

Law & Governance

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CEOs to Boards: Don't You Trust Us?

Let's face it, a lot don't—maybe with reason. But this is a dangerous trend that both sides need to correct while they can. Some chief executives and directors are doing just that.

Julie Connelly

After nearly three years of fallout from Sarbanes-Oxley, plus the frightening realization that directors may be held financially liable for their oversight failures, boards are no longer looking at their CEOs with wonder. In fact, they're downright skeptical. "Trust in the CEO is not at the levels it used to be," says Richard Koppes, a director of Apria Healthcare and Valeant Pharmaceuticals International. Adds Philip Burguières, chairman emeritus of Weatherford International and a former CEO of Panhandle Eastern Corp. and Cameron Iron Works: "The element of trust seems to be gone. A few guys have done great harm."

Obviously the vast majority of CEOs are trustworthy, but all have been slimed to some extent by the scandals of recent years. In 2003 a joint BusinessWeek/Harris Poll survey found that nearly 80% of Americans believed that CEOs of large companies put their own interests before those of workers and shareholders.

To say that boards don't trust the CEO is not to say that they suspect dishonesty. If they did, turnover at the top of the corporate totem pole would be even higher than it is. Last year 663 CEOs decamped to other jobs, retired, or were fired, down from the high-water mark of 1,106 in 2000, according to Challenger Gray & Christmas, an outplacement firm that keeps track of these peregrinations. Rather, what boards fear is that their CEO isn't leveling with them, that all information that directors receive about the company is filtered through the CEO's ego.

When McKinsey & Co., a management consulting firm, surveyed 150 directors in 2004, 81% said that the CEO largely or completely controlled and shaped what board members learned about the company. Only 30% said they felt they really knew what was going on. Directors want to take more control of the information they are getting, and that's a direct challenge to the CEO's power.

Of course, governance reforms have already chipped away at that power base. "Before these changes, the board saw only the tip of the iceberg in terms of information," says Alice Kane, founder and former chairman of Blaylock-Abacus Asset Management, who sits on a number of public-company boards. "Now we go down deeper into the company."

Board members are demanding and getting access to senior managers without the CEO present, to learn more about the internal workings of the organization. Twice a year, for example, General Electric directors spend time with the management and employees of various business units, unaccompanied by anyone from headquarters. At InCode, a wireless-technology company in San Diego, Edward Kingman, a former assistant secretary of the Treasury, chairs the audit committee. "His expectation is to have unlimited access to our CFO and treasurer—and he has it. So I don't drive the agenda," says John Donovan, InCode's CEO. "There's a lot more interface between the board and the functions at the company."

More directors are also getting together without the CEO to compare notes. Marshall Carter, the retired chairman and CEO of State Street Bank in Boston and currently a director of Honeywell International, notices that outside directors are meeting more often in executive session—sometimes after every board meeting, or at least once a quarter. "This gives us the chance to talk about whether we liked what was being done or not," he says. "Then the lead director gives our feedback to the CEO." And some CEOs love it, or say they do. "I do encourage our directors to express their disagreement, and it's a very outspoken group," says Steven Kriegsmann, president and CEO of CytRx, a NASDAQ-traded biotech company that is working on effective treatments for Lou Gehrig's disease and type 2 diabetes. "Sometimes I get a little hurt, but not where it bothers me. There's nothing personal—it's all about the company and the business."

According to Harvard Business School professor Jay Lorsch, who is a director of Computer Associates: "We're headed in a different direction now, where the board is supreme—and this is a permanent change. People won't take the risk of being directors if they can't do the job."

A danger is that directors will feel sufficiently empowered to usurp roles that properly belong to the executives. Sarbanes-Oxley compliance procedures are the thin end of the wedge here, because they are requiring board members to delve into management's activities in the process of ensuring that companies abide by the rules. Most directors have become mired in accounting oversight and control—and some CEOs are happy to have them there. Says InCode's John Donovan: "My job is to spend my time with customers. I need to build a business, and I can't spend my

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time on controls. I want someone who will spend time with the auditors. I have to parachute in periodically to know what's going on. But let the board deal with the control issues; let them be the building inspectors."

At some point these oversight functions of the board will become a manageable routine, and when that happens, newly energized directors have indicated that they want to become more engaged in other aspects of the company. That's what Robert Felton, a director at McKinsey & Co., has concluded from a McKinsey-sponsored January 2005 survey of board members at 1,000 public companies worldwide. Three-quarters of the directors wanted to spend anywhere from 25% to 100% more time on strategy formation, risk assessment, and people development—management's traditional areas of responsibility, Felton notes. "Boards want to get more involved," he says. "They want to move from compliance to value-added activities."

Although the CEO has always served at the board's pleasure, many directors are only now seeing themselves as the CEO's boss, and like any conscientious employer they want to keep tabs on what the workers are up to. CEOs are learning to go along with this. Listen to Kriegsman describe his relationship with the CytRx board: "There are no stars here; I answer to the board. They call the shots. I implement their decisions. My obligation is to keep them apprised of everything that is going on."

they think are our biggest problems. There are times when the board suggests something to which I can say 'Thanks' and go my way. But I have to be aware of where the board is an adviser and where it's a contender. On financial matters, it's pretty clear where it's their call. It all boils down to engaged board members, a respectful CEO, and open dialogue."

One director told Donovan that during the recruiting process board members had said they thought highly of their CEO. Replied Donovan: "Tell them to tell that to me!"

Kriegsman communicates with his directors as often as matters develop that are material to CytRx; sometimes that's every day, sometimes every couple of weeks. "I don't count the time that I spend talking to board members, because I work all the time," he says. "But you build a relationship by communication that is face-to-face or over the phone or in writing, and by conversations that are both business and personal."

Nothing gets directors' backs up faster than a CEO who kites off on his or her own without discussion in the boardroom. "A CEO can't come to the board and say, 'I've been talking to so-and-so and we've decided to merge our two companies. Whaddaya think?'" says Jay Lorsch. At least not without paying a career penalty.

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All of which takes time. Loren Carlson, chairman of an organization for chief executives called CEO Roundtable, estimates that more than 30% of a CEO's time is now spent managing the board. "That's a lot," he says, "because the CEO needs to have one-on-one conversations with each of the board members on a consistent basis, and especially prior to the board meeting so that there are no surprises at the meeting."

Donovan, who says he spends four hours a week recapping issues for his InCode directors, explains that they are "helping me prioritize things; they are telling me what

"It's to the CEO's advantage to share things with the board when they are still in the formative stages," says Honeywell director Marshall Carter. "If you've said nothing, it doesn't help when six months later something goes wrong." He recalls an instance of a CEO who involved his company in a big acquisition. The board felt it was not in the loop about the deal—a point clearly made to the CEO by the lead director. When the deal collapsed, the CEO took early retirement.

Yet some chief executives complain that Sarbanes-Oxley is making boardrooms so formal and process-

oriented that boards will only listen to formal presentations. Laurence Stybel of Stybel Peabody Lincolnshire, a consulting firm, recalls that in the course of a board self-evaluation at a Fortune 500 company, the CEO complained that the directors paid so much attention to audit and oversight that he felt he couldn't run trial balloons past them, and he didn't know whom else he could talk to about certain issues. "So the board created the 'half-baked ideas' concept," says Stybel. "They told the CEO that if he made a formal proposal, they'd evaluate it as a formal oversight matter. But if he said the magic words half-baked idea, they'd give him advice and counsel."

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Of course, many CEOs have intuitively sought advice and counsel outside the boardroom, because the job is lonely and they know they need reality checks from people without an agenda. Brad Thompson, the chairman and CEO of Oncolytics Biotech, a NASDAQ company in Calgary, Alberta, has what he calls his "quack club," a couple of other CEOs whom he's known for years and who join him in letting off steam. "I quack and they grumble," he says. "Finding these people is the hardest thing for a CEO, because what you tell them cannot go further."

With directors wanting to become so much more involved, it won't be difficult for them to trip over the line between governance and management, to move

from oversight to decision-making. Stybel believes that boards are not eager to usurp management's role, because they know that however open the CEO, the best information they can get is historical. "They are looking at last quarter's data or last year's data, and it would be as if they were trying to drive the car by looking in the rearview mirror," he says. "They're hoping the CEO is looking ahead, so they're not going to say, 'Let me have the wheel.'"

And yet the line of demarcation is so tenuous that this can happen. Edward Zajac, a professor of management and organizations at Northwestern University's Kellogg School of Management, notes that at one company where he has done some consulting, the managers were receiving e-mails from both the CEO and an outside director about a strategic matter. Says Zajac: "The e-mails were not in sync."

But sometimes a CEO is on less solid ground when he or she objects to the board's incursions. Consultant Thomas Doorley, the CEO of Sage Partners, says he is working with a public company whose directors believe that the business model is running out of gas and needs to change. The CEO disagrees, and he and the board are at loggerheads. "Is this something the board is supposed to look into?" Doorley asks. "If it is and the CEO is right, the board's confidence in him will be restored. If the directors are right, the CEO can do something about it before it's too late." And then there is the case of Hewlett-Packard. Were the directors intruding on management's prerogatives when they insisted that Carly Fiorina delegate some of her responsibilities to three subordinates? Or were they finally waking up to the presence of a dangerous control freak in the corner office?

For CEOs, life has become more difficult and uncertain because distrust has undermined their relationship with their boards. Restoring that trust is going to take time and ceaseless effort. Says Brad Thompson of Oncolytics Biotech: "You build trust with your board by year-in, year-out doing what you say you'll do. The board sees the consequences of this and sees that your intentions were the right ones. But every time a new board member comes on, you have to build a new relationship of trust." That's also a two-way street. **L&G**

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