree that proxy access "will fit a small number of investors and a small number of situations" (*Proxy Access: Don't Believe the Hype*, Stephen Davis and Jon Lukomnik, October 12, Compliance Week)[9]

Small business lending is an issue that remains unsolved.

A new report by the New York Fed shows that lending to small business is lower in the first quarter of 2010 than it was in the second quarter of 2008.

"Small businesses are not getting access to the credit they need, and as a result, they are struggling to generate the jobs needed to lead the nation toward recovery. Of the 426 small business owners polled by the New York central bank between June and July of 2010, 59% applied for credit during the period...More than three-quarters of small businesses that applied for a loan during the first half of 2010 received only 'some' or 'none' of the credit they desired, the report finds...Unmet demand for small business loans could be even stronger than the numbers in this report state, since it only considers small businesses that actually applied for a loan in the first half of 2010". (*Credit still tight on Main Street - NY Fed report*, Catherine Clifford, CNNMoney, October 18)[10]

British bankers have made a modest proposal. "The British Bankers' Association unveiled a £1.5bn equity fund on Wednesday as one of a raft of measures aimed at easing funding constraints for SMEs, after the banks admitted they needed to do more to help companies struggling for cash...Attempts ...appear to have fallen flat after it emerged that the centrepiece of new proposals could help as few as 150 businesses over the next decade" (*Lenders' plans for cash lifeline fall short,* Sharlene Goff and George Parker, October 13, Financial Times)[11]

> Will corporations solve this problem of small business access to capital, will no one - or will governments do so?

Corporate Culture

Besides lack of capital and pressing economic and regulatory matters, what is standing in the way of forward movement?

Negative corporate cultures can be a stumbling block – atmospheres where employees feel intimidated or abused. Some negative corporate cultures have been in the news giving warnings to others with respect to the boardroom's oversight of CEOs and the cultures they create. Will directors stand still – or look closer?

The Hurd scandal, for example, generated comments from long time staffers about wider harassment and a poisoned atmosphere. (Comments on *Live-Blogging H-P's Announcement to Investors*, August 6, 2010, Wall Street Journal).[12]

The Goldman discrimination suit (*Goldman Sachs Sued Over Alleged Gender Discrimination,* Bob Van Voris and Christine Harper, September 15, Bloomberg)[13] and the Citigroup discrimination suit (*6 Women Accuse Citigroup of Gender Bias,* October 13, Thomas Kaplan, New York Times)[14] were recently in the news.

Last year, I was invited to speak to a group of women financial executives in New York and to listen to their stories. They spoke eloquently of the discrimination that is common place still today in the financial industry and the damage it was doing to the women and to their companies. I spoke then of the need to re-think the way in which performance management occurs inside our organizations.

The leaks of information about a poisonous culture at the Tribune have put that board in the spotlight. (*At Flagging Tribune, Tales of a Bankrupt Culture*, David Carr, October 5, New York Times)[15]

If such tangible issues are on the surface, what lies below?

> Addressing leadership, succession and recruiting from a strategic perspective are good ways for the board to address culture.

The new way we recruit and train will have long term negative consequences related to the value of firms. We need to reboot the way we think about recruiting and training to solve the skilled worker gap.

Please see my latest blog post, which includes reference to some interesting new leadership research reported on by the New York Times. www.thebloxhamvoice.com or http://thevaluealliance.com/Blog/?p=31

> Have you hired a CEO who will act in the best interests of the company rather than his own?

"Only 14.5% of chief executives would do better selling their companies at a 25% premium than they would under their current pay packages, according to an analysis of compensation packages for CEOs of companies in the Standard & Poor's 1500 index by compensation consulting firm Shareholder Value Advisors." (*In M&A, Shareholders' Win May Be CEO's Loss*, Gregory J. Millman, October 14, Dow Jones Investment Banker)[16]

Boards need to take control of succession and recognize that different skills are needed at different times from CEO leaders.

See another way to think about the CEO job here. http://money.cnn.com/2010/09/13/news/companies/interim_CEO_HP_Sears.fortune/index.htm

> Boards should also encourage corporate focus – and enhance their oversight of corporate spending and capital allocation generally – and, related to political activity, specifically.

"A study by John Coates of the Harvard Law School, released just last month, which looked at firms during the time period 1998-2004 shows why the issue is important. The study found that firm value and political activity are strongly negatively correlated. **In other words, greater political activity seems to be tied to lower firm value."**

"According to a recent study by the Sustainable Investments Institute and IRRC Institute, less than a quarter of boards in the S&P 500 have formal board oversight of political spending. And less than 2% of all firms said their boards reviewed political spending more often than annually (although one-third of those with some form of board oversight did not respond)."

Related to its political spending, "At News Corp.'s annual meeting last week, the board's audit committee chair, Sir Rod Eddington, faced 'no' votes from UK asset manager F&C and the Nathan Cummings Foundation, according to *The Guardian*..."

"[And] last week, investors filed shareholder resolutions with Occidental Petroleum, Valero Energy and Tesoro Corporation requesting oversight of the companies' political spending." (*Boards take heat for political spending*, Bloxham, October 18, CNN Money Fortune)[17] [18] [19]

> There are many issues on the horizon. Focus we must.

"Chinese officials are signaling plans to further reduce rare-earth exports next year... China, which uses around half of its output of the elements and **produces around 97% of world supply,** says its limits—which this year aim to cut exports around 40% from 2009—reflect its growing environmental awareness, are perfectly legal and won't be used as a policy tool."

"Yet, foreign importers worry reductions are designed to lift their metals import costs, undermine their high-technology industries and unnerve their defense departments." (*China Signals Further Rare-Earth Cuts*, James T. Areddy, October 19, Wall Street Journal)[20]

Endnotes:

1 http://www.ft.com/cms/s/0/ca170960-dadf-11df-a5bb-00144feabdc0.html?ftcamp=crm/email/20101018/nbe/BreakingNews1/product

2 http://www.biz.org/publ/bcbs178.htm

3 http://money.cnn.com/2010/10/19/news/economy/business_paralysis.fortune/index.htm

4 http://www.businessweek.com/ap/financialnews/D9IQSLO00.htm

5 http://www.businessweek.com/ap/financialnews/D9IE97DG0.htm/

6 http://finance.fortune.cnn.com/2010/10/21/the-case-for-more-government-spending/

7 http://news.xinhuanet.com/english2010/indepth/2010-10/12/c_13552612.htm

8 http://www.law.harvard.edu/programs/olin_center/

9 http://www.complianceweek.com/article/6173/proxy-access-dont-believe-the-hype

10 http://money.cnn.com/2010/10/18/smallbusiness/small_business_credit_crunch/index.htm

11 http://www.ft.com/cms/s/0/4486d68a-d702-11df-aaab-00144feabdc0.html

12 http://blogs.wsj.com/digits/2010/08/06/live-blogging-h-ps-announcement-to-investors/tab/comments/

13 http://www.bloomberg.com/news/2010-09-15/goldman-sachs-sued-by-three-women-over-alleged-gender-discrimination.html

14 http://dealbook.blogs.nytimes.com/2010/10/13/6-women-accuse-citigroup-of-gender-bias/

15 http://www.nytimes.com/2010/10/06/business/media/06tribune.html?_r=1&scp=5&sq=randy%20michaels&st=cse

16 http://blogs.wsj.com/deals/2010/10/14/in-ma-shareholders-win-may-be-ceos-loss/

17 http://money.cnn.com/2010/10/18/news/companies/corporate_political_spending.fortune/index.htm

18 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1680861

19 http://www.irrcinstitute.org/projects.php?project=48

20 http://online.wsj.com/article/SB10001424052702303550904575561922857320014.html

