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THE ROLE OF THE DIRECTOR IN CORPORATE ACCOUNTABILITY

An Address By Harold M. Williams, Chairman

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In each of my careers, I have had the opportunity to observe the gestation of legislation regulating business. The script is standard -- only the length of the acts and the names of some of the actors seem to change. Act one typically consists of the occurrence of several isolated human events -- some of which might attract broad interest and press coverage -- followed by thinly scattered comment from public interest types to the effect that perhaps we should do something to prevent such things from happening again. At the curtain of act one, the plot seems insignificant and easy to ignore.

Act two is usually the long act -- not much new happens at first. Then events begin to accelerate. Public sentiment is fanned, usually by the reporting of further incidents of the same type as opened the drama. Public interest groups form. Congress shows interest. Often legislation is introduced but goes nowhere, lulling opponents into a false sense of security. Act two closes with a bang, however, when Congressional and public interest, sometimes inflamed by a single dramatic and widely publicized occurrence, lead to a full blown legislative effort.

The last act is always the same -- legislation. The moral with which the viewer is left seems to be: It takes a law to get business to behave responsibly. Recognize the play? Call it "Auto Safety," Truth in Packaging," "Occupational Health and Safety," ERISA," what ever.

The most unbelievable and aggravating part of the entire script is the role business plays. Typically, business ignores the early rumbles of dissatisfaction and then turns to the stone-walling approach. Finally, usually late in act three, business begins to engage in the legislative process, but too late, and often only to exaggerate the dire consequences which will follow if legislation is passed. Only infrequently does business participate in the legislation scenes in a timely and constructive manner. To the extent that it does, it may be able to avoid legislation, or at least to help shape it positively so that the purposes are more clearly defined and are achieved with a minimum of dislocation and cost. Even more rarely does business consider positive steps to alter its conduct, or to correct the perception of its conduct, as a means to avoid or minimize the legislative solution.

What does all this have to do with directors and corporate accountability? To put it succinctly, I believe we are in the early stages of act two of a play entitled "Federal Legislation on Corporate Accountability -- subtitle: Federal Regulation of the Corporate Decision-making Process." I am one of the players. I help focus the problem -- and thus perhaps I contribute to the likelihood of a legislative solution. But I don't like the script. I want to see act three rewritten. The superior economic achievement of our private enterprise system and our unequaled political and personal freedoms are closely intertwined and mutually reinforcing characteristics in our society; we must be extremely cautious in tampering with their balance. The only viable alternative to corporate governance legislation which I have been able to come up with -- that is, without changing the basic governance structure we now have -- is to organize the corporate board so that it can truly discharge the responsibilities it already has under state law. The only other alternative script I can visualize is to convince everyone that things are fine as they are. But I don't believe that it would have a long run either in Waukegan or Washington.

As a consequence, and as you may have heard, I proposed in a speech last January that public corporations should -- voluntarily -- take steps to structure their boards so that the board is able to exercise more meaningful oversight and control over corporate management. I expressed at some length my concern that the corporate sector must recognize the gap between the public's perception of business responsibilities and the private sector's own understanding of its role. In order to meet that challenge, I suggested that, as an ideal, the board should be composed entirely of independent directors with one exception; that the corporate chief executive officer should be the sole management board member; and that the role of corporate CEO and the role of chairman of the board should be separate.

The reactions to my talk have been numerous, diverse, thought-provoking, and often quite emphatic. A number of communications from outside directors, company employees, and shareholders were very supportive. Some corporate executives responded that they were in agreement with my thoughts and that their boards already came close to the ideal I had proposed. Others told me that they shared the concerns and agreed with the principles underlying my proposals, but not with the proposals themselves, particularly with regard to excluding all but one management representative from the corporate board. A number of CEO's, but with notable exceptions, were not particularly attracted to the prospect of relinquishing the board chairmancy. Still others who responded were unreservedly critical. Some of those who disagreed most strenuously with my views directed their displeasure primarily at points which I had <u>not</u> made. For example, my suggestions were characterized as an "ill-advised attempt to expand the authority of the

SEC;" in fact, the central point of my talk was that corporations should explore ways to respond to the demand for greater accountability voluntarily in order to avoid further encroachment of government regulation. I was chastized for advocating "special interest" directorships on corporate boards, a position I never mentioned and strongly oppose. And one correspondent accused me of being among what he called the "sinister forces" favoring nationalization of American industry.

I intend to undertake this afternoon to amplify somewhat on my views concerning the role of corporate directors and, in that way, to respond to some of the criticisms which were leveled at my earlier comments. I do not do so defensively or because I believe that my proposals are flawless or because the Commission is about to impose them upon public corporations, but rather to pursue a vital dialogue. The process by which corporate power is effectively and responsibility exercised, in a manner consistent with public expectations concerning corporate accountability, is one which cannot be meaningfully strengthened by fiat or prescription. Legislation, and government regulation in general, necessarily embody one solution which those regulated must apply to many circumstances. Corporate accountability cannot, in my view, be addressed in that fashion. Even mandating independent directors, for example, could not alone ensure that the board would play its proper role; the Commission's release on its investigation of National Telephone Company is a recent demonstration of that. What is indispensible is that corporate directors and managements be committed, in their own long term self interest, to making the board work. No legislation or rule can substitute for that commitment.

For that reason, my goal is to stimulate the corporate sector to greater sensitivity and appreciation of the need for it to address squarely the issue of corporate accountability. If too many business leaders insist that there is no problem or that, as one of the critics of my speech stated, the "vehicle for corporate accountability is the bottom line," then I suspect that the political processes will ultimately take more and more of the control of the corporate sector out of the hands of private managers and transfer it to the hands of government regulators. And that is a prospect which I would neither greet with enthusiasm nor expect to be, in the long run, consistent with a system of private enterprise.

The task of shaping the mechanisms of corporate accountability in a way which is a positive alternative to the enactment of a statute or the creation of a regulatory agency is not an easy one. The job is one which requires continuous sensitivity to the need to match corporate processes to the constantly changing social environment in which we live. And, in my view, a board of independent directors -- that is, directors who are not merely "outside" in the sense of holding none of the corporation's managerial posts, but are also unencumbered by any other conflicting links to the corporation -- provides the best solution consistent with today's corporate governance and decision-making structure.

Corporate Accountability and Regulatory Solutions

Over the years, a vast array of remedial social legislation has injected the government into the regulation of areas traditionally regarded as private. Indeed, as a society, we tend increasingly to look to government -- and that more and more often means to the federal government -- to regulate the performance of private conduct in order to insure that it is directed to what is perceived to be the public good.

The signs are beginning to multiply that the structure and governance of corporations may not long remain immune from that trend. The media have sensitized the public to examples of corporate "unaccountability," -- and accusations substantiated and otherwise, of such unaccountability continue to multiply. Public opinion polls reflect the predictable response to these sorts of well-publicized incidents. On the one hand, the public retains its confidence in the efficiency of American business -- its ability to provide goods and services -- and still overwhelmingly supports the private enterprise system. At the same time, however, the public has a deep-seated unease over the exercise of what is perceived as the enormous power of American business; the narrow, self-interested way in which that power is used, or perceived as used; and the lack of perceived congruity between business's goals and objectives and those of the rest of our society.

Some who wrote to me regarding my remarks on corporate accountability argued that, whatever business's stature in the public mind, government's is worse. While this may be so, I think that corporate leaders who take consolation from that fact -- or use it as an excuse to cling to the status quo -- seriously err. Despite mistrust of government regulators, articulate and influencial advocates of the view that corporate power needs to be further bridled by government action continue to be heard. Indeed, a recent survey of attitudes toward business concluded:

> "Given the strength of public concerns about business' irresponsibility in its pursuits of profits, we find generally strong support for government regulation of business. Fewer than 1 out of 4 Americans think that business is overregulated. Moreover, while over 7 out of

> 10 Americans will complain about government in terms of waste, inefficiency, and red tape, only 25% will complain about too much regulation."*/

Moreover, lack of trust in government is, I believe, a manifestation of an erosion of confidence in large institutions generally. The same survey I mentioned a moment ago also concluded:

> "At the same time, however, our results indicate a continuation of a growth in public cynicism and mistrust directed at institutions. Indeed, there is no institution in America which has not, at some time in the past ten years, suffered a serious decline in public confidence. In the case of business, confidence has fallen from the 70% level in 1968 down to 15% in 1977." **/

Accordingly, rather than comfort ourselves with the notion that other institutions may enjoy still lower esteem, each of us needs to examine the reasons for the disintegration of institutional confidence and to determine what our role can be in rebuilding the trust which cements the social order.

The Role of the Corporate Director in Fostering Accountability

With that thought in mind, I want to turn to the role of the director in corporate accountability. In my judgment, the strengthening of corporate accountability -- and ultimately

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*/ Yankelovich, Shelly and White, Inc., Report to Leadership on 1977 Findings of Corporate Priorities at 10 (1977).

**/ Id. at 5.