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Seeking Trust?

Eleanor Bloxham

A new reality confronts CEOs and boards today. It includes greater shareholder activism, more independent boards, cross border regulatory cooperation, greater media and rating agency scrutiny, and customers who increasingly respond to social and ethical arguments. The steady breakdown of trust that began with the dot.com bust and Enron and WorldCom scandals remains a potent tide. To rebuild a bridge of trust across those stormy waters, CEOs and directors must focus on the three R's of good governance: relationships, risk and return.

Building Relationships

In Conversations That Build a Bridge of Trust, a video series on governance and leadership produced by The Value Alliance and AthenaOnline, we talked with CEOs and directors of U.S. and global companies, capital providers, sophisticated investors, community representatives, regulators, employee advocates and those that analyze them, such as credit and governance raters. What emerged was a picture of what is required of a successful CEO today: one who has embraced the new paradigm as chief relationship officer and manager, with board oversight, of the corporation's portfolio of relationships.

Today, boards consciously and proactively, or reactively, judge CEO performance based on how effectively they manage the corporation's relationships. As John Nash, founder of the National Association of Corporate Directors, said recently, boards today must ask themselves: "What is the quality of the CEO's relationship with shareholders, employees, analysts, regulators and others?" Smart CEOs understand this.

The push to manage this constellation of stakeholders comes from rising requirements fostered by a number of factors, such as:

Focus and awareness. Stakeholders today are more focused and aware. Recently, Ken Bertsch, head of governance rating at Moody's Investor Services, described their work in looking past the "window dressing" of governance, which is often employed to patch over real problems, to the reality of good solid governance.

Globalization. Stakeholder management has been an important aspect of governance in Europe for years. Now that wave is spreading across the U.S. Investors who once brushed off corporate social responsibility as a fad now embrace "environmental social governance" (ESG).

Organization. The ability to organize and conduct multipronged campaigns globally with minimal resources is clearly a requirement today. Peter Clapman, former chair of International Corporate Governance Network (ICGN), notes that ICGN formed a network of international investors and governance professionals in 2004 and that Governance for Owners plans to establish bases throughout the world so global investors have the resources to interact with managements and boards.

Given this recognition of significant change, the management of seven key relationships is more important than ever:

1. The board, management and capital providers (i.e., shareholders and creditors). For Tom Lehner, director of public policy at the Business Roundtable, this means proactive involvement by the board in shareholder relations.

2. **The board and management**. In rating firms on their governance, Nell Minow, co-founder and editorin- chief of The Corporate Library and Board Analyst, says that you can tell a lot about the relationship between the board and management by looking at CEO compensation.

3. **The board, management and employees**. Key questions for boards and CEOs today with respect to their senior leaders and employees are: Are they stuck looking inward or have they embraced Peter Drucker's exhortation to look outside? Do they understand this new reality, the constellation of relationships, and are they aligned to harness these changes to create future innovation and growth?

4. **The board, management and suppliers/outsourced firms** (legal, audit and compensation firms).

5. **Customers.**

6. **Regulators and the community.**

7.**Media, rating agencies and other commentators and influencers**.

With respect to numbers four through seven, the ability of the tides to change quickly and fiercely makes this a top risk for CEOs and boards. We saw this paradigm in action at Hewlett-Packard. What started as an internal matter quickly escalated into a cluster of issues, including a failure to manage the media and employees, which, in turn, evoked issues with regulators and, ultimately, headlines.

Managing Risk

For years, the paradigm for risk in banks and financial services firms has been focused on three main categories: market/interest rate risk, credit risk and operating risk. As more firms move to enterprise risk management systems, the Committee of Sponsoring Organizations of the

Treadway Commission (COSO) has suggested three primary categories: compliance/legal risk, financial/reporting and business risk (representing everything else).

The relationship model allows a useful view that recognizes today's reality: Strategic risks can be found in failures in the interactions between people both inside and outside the company. Therefore, it behooves every board and CEO to ask: "For each of the seven key relationships, do we have:

- The right culture, tone and ethics?
- The right sets of loyalties and alignments?
- The right chemistry to work together along with the right level of independence?
- The right understanding of the roles, responsibilities, views and relationships of each party?
- The right mechanisms to promptly detect and address any slides off course?"

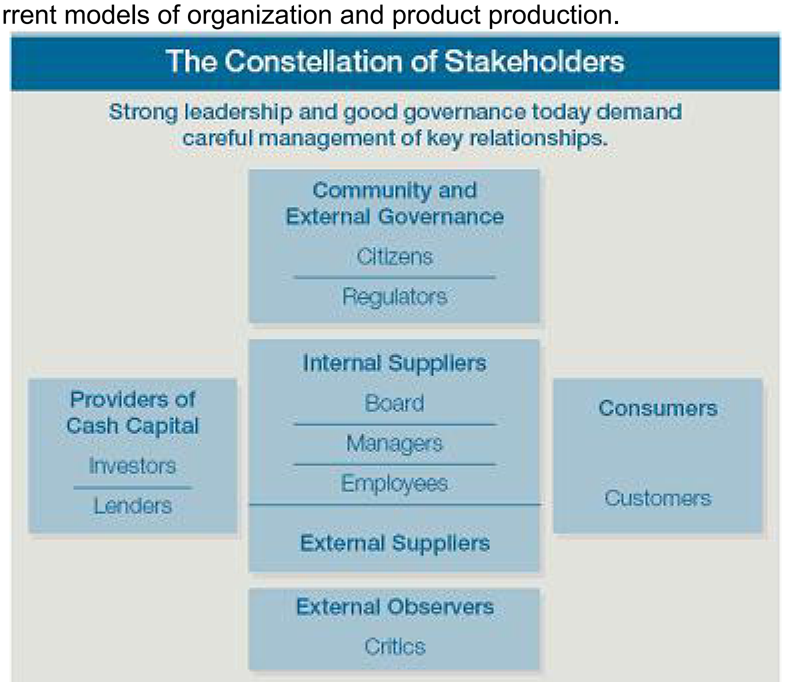
By examining the seven key sets of relationships in depth, boards and CEOs can avoid a key strategic risk for any firm today—that which author Michael Shermer, writing in the July 2006 Scientific American, called "confirmation bias, whereby we seek and find confirmatory evidence in support of already existing beliefs and ignore or reinterpret un confirmatory evidence."

Creating Return

Viewing the corporation through the prism of this new paradigm shines the light on new opportunities. That's critical to governance because leadership and governance are ultimately about creating return.

How is it done? In FutureThink, author/futurist Edie Weiner discusses what she calls the "right-of-way asset," citing Macy's advertising use of the side of its building as an example. She notes its right-of-way assets may be related to one or a combination of the relationships it has and its comparative strategic advantage with respect to that asset.

It may be a customer base to whom you can cross-sell another firm's products or services, or a strong relationship with another stakeholder that could spur an alliance, partnership or merger. These relationships require constant nurturing, but become sources of future opportunities that can leapfrog current models of organization and product production.



The relationship model can also help the organization identify new strategic models of organization, which is important because, while stakeholders are more dispersed geographically, functionally the accordion has moved inward, and we are currently witnessing a collapse, overlap and blurring of roles.

This collapsing of roles is changing the nature of relationships, of production and the definition of producer. As Alvin and Heidi Toffler point out in using the term “prosumer” in Revolutionary Wealth, today’s consumers are a source of production. This is a growing trend as web portals accept content from the general public and as firms like Yahoo open up their proprietary email programs to allow outsiders to create new services themselves.

However, it’s not just consumers who are shaping what is produced and who produces it. Increasingly, other stakeholders are influencing these shifts. Organizations such as Ceres and the Interfaith Center on Corporate Responsibility (ICCR) have had a profound impact on products and production, whether raising the issue of biodiversity risks in food or of sweatshop labor.

And it extends to a view of production itself. What is the corporation offering? Michael Lipper, founder of Lipper Advisory Services and managing member of L&S Partners, exhorts boards and CEOs to view their stock as an investor would. How does it relate to other industry offerings and then within an industry? How is it better or worse?

These trends can be seen at one of the most admired companies. General Electric has worked to turn what was a relationship risk with respect to the environment into a new return. Keith Sherin, CFO of GE, explains a conscious decision to clean up the legacy issue of PCBs in the Hudson River. In launching “ecomagination,” GE developed targets around reducing emissions, doubling R&D spending and increasing revenue from selling products that solve “the world’s toughest problems around energy, environmental efficiency and pollution.” It’s impacted other stakeholders as well. “Employees have embraced it, and our recruiting on college campuses is good,” adds Sherin.

Strategically, this involves a new level of relationship management and partnering along with a redefinition of the corporation’s role in society. As Jeff Immelt, CEO of GE, sees it: “The private sector must assume its rightful place as a fundamental catalyst for environmental change, in coordination with governments, academia and experts on the environment. Ecomagination is a growth strategy, driven by our belief that applying technology to solving problems is good business.”

The questions for every CEO and board are: Have we created respect and trust and the best possible win-win scenarios to create strategic advantage in our relationships and how can we continue to do that? Do the senior leaders of our organization understand this and how critical it is? Can they articulate it in plans and do they embrace it in tactics?

With that focus, boards and CEOs can build a bridge of trust, which is the key to good governance and long term sustainability and success.

Eleanor Bloxham is CEO of The Value Alliance and Corporate Governance Alliance, and author of Economic Value Management, Value-led Organizations and the video series, Conversations that Build a Bridge of Trust.