



## Global Governance

- Moderator: **Rakesh Khurana**, *Professor of Business Administration*
- Panelists: **William W. George**, *Professor of Management Practice*  
**Nell Minow**, *Editor & Cofounder, Corporate Library*  
**Damon A. Silvers**, *Associate General Counsel, AFL-CIO*

### Overview

Boards of directors are the entities charged with ensuring the long-term viability and success of corporations. So where were they prior to the financial crisis and does this crisis indicate fundamental problems with boards and governance?

Panelists do see multiple problems in how American boards are comprised and operate. The solutions lie in changing how boards are selected, changing the expectations for how boards operate, and reexamining the motivations for why board members serve.

### Context

Led by questions from Professor Khurana, the panelists and audience members explored the problems with corporate governance in America and offered possible solutions.

### Key Takeaways

- **Boards have received little blame for the current financial crisis, yet bear much of the responsibility.**

Not only did boards fail to protect corporations' interests from the forces that have culminated in a meltdown of the financial system, but no one appears to have expected them to. Discussion of board culpability has been notably absent amid the finger-pointing in the wake of the crisis, noted Professor Khurana.

Yet the board of directors is the entity charged with ensuring the well-being of a corporation. As Professor George said, "The first job of any board of directors is to ensure the survivability of the firm." However, often boards—like CEOs and other executives—become overly focused on the company's short-term stock price as opposed to its long-term viability.

In retrospect, it appears that the boards of the failed financial institutions had the clues and the means, and certainly the responsibility, to detect the risks that materialized into the subprime crisis. The reasons this did not happen are many and include:

- *Flawed board member selection.* There are many unqualified individuals serving on boards, people who have personal connections, personal wealth, and/or view being on a board as an "honor," but who lack relevant knowledge and experience to perform the basic duties required of a board member. Ms. Minow observed that a teenager applying for a driver's license receives more scrutiny than most board members. When board members view being on a board as an honor, they take their duties lightly, meet infrequently, are overly polite, and fail to exercise the fiduciary

responsibilities required of a board. Mr. George sees board service as a calling and an extremely serious responsibility; not an honor.

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*"It is not an honor to serve on a board; it is a calling. There's a big, big difference."*

— William W. George

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- *Difficulty ousting board members.* Ms. Minow believes that shareholder proxy and proposal processes "make it just about impossible" for investors to replace directors. She believes that requiring directors to receive a majority of votes will go a long way toward making directors more accountable.
- *Boards lack independence.* While Sarbanes-Oxley mandates a certain level of board independence, true independence is often lacking. Boards often feel a certain sense of "deference and protectiveness" toward senior executives, said Mr. Silvers, clouding objective analysis of troubling situations and fostering denial. Boards also often fail to ask hard questions and engage in rigorous inquiry.
- *Boards don't do their jobs.* In addition to ensuring the corporation's long-term survivability, boards should ensure proper risk management, monitoring, and governance—which often does not occur. For example, Mr. Silvers described how the audit committee of a major financial firm met just twice in one year, as the company was engaged in highly risky activities.

- **Through poorly designed executive compensation plans, boards have exacerbated the short-term focus that exists in corporate America.**

Many boards seem to ignore their own mission of long-term stewardship when they approve executive compensation packages based heavily on short-term results, particularly the firm's short-term stock price. Such incentives produce outsized short-term CEO compensation but don't necessarily produce solid long-term performance.

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*"When three years defines a long-term incentive plan, we're really at the edge of the deterioration of Western civilization."*

— Rakesh Khurana

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In fact, Ms. Minow's work has found a correlation between CEO compensation and firm performance—an inverse one: The greater the CEO compensation, the more likely a firm will get into trouble. The reason: High compensation causes corporate leaders to take more risks. In addition, such compensation plans only have a financial upside for the CEO and other executives, and rarely any downside.



*“There’s an inverse correlation [between CEO salary and performance]. . . . The biggest risk factor that we have found is excessive CEO pay.”*

— Nell Minow

Creating toxic compensation plans is just one way in which boards often fail to balance the power of CEOs. Too often, boards choose powerful leaders as CEOs, who seem to accrue even more power in their post. This can grow to the point where the board reveres them too much to manage them or rein them in. Boards “don’t balance that power,” said Mr. George. “They need to step up and take control. The board governs; the CEO manages.”

▪ **Like the problems with board governance, appropriate fixes would be both cultural and structural.**

Among the changes suggested to improve boards and governance are:

— *Selection based on character and commitment.* A new standard should be applied in selecting board members: They should be selected based on character and their commitment to serving on the board. While there is no specific test to measure these attributes, a rigorous screening process should be able to assess a person’s character and motivation for serving on a board. The character standard should also apply to CEOs.

— *Activist boards.* An audience member noted that typically the boards of private companies are much more active. They are actively engaged in the company’s business and success, providing guidance and advice. But for public companies, the focus often shifts to compliance with regulations. The panelists agreed that more activist boards are required, not to manage the business, but to engage in the business and ask hard questions of management—to lead.

— *A long-term perspective.* Boards need to take a long-term perspective, which is reflected in the board’s focus, its approach to risk management, its compensation, and the compensation plans of executives (which must be better tied to long-term organizational performance). Mr. Silvers would make directors accountable to a long-term-focused constituency through changes in shareholder proxy design. There might also be changes in tax policy that would encourage longer-term thinking.

— *Majority vote.* Ms. Minow would mandate a majority vote in director elections, rather than the common rule that an unopposed board member can be elected by one vote.

▪ **The behavior of American boards reflects society’s focus on short-term personal gain versus creating an organization of significance.**

The panel and audience probed what it is about American society that supports board abdication of responsibility.

Both the panelists and audience members expressed the view that business has lost its sense of societal purpose. In 1908 when HBS was founded, contributing value to society was a major aim of business. HBS was formed to study how to reconcile profit aims with the need to take

care of workers. “This society has moved so far away from our basic notion of what business is all about,” said an audience member.

*“If the purpose of business . . . is only to make a few people rich, then we’ve got a pretty good governance system. If the purpose of business is to make society work well, we’ve got a lot of work to do.”*

— Audience Participant

An audience member from Europe was puzzled by Americans’ obsession with accruing enormous amounts of money. Also puzzling to him was the two-step model typified by Bill Gates’s life—first one makes a fortune, then one gives back—versus a more integrated lifelong approach to societal contributions. In Europe, work is pursued less for compensation than for personal rewards.

While the session did not resolve the reasons for America’s wealth obsession, examples of it flowed freely (e.g., CEOs of failed firms insisting on their full severance packages despite having destroyed their firm, at the cost of their reputations, integrity, and career; HBS grads headed to Wall Street despite deep dread of “selling their souls”).

American materialism plays out in board governance through short-term horizons. Three-year incentive packages for CEOs “were intended to make CEOs rich as fast as they can,” said an audience member, which flies in the face of the board’s supposed mission to build companies sustainable for the long term. A solution in Mr. George’s view is for every director of every public company to recognize that their job is to have a corporation that serves society. This is an important step toward changing the culture of American corporations.

## Other Important Points

- **How “boards” began.** The term “board” goes back to medieval times, when an actual board of lumber was put over two sawhorses and used as a makeshift meeting table. Most meeting participants sat on stools, but the person in charge sat in a chair and was designated the “chair-man.”
- **Clawbacks.** Mr. George floated the idea as part of the U.S. government’s bailout package that clawbacks be considered. Those in the financial sector who made huge sums of money should be held accountable for the money they took out beforehand (as happens in the context of bankruptcy), and clawback provisions could have been established. However, despite the havoc wreaked by those in the financial sector who extracted huge personal gains, there was no political appetite in Congress for any type of clawback provisions.
- **Rating tool.** Ms. Minow’s company rates the effectiveness of boards, much as debt is rated, providing a tool for investors that hopefully will foster increased accountability of directors.



## Speaker Biographies

### **Rakesh Khurana, Ph.D. OB 1998 (Moderator)** *Professor of Business Administration*

Rakesh Khurana is a professor in the Organizational Behavior unit at HBS. He teaches a doctoral seminar on Management and Markets and The Board of Directors and Corporate Governance in the MBA Program. He received his BS from Cornell University and his MA (sociology) and Ph.D. in organization behavior from Harvard University. Before attending graduate school, he worked as a founding member of Cambridge Technology Partners in sales and marketing.

Khurana's research uses a social network perspective to reframe classical economic and sociological explanations of market outcomes. His research focuses on the processes by which leaders are selected and developed. He has written extensively about the CEO labor market with particular interest on the factors that lead to vacancies in the CEO position and affect the choice of successor; the role of market intermediaries like executive-search firms in CEO search; and the consequences of CEO succession and selection decisions for later firm performance and strategic choices. His 2002 book, *Searching for a Corporate Savior: The Irrational Quest for Charismatic CEOs*, analyzes the labor market for CEOs.

Khurana's most recent book, *From Higher Aims to Hired Hands: The Social Transformation of American Business Schools and the Unfulfilled Promise of Management as a Profession* (2007), chronicles the evolution of management as a profession, focusing particularly on the institutional development of the MBA. How have certain occupations within business (executive management, consulting, private equity, and investment banking) come to require the MBA credential as a prerequisite for entry? How has professional management claimed and received legitimation for its role as the steward of much of society's material wealth and resources?

Khurana expects the results of this research on professions to have implications for our understanding of how, exactly, professional managers do, can, or should "contribute to the well-being of society."

### **William W. George, MBA 1966** *Professor of Management Practice*

Bill George is Professor of Management Practice at HBS, where he is teaching leadership and leadership development in the MBA Program and in several Executive Education programs. He is the author of a best-selling leadership book, *True North: Discover Your Authentic Leadership*. His previous book, *Authentic Leadership: Rediscovering the Secrets to Creating Lasting Value*, was also a bestseller.

George is the former chairman and CEO of Medtronic, which he joined in 1989 as president and COO. He served as CEO from 1991 through 2001 and was chairman of the board from 1996 to 2002. Under his leadership, Medtronic's market

capitalization grew from \$1.1 billion to \$60 billion, averaging 35 percent a year.

George serves as a director of ExxonMobil, Goldman Sachs, Novartis, the Carnegie Endowment for International Peace, and the World Economic Forum USA.

During 2002–2003, George was Professor of Leadership and Governance at IMD International in Lausanne, Switzerland, and executive-in-residence at Yale University's School of Management. Before joining Medtronic, he spent 10 years as a senior executive with Honeywell and 10 years with Litton Industries, mostly as president of Litton Microwave Cooking.

George received his BSIE with high honors from Georgia Tech and his MBA with high distinction from HBS, where he was a Baker Scholar. He has received an honorary doctorate of business administration from Bryant University. George was named executive of the year by the Academy of Management (2001) and director of the year by the National Association of Corporate Directors (2001–2002). In 2002 George was named one of the 25 most influential businesspeople of the last 25 years by the PBS *Nightly News*.

### **Nell Minow** *Editor & Cofounder, Corporate Library*

Nell Minow is the editor and cofounder of the Corporate Library. She was named one of the 20 most influential people in corporate governance by *Directorship* magazine in 2007 and was dubbed "the queen of good corporate governance" by *BusinessWeek Online* in 2003. Before cofounding the Corporate Library, Minow was a principal of Lens, a \$100 million investment firm that took positions in underperforming companies and used shareholder activism to increase their value. Her other professional experience includes serving as president of Institutional Shareholder Services Inc. and as an attorney in the U.S. Environmental Protection Agency, the Office of Management and Budget, and the Department of Justice. She has written hundreds of articles and cowritten three books with Robert Monks, most recently the fourth edition of an MBA textbook, *Corporate Governance*, published in 2008.

Minow is a graduate of Sarah Lawrence College and the University of Chicago Law School.

### **Damon A. Silvers, MBA 1995** *Associate General Counsel, AFL-CIO*

Damon Silvers is an associate general counsel for the AFL-CIO, responsible for bankruptcy, corporate governance, and pension and general business law issues. He led the AFL-CIO legal team that won severance payments for laid-off Enron and WorldCom workers.

Silvers is a member of the Public Company Accounting Oversight Board Standing Advisory Group and the Financial



Accounting Standards Board User Advisory Council. He is also a member of the U.S. Treasury Department Investors' Practice Committee of the President's Working Group on Financial Markets and the chair of the Competition Subcommittee of the U.S. Treasury Department Advisory Committee on the Auditing Profession.

Before working for the AFL-CIO, Silvers was a law clerk at the Delaware Court of Chancery for Chancellor William Allen and Vice Chancellor Bernard Balick.

Silvers received his JD with honors from Harvard Law School and his MBA with high honors from HBS, graduating as a Baker Scholar. He is a graduate of Harvard College, summa cum laude, and has studied history at King's College, Cambridge University.

Silvers is the main author of "Challenging Wall Street's Conventional Wisdom: Defining a Worker-Owner View of Value," in *Working Capital: The Power of Labor's Pensions*, Archon Fung and others, eds. (2001), and "The Origins and Goals of the Fight for Proxy Access," forthcoming in Lucian Bebchuk, ed., *Shareholder Access to the Corporate Ballot*. He is also the author of "A Response to Vice-Chancellor Leo Strine Jr.'s Toward Common Sense and Common Ground? Reflections on the Shared Interests of Managers and Labor in a More Rational System of Corporate Governance," in the *Journal of Corporation Law* (2007), and "The Current State of Auditing as a Profession: A View from Worker-Owners," in *Accounting Horizons* (2007).