



Rebuilding Corporate Leadership: How Directors Can Link Long-Term Performance with Public Goals

The financial crisis of fall 2008 transformed U.S. financial markets and provided a painful reminder of the conflict that can occur between private-sector actions and public goals. Public confidence in business and business leaders has been damaged by events stretching at least as far back as the corporate scandals of Enron and WorldCom, and forward to today's economic and financial crisis. Today, public anger has boiled over, heated by reports of greed, conflicts of interest, and other misdeeds, and by the growing expenditure of public money to support private businesses.

CED reports since 2006 have recommended measures in accounting, corporate governance, other board and management practices, by which to restore confidence and trust in American corporations and their leaders—a task made more urgent by our current economic crisis.

Our focus in this report is on the potential contributions boards of directors can make to improve corporate strategy and long-term performance by engaging responsibly with the society around them.

The Sarbanes-Oxley Act and other recent reforms have given directors more responsibility and power as overseers of the corporation. But many directors have interpreted those reforms solely in terms of fiduciary loyalty to shareholders and, consequently, to the maximization of short-term share value, despite the diversity of shareholder interests and the transitory membership of that group. For many directors, the daily share price has come to represent the success or failure of a board's ability to represent shareholders' interests. But shareholders will not prosper long when other groups linked to the health of the corporation—broadly, society—do not also thrive.

Many corporate leaders—directors and CEOs—have found that a principled, long-term view fosters greater appreciation of the interdepen-

dence between the corporation and the society in which it operates. These individuals are leading the development of business strategies that take account of societal challenges as a means to ensure their corporations' and society's long-term prosperity. Although many boards remain behind the curve, a number of forward-thinking directors seem willing if not eager to consider actions to abate climate change, disclose environmental risks, or incorporate human rights best practices. As important, some are speaking out to urge U.S. political leaders to repair *their* broken systems so they can begin to solve long-term societal problems that hamper business as well as society's other constituents. But too few business or political leaders are following these paths.

Our central conclusion is that corporate boards and the leaders they select must integrate relevant societal concerns (such as environmental and human rights considerations) into corporate strategy, to strengthen long-term competitiveness and the sustainability of both the corporation and the society in which it exists. A successful framework requires that societal and business leaders view and treat each other as partners, not adversaries. Their actions and public communications should recognize their interdependence and shared goals.

Our recommendations to all directors emphasize the need for independent judgment and fidelity to the long-term interest of the corporation. They are not “one-size-fits-all” solutions. Each corporation will have unique solutions that fit its need. In summary, we recommend:

- **The board of directors has ultimate responsibility for the performance of the corporation. This responsibility is well served when directors, acting as stewards of the corporation's long-term interest, give weight**

to societal issues that impact the firm's longer-term performance.

- **Boards should encourage company management to evaluate societal concerns, examine the various strategic responses, and decide on sound business grounds what management ought to do.**
- **When choosing a CEO, the board's selection committee should be mindful of the role that person will play in setting the tone and direction of the company with regard to ethics, honest reporting, and engagement with shareholders and other interested parties. Boards should tie a portion of CEO and senior management's performance compensation to metrics based on the corporation's performance on such concerns.**
- **Directors regularly should consider how the company plans, manages, and communicates about the company's interaction with society. The board should insist that management report regularly to it and to the public on non-financial performance, including social performance. To institutionalize the process, the board may want to establish a special committee or empower its governance committee to take responsibility for oversight and reporting. That committee should report to the full board and appear on its agenda on a regular basis.**
- **Directors should recognize the value of communicating to shareholders and the public on issues that bear on the company's reputation and brand value, even when such communication may not be required by regulation or fit neatly into financial disclosure formats. Boards that have a non-executive chair or lead director may want to consider a communications role for that person on such issues and topics.**

Our analysis shows that while businesses must play a greater role than they have hitherto, governments clearly have primary responsibility for addressing societal concerns.

Government plays many economic roles in market capitalist systems. Most relevant to the issues addressed in this report, governments generally supplement markets by providing public goods and compelling private entities to account for the

costs they impose on society—the two primary concerns that corporations are increasingly called upon to address. Government must establish and enforce social policies in these areas.

In the U.S. context, a lack of trust in political institutions undermines social progress and shifts public demands from political leaders to business leaders. A better outcome would be one where political institutions could be relied upon to address intelligently public concerns and close the gap between social expectations and government policies. Elsewhere, CED has addressed the problem of Washington's broken policy process. **Our conclusion and recommendation, adapted from that analysis, is that political leaders should understand the costs they impose on business and society at large if they do not take action to improve political governance and policy making. They need seriously to address reforms in ethics, lobbying, redistricting, earmarks, and other legislative procedures and executive practices to break the logjam holding back policy reforms in substantive areas such as global climate change.**

Conclusion

CED was founded by a group of business statesmen who had strong views on the direction of public policy and the role of the business community in helping to advance our society as a whole. A key, if not critical, contribution of the business community to overcoming societal problems may lie not only in individual corporate policies but in business statesmanship—the willingness of business leaders to speak out on pressing public concerns, such as unsustainable cost increases in federal entitlement programs, the lack of universal health care, environmental damage from climate change, and the threat to human rights.

U.S. business leaders should consider both how their business strategies interact with societal issues and how they personally can make a difference by supporting sound public policies that address society's key concerns.

The full statement is available at
www.CED.org.