July
August
2009

CORPORATE Finance REVIEW

Coping with Change:
Corporate Governance in a Time of Crisis

The Flaws of Value at Risk: Tracking a True Culprit

A Single Global Regulatory Framework: Solution, or Problem?

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CORPORATE FINANCE REVIEW (ISSN 1089-327X) is published bimonthly by Warren, Gorham & Lamont, Division of Thomson Reuters, 195 Broadway, New York, NY 10007. Subscriptions: $260.00 a year. For subscription information, call 1 (800) 950-1216; for customer service call 1 (800)431-9025. Foreign callers (who cannot use our toll-free numbers) should call (914) 749-5000 or fax (914) 749-5300. We encourage readers to offer comments or suggestions to improve the usefulness of future issues. Contact Scott Gates, Editor, Thomson Reuters, 195 Broadway, New York, NY 10007; (212) 337-4129.

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Postmaster: Send address changes to CORPORATE FINANCE REVIEW, Thomson Reuters, 117 East Stevens Avenue, Valhalla, NY 10595.

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COPING WITH CHANGE: CORPORATE GOVERNANCE IN A TIME OF CRISIS

Eleanor Bloxham, CEO of the Value Alliance, offers her views on corporate governance problems in light of the current economic crisis, in an interview with the editor-in-chief of *Corporate Finance Review*.

ELEANOR BLOXHAM, IN AN INTERVIEW WITH MORGEN WITZEL

The ongoing economic and financial crisis has put even healthy and well-managed companies under severe stress. The crisis itself is beyond the experience of most managers: Few have seen or worked through an event of this magnitude. Many are struggling to chart a way forward.

In order to do so, companies are finding that it is necessary to return to old values like trust and fairness. In this interview, Eleanor Bloxham offers her views on these issues and others, including the need for compliance with new regulations and laws and the idea that the crisis can be an opportunity if companies and boards are prepared to be positive and forward-thinking. In response to a series of questions from *Corporate Finance Review*, Eleanor gives her thoughts on the way ahead.

What are the warning signs of corporate governance problems? What signals should a company be looking out for?

EB: That is a really big question and an important one. An obvious warning sign is implicit or explicit complaints from stakeholders. If a company is not good at addressing stakeholder complaints, and if there is a disconnect between the way the company is operating and the expectations of stakeholders, it is likely that its governance system needs to be reworked.

Complaints can take many forms. They may come from customers, suppliers, shareholders, citizens, regulators, or employees or their representatives. Sometimes these complaints are explicit, in letters or in articles published by the media citing the company itself. Other times they may be more hidden in online forums or chat rooms. Even less explicitly, general comments by legislators or other groups may imply criticisms or complaints that need to be addressed. Boards and companies who are on the lookout for all of these kinds of information can do a better job of evaluating the gov-

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ernance structures and improving them as needed.

COMPANIES SHOULD NOT BE ASKING, WHAT IS THE BEST PRACTICE I CAN FIND? BUT RATHER, WHAT IS THE BEST POSSIBLE PRACTICE?

Another obvious warning sign is a lack of equity or fairness in the system—or a governance structure that creates the perception of that condition. Stakeholders will put up with a lot, but built into the fabric of human DNA, it seems, is revulsion for what seems unfair. The ongoing controversy over executive pay is an example of this. Even if no one has yet complained, boards and companies need to ask themselves from A to Z what stakeholders would think; what their perceptions would be; whether the actions of the company are fair; and how others would see it.

Still another sign of corporate governance problems is when the people on the board (or in the company) look alike and all share similar backgrounds and views. That's when blind-sidedness can set in. That's when peripheral vision will be diminished and understanding other points of view may become very difficult. This is something boards should work scrupulously to avoid in this multicultural world we live in.

How important is it to be aware of cultural and political differences between countries and regions? What impact can these have?

EB: That's a great question because cultural and political differences are critically important. Most every company today is global. Employees and suppliers represent different cultures and countries; customers are global. And shareholders and regulators are cooperating cross country as never before. This means that you can spot trends just by understanding the interplay between regions and countries and how that impacts views and beliefs.

It is also important because despite the multicultural nature of companies and more and more countries today, there is still a sense in which even global companies can be typecast based on their headquarters' country, other companies located there, and their government. Because this can impact your ability to do business, understanding the biases that exist are important.

The governments of countries today help shape the views of potential business partners globally. This has a tremendous impact.

So, too, companies located in the same country as your headquarters can shape perceptions about your business. High standards thus become important, not only within your company, but in other companies as well. Ensuring that high standards are maintained in your country of origin as a matter of business practice is important.

What should companies do to identify best practice in one part of the organization and spread this throughout the organization? How can this best be done?

EB: One great way to do this is to provide opportunities for individuals to move to and manage different parts of the organization. Instituting a regular program for doing this will test the leader's ability to move beyond specific fields or business lines. It will facilitate not only the transference of good ideas but also their implementation. This was something I had the opportunity to do in my career and it provided me the perspective of an outsider, which is essential to bringing real innovation to teams.

Another way to facilitate this is to give team members more exposure to their internal customers and suppliers and to encourage ideas for change as part of the normal processes of the organization. My career has demonstrated to me that if given a say, employees will become engaged, especially if it is their idea that is being implemented.

Similarly, should companies be looking for examples of best practice in other organizations and seeking to learn from these?

EB: Absolutely they should. But maybe I should back up and make a distinction. Companies should be looking for examples of best practice inside their organization and in other organizations, but not in a rigid way. They should use what they find in other companies as a guidepost, as a general way forward but not a literal step one, two, and three. Companies should not be asking, What is the best practice I can find? but rather, What is the best possible practice? As part of that inquiry, the antennae should be up regarding any practices that might help lead them to the best possible practices.

The reason I emphasize this is that too many companies focus narrowly on "best practice." If no one has ever done it before, that becomes an excuse for not following a better way.

But in any given industry (let's take financial services), what might be considered "best practice" can be sorely lacking. So asking the right question is essential.

I think that constantly seeking the best *possible* practice—whether it currently exists or not—will lead you to discover better practices that you then should not be satisfied with but seek to improve.

Are there other sources of learning or knowledge that companies can tap into in order to reduce problems?

EB: Yes. I think it is critically important for companies consciously to go out of their way to understand others' opinions. Whether it's the worker in the trenches or the short selling hedge fund manager or the environmentalist with the sign or the politician on the other side of the spectrum, there is probably at least a kernel of truth in their observations and too often companies are dismissive rather than asking the question: If this were true, what would it mean? And what should we do to address it? And how did this perception arise in the first place?

I also think that another source of knowledge is in their own documents and databases. Robert Townsend once said that consultants are people who borrow your watch and tell you what time it is. This is in one sense a joke about consultants but it also reveals another truth: most companies have the watch. Many of them just haven't bothered to learn to read it. Many times, if the board, managers, and employees were to read carefully their own annual report, it would reveal the weaknesses they need to overcome and the opportunities they aren't taking. Companies spend millions gathering data but don't really use it effectively. Part of the key to success here is asking the big questions continually and looking at information that already exists for some of the answers.

Finally, it is important for companies to encourage individuals to study both inside and outside their field. Managers need to be relentless about encouraging employees to eliminate useless activities and to spend time every day absorbing new information. Managers should encourage employees to be well rounded as individuals and to read and study areas of expertise that have nothing to do with job responsibilities. Managers should encourage a curious mindset. Internal book clubs with leaders discussing topics that can be applied to work is a way to encourage a community of thinkers, who can then take meaningful action.

How important is early and prompt compliance with new regulations and laws?

EB: One of the ways early and prompt compliance with new regulations and laws is important is as a cultural signal. Whether the outside pressure is regulation or some other pressure, when bosses complain and act victimized rather than embrace and work to optimize, they send a signal that their organization is an organization of complainers and victims. Whereas when bosses say, We intend to be a role model for our industry, and then do so, that's the message employees get about their role too.

Regulations are a wake-up call. Legislators and regulators act when there is pressure for them to act, and usually not any sooner than that. They aren't generally lazing about, eating chocolates and dreaming up ways to make the life of business miserable; rather, there is generally pressure for them to take action if they do so. Companies need to view regulations as a failure of industry-wide associations to effect enough change inside the industry to persuade individual stakeholder groups of its best intentions and prevalent adherence to what are now viewed to be reasonable norms.

In addition to being a wake-up call, regulations are also a baseline standard. As with all opportunities to innovate, early and prompt compliance is just the first step; more fundamentally, the organization should ask how it can do better than required, what more it can do to demonstrate clearly its good intentions.

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Alignment of the interests of shareholders and management is often seen as an important step to better relations. How can this be done?

EB: To really drive the alignment requires discernment.

It is important to read the papers and study what is creating discontent among long-term shareholders. And it is important for the board and top executives to engage in dialogue with the company's own long-term shareholders to understand their perspectives and concerns.

However, the board must go beyond this. It must insist that the metrics used by the firm in making resource-allocation decisions (i.e., determining strategies and budgets) and the incentives (i.e., remuneration schemes) used are aligned with long-term shareholder interests. As I discuss in my book *Economic Value Management,* creating true alignment is a much more sophisticated task than many companies realize—and many companies run into trouble in the implementation by confusing means and ends.

Simply because earnings statements are provided to investors doesn't mean earnings should be the gauge for strategies and budgets. And simply because investors are rewarded when stock prices rise doesn't mean managers should be.

Though the end is alignment, the means should not be identical.

Creating alignment in setting strategies and budgets is achieved by allocating resources to initiatives that most support the company's purpose and resourcing those that over the long term will produce the most positive likely outcomes on a risk-adjusted basis. Creating alignment in incentives is achieved not by rewarding managers for the variability in stock price created by stock-market demand, supply, and risk appetite. Rather, alignment is achieved by rewarding managers for their risk-adjusted contributions to the long-term welfare and purposes of the firm.

What kinds of pressure points can cause stress and disrupt relationships with shareholders and others?

EB: Subtle changes in the wider environment can sneak up on boards and managers. One big example is the environmental movement. In the past, Exxon shareholders were happy about the company's direction; now, the winds have shifted and some want more of a focus on energy alternatives. The same has happened with the auto industry.

Changes in demographics along with changes in the future nature of organizations and views of equity markets are likely to have a marked impact on the business model for investment management going forward—and these same changes will impact many other kinds of organizations as well.

Changes in focus and values on the part of shareholders, governments, and customers move in global waves today. Increasingly, this will be true of employees also. If you operate in a geographical mentality unaware of these trends, you are likely to be surprised.

When changes arise that can cause stress and disrupt relationships with customers, or impact employee attraction and morale, or adversely impact relationships with citizens or the media or government, they are likely to cause stress on shareholder relationships as well, if not proactively addressed by management and the board.

How important is it to educate board members in their responsibilities? What prevents this from being done more often/more thoroughly?

EB: Board member education and awareness is one of the most important issues corporations and countries today face. Addressing this issue is critical to future prosperity because failures in oversight by boards cause corporate failures and contribute to broader economic woes.

Education and awareness are much broader than "in classroom time" and there are many obstacles to the better education of directors.

First, there is the general overreliance of boards on a small handful of internal and external voices and advisors. Second, many boards even today remain shielded in a cocoon created by the company's managers and the C-suite and supplemented by their discussions with other directors who share similar views. Third, there is a lack of recruitment diversity on boards; if this were not the case it would create new awareness and perhaps enough tension on a variety of subjects in the boardroom to create the thirst for more education and information. Fourth, there is a lack of curiosity and interest in engaging in knowledge seeking for its own sake. This is exemplified by a wide swath of directors who are only willing to attend events approved by Institutional Shareholder Services (ISS, now part of Risk Metrics), because only attendance at those events, those that meet the set requirements for time and other specific ISS rules (unrelated to educational value) will boost their governance score with ISS and thus may impact proxy votes. Fifth, the education that does go on is not more thorough because many instructors unfortunately aren't multidisciplinary deep thinkers on these topics; in addition, many of the organizations that run the training and the instructors they use aren't truly passionate about the topics; and finally, many organizations that run the training have a major aim of keeping and growing memberships and/or having better attendance at their events or use of their services in other ways and are therefore consciously loathe to challenge the participants.

How important are relationships with employees in ensuring good governance?

EB: Very important. Employees in surveys often turn out to be the first line of defense in detecting fraud. They know where the bodies are buried and who buried them. Surveys also show that employees will only divulge what they know (blow the whistle) if they believe something will be done about it. That means a straightforward, trusting relationship with employees is key. So that's one of the key areas of importance from the negative side.

Employees also understand the risks and tend to be less delusional about the ugly side of corporate realities. That perspective is very helpful in getting the straight scoop, but like the fraud information you'll only get it if they trust you.

Employee relationships built on trust are essential to getting ideas of all kinds: suggestions for improvement, innovations large and small, as well as timely feedback related to stakeholder concerns.

Employee relationships built on trust are key to a successful culture where words are turned into action and the norms of good behavior are enforced at every level because of the pride that exists with respect to the affiliation with the company.

To ensure good relations, and achieve this level of governance, boards and managers must recognize employees' needs. Employees need to be treated with fairness and dignity. And employees themselves need to be able to rely consistently on management and the board to do their parts.

It is sometimes argued that compliance can be a source of competitive advantage. Is this possible? And, if so, how?

EB: I think compliance can definitely be a source of competitive advantage. Early and prompt compliance can provide a competitive advantage for the organization's reputation. When bad times hit or mistakes are made, this is money in the bank that the organization can draw from. Even more importantly, early and prompt compliance can reinforce a culture of success, one that is open to change, innovation, and a commitment to do good.

Compliance with tough regulations (on fronts ranging from securities disclosure to consumer protection) can provide a kind of "good housekeeping" seal that says given the choice I'll buy products from company A in country B—or I'll buy shares of stock from company C in country D.

Compliance with tough regulations can influence buying behaviors, whether it is the company's stocks, bonds, or products, and its ability to attract top-notch talent. Because it can impact the company's bottom line in so many different ways, it is indeed a key to competitive advantage.

The problems we face are not going to go away. How important is it to stay on top of changes and look for opportunities?

EB: I agree that the problems we face are not easily going to go away because at their core the problems we face are human problems. And the adventure of life is about coming to understand those core human problems as they are—either

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reflected in our own behaviors or those around us.

I enjoy the science of quantitative finance, of law and business, but the real core of all the issues for companies and boards are human ones. These problems that are not going to go away easily aren't just related to inaccurate credit scoring or faulty analyses or ineffective risk monitoring. Rather, at their core the problems we face include inertia, indifference, incompetence, bias, greed and envy, desire for approval and affiliation, and selfish disregard for others. And it's all of them. Not just some. Making those problems go away takes more than the latest quick fix or doctoral research.

Awareness is critical.

Life's adventure is about each of us finding our own way through these human problems and examining closely how we can influence our own behavior first and then the behavior of others. Staying on top of changes and looking for opportunities to solve human problems of our own and others' making in whatever sphere is the key to business and life success, a life lived well, with contentment and vigor.

Doing the job we have each set out to do, playing out the adventure we have created, requires daily learning and daily mid-course corrections: asking key questions consciously, such as, Who do I want to be with respect to this? and, What actions must I take to do that?

Every day we are each given challenges that we can choose to take up—challenges that present themselves due to changing circumstances. If we are really aware, we may even anticipate the changes and the possibilities that will open up for us. Awareness combined with understanding our own mission and our own ability to influence the world positively can produce incredible outcomes. At the end of the day, thus aligned with our purpose and our strength, those of us who seek to solve human challenges are simply looking for the individual ways we can contribute by our own behavior and by influencing outcomes and the actions of others.

The continued searching for those opportunities to serve is key—to success, and to a life well lived. ■