ENDANGERED CEOs

The poster boy of the late 1990s corporation is likely to become last year's model—unless they quickly clean up their act. • By Dan Keeler and Mark Johnson

It may seem like all the news for CEOs recently has been bad. As a group their credibility has been undermined by scandals such as that at Enron. Revelations of sharp recent increases in compensation for CEOs who are clearly doing a poor job have not helped build confidence in the profession. A widespread—and growing—public perception that CEOs' primary role in life is to line their own pockets, if necessary at the expense of everyone else, completes this grim picture.

There is no doubt the corporate environment, particularly in the United States, has changed in recent months. CEOs are expected to maintain higher personal standards, to operate with more transparency and openness and to accept greater personal accountability for the fortunes of the companies in their charge. And, more than ever, they have to show they are worth the money they're paid.

Amid all the gloom, however, there is a ray of sunshine. The dazzling spotlight currently trained on the role of the CEO, their relationship with the board, and with employees, shareholders and customers, is throwing into sharp relief what it takes to do the job right.

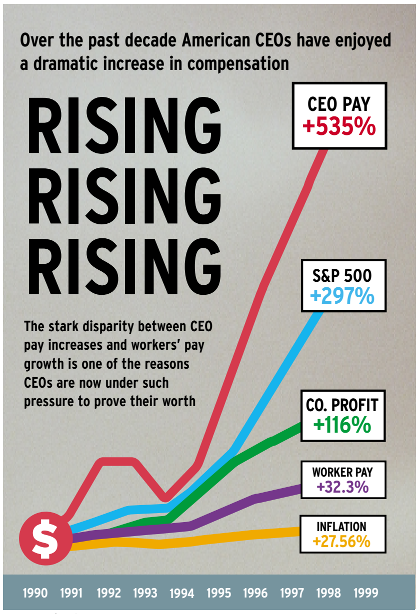
Grasping the Nettle

"Instead of viewing this as a problem, the CEO should be viewing it as an opportunity," says Jerry Wind, director of the SEI Center for Advanced Studies in Management at Wharton business school in Philadelphia, Pennsylvania. "It's a chance for the CEO to lead the company in changing, growing and developing."

Certainly, the increased attention being paid to the role of the CEO and to their effectiveness as a group is prompting the generation of multitudes of reports about what is wrong with the prevailing corporate environment. Within those myriad reports are the keys CEOs need to ensure they not only survive in their jobs, but thrive in the brave new world of corporate transparency.

In its most recent survey of middle market business owners, Chicago-based business consultant Grant Thornton found a sharp increase in the perception of the importance of good leadership to a company's success. The report, released in May this year, found that 80% of the 400 business owners questioned believed quality leadership was more important than ever in the current business environment. The report found almost unanimous agreement that the key qualities of a good leader are honesty, the ability to listen and to make hard decisions, consistency and caring about employees (see GF Solution, page 26).

Two recent studies by Washington, DC-based consultant Watson Wyatt Worldwide turned up similar concerns about leadership. Bruce Pfau, national practice leader for organizational effectiveness at Watson Wyatt, says: "The issue of trust and confidence in senior leadership—the most paramount being the CEO—comes up as a gigantic factor in terms of whether a company will generate shareholder value and employee commitment and be able to adapt to change. The sad news is that that trust has dropped."



Source: ufenet.org

These findings are reflected in other recent studies about the issues confronting senior executives in the current market. And while they wouldn't look out of place as topics to be covered in a Business Management 101 class, it seems that many chief executives have been forgetting to take care of such basic responsibilities.

Confidence Through Communication

According to Pfau, the most effective action a CEO can take to restore or build confidence in their capabilities is to communicate. "CEOs should be out in front and communicating the business strategy, the reasons behind it and any changes to it in a very direct and frequent way," he says. Wind agrees: "You can be the most charismatic CEO, but you cannot run an organization by yourself. Communicate with other stakeholders—customers, suppliers and so on."

Nat Stoddard, chairman and CEO of New York-based outplacement consultants Crenshaw Associates, advises CEOs to consider themselves as constantly reapplying for their position. "A standing CEO should be seeking feedback—from the board and from direct reports—as if he were interviewing today for his own job," he says. "You want to take advantage of the information your replacement would get—before you're replaced."

Board Games

Jay Lorsch, professor of human relations at Harvard Business School, believes CEOs need to focus more on the role of the board of directors. "There is clearly a pressure for being sure the boards really are as clean as a hound's tooth," he says. "In the US the vast majority of directors should be independent. It is within the power of the CEO to promote this," he adds. And will they promote it? "No. They won't like it."

Charles Elson, director of the University of Delaware Center for Corporate Governance, agrees that moves toward the creation of more independent boards are likely to be prompted more by regulation and shareholder pressure than by individual CEOs. But, he contends, the solution doesn't necessarily have to come from regulation. "It is within the power of the CEO to create an accountable environment. The solution to the issue can take place overnight if the CEO is serious about wanting to reform."

Pharmaceuticals giant Pfizer's executive vice president for corporate affairs, Lou Clemente, believes the key is communication: "Share as much as possible with the board. You never want to be out there on a limb all alone; you want company." Clemente believes a dialogue between the board and the CEO encourages a close relationship, so if things do get rocky, the board is there beside the CEO, not at their back.

According to Lorsch, for many companies even ensuring the board is doing its job at all will be a step forward: "In the past for too many CEOs the less the board did, the happier they were. Those days are gone forever. The CEO has to accept the notion that there will be an active, empowered board, and the best course of action is to facilitate the board's working well with each other and with the CEO," he says. Elson compares the old attitude toward the board to the human appendix: "No one knows it's there until it bursts. Enron was the appendix bursting."

Urging their boards to continually focus on inde-

Photo by FPG

pendence and on fulfilling their role is crucial to a CEO's success in the post-Enron environment. But an equally vital lesson to come out of recent accounting debacles has been the importance of the relationship between the auditors and the board—and with the company's senior executives. Auditors need to understand that the audit committee is the ultimate client. "It's also important that the CFO has a relationship with the auditor," says Lorsch. "This can be worked out so that ultimately the auditor is responsible to the audit committee."

The Good, the Bad and the Underrated

Clearly not all CEOs need to be sent back to school. Defenders of the CEO claim the high-profile cases tend to obscure the reality of life as a CEO, and that the majority are not hugely overpaid or guaranteed incomes in spite of poor performance. They may have a point: According to New York-based human resource consultant Mercer's study of CEO pay in 2001, average total annual compensation actually fell. Not by much, but it did fall nonetheless.

The survey, which examines the pay packages of 356 chief executives at 350 large US corporations, showed their median salary climbed 4.7% to $900,000 in 2001, but total annual cash compensation (base salary plus annual bonus) dropped 2.8% to $1,603,125. More than a quarter of the CEOs (26%) received no base salary increase in 2001, and 22% received no bonus.

This year is unlikely to be any better for CEOs as companies seek to shift more emphasis to the role of the CFO. New York-based executive compensation consultants Pearl Meyer & Partners predicts the average total remuneration for CEOs at the top 200 US companies will be 4% less in 2002 than it was in 2001. At the same time, it believes CFOs' pay will rise by 19% to an average of $3.3 million.

And not all CEOs are assured increased rewards even as their companies stumble. According to Crenshaw's Stoddard, the life of the average CEO is a precarious one: "CEOs have approximately five poor earnings quarters before they have to relinquish their post," he says. Although this is probably considerably longer than most other failing employees would get before the axe fell, it still contradicts the prevailing view that CEOs enjoy some kind of special immunity. "Two-thirds of the world's corporations have changed CEOs in the past five years," Stoddard adds.

The Ultimate Survival Kit

Clearly, the most important survival tool for a CEO in today's increasingly demanding market is competence. As Wind points out: "The critical question the CEO should be driven by is, how does he create value. There are no ifs or buts; the CEO's role is to assure the company he is leading can create value."

Peggy Foran, vice president, corporate governance at Pfizer, has a checklist of four key habits for the successful CEO: "The most important things are high integrity, transparency, focus on the long term for shareholder value, and respect for people," she says.

Having a clear understanding of the role and what CEOs should expect of themselves is just as important. Says Stoddard: "The most important element is to know yourself. Know your strengths, know your limitations."

Lastly, keep abreast of the firm's financial and operational health. Pfau echoes the views of many when he says, "If a CEO doesn't have a fairly firm grasp of the fundamental financials of their outfit and in particular doesn't have a grasp of where the big risk factors are, then they shouldn't be in the job." When former Enron chief Kenneth Lay said he didn't know the details of the company's off-balance sheet financings he provoked—at best—widespread astonishment.

Even the best-prepared CEOs can find themselves in hot water. As a precaution, Wayne Outen, managing partner of New York-based law firm Outen & Golden, urges executives to take a close look at their contract. "There is a climate now where the board will be exercising extra diligence to look at the legitimacy of the apparent performance of the company and the decisions that the CEO has made about, say, off-the-books transactions, reporting decisions and so on. If that is the case, my guess is they will find more circumstances in which they feel they have grounds not only to terminate the executive but also to take legal action against them." ■

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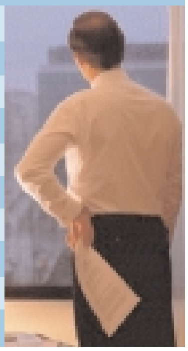
CHECKLIST
Crucial Leadership Qualities for CEOs

1. Be honest
2. Communicate–with customers, shareholders, staff, board members
3. Don't shy away from hard decisions
4. Be consistent–in words and actions
5. Tell your employees you care–and mean it
6. Don't be afraid of change
7. Lead by example
8. Hold people accountable–including yourself
9. Articulate the vision of the company
10. Stay optimistic; believe anything is possible



Source: Grant Thornton survey of business owners

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New Ideas from the Old World

In Europe, too, the CEO's role is under scrutiny and may be reinvented

"Check your contract, tap the chairman's phone line, and make sure you've got the number of a good lawyer." That's the only-half tongue-in-cheek advice to CEOs from a banker who's counseled a handful of Europe's largest companies through the late 1990s' technology boom.

And it may be sound advice in an environment that's rapidly turning against the CEO-as-star. While corporate scalps may not be falling quite as quickly and brutally as in the United States, there's little doubt that chief executives at Europe's top companies are on the defensive as never before. The humiliation of ex-ABB CEO Percy Barnevik earlier this year was the clarion call for this particular revolution. But while Barnevik was forced to hand back part of his pension settlement after he left the Swiss/Swedish combine, the pack is at the door of serving CEOs as well. In May, UK life assurer Prudential withdrew a pay package it had drawn up for chief executive Jonathan Bloomer. An army of largely quiescent small investors would have ensured the package would have been signed off, but at least 25% of the company's large shareholders had signaled their intention to abstain or vote no, according to the UK's National Association of Pension Funds.

Ben Verwaayen, new chief executive at BT,

Photo credit

Sure, that kind of pressure reflects the pain of shareholders put through the wringer by souring economies and plunging stock markets—the Dow Jones Stoxx index was off 17% in 2001. But it also marks a shift against the rapidly rising cult of the manager in Europe—one that CEOs need to be aware of.

"The CEO as superhero hasn't been raised quite to the same height as in the US," says Julian Burkinshaw, associate professor of strategy and international business at the London Business School. But, he says, US business practice typically seeps into the United Kingdom. "Is the CEO going to be under much greater scrutiny than during the golden years?" asks Burkinshaw. "Absolutely," he replies.

Failed companies and discredited business models may change the way in which CEOs are expected to run their companies. Burkinshaw has just written a book that cites Sven Goran Erikson, the soft-spoken but confident Swede who coaches the England soccer team, as a new archetype of manager. "He's an example of a transition to a softer style of leadership," says Burkinshaw.

That may be a populist play, but there are more concrete examples. Ben Verwaayen, new chief executive at BT, is cited by Burkinshaw and others as a template for the post-boom manager. Verwaayen is certainly no pushover—since taking over the stumbling telco in January this year he's sparked competitor ire by an aggressive push into retail broadband—but observers say he's listened to customers, line managers, and even regulators. Only then has he set out a strategy that aims to play to BT's strengths.

Here's what the new executive might look like:

* A manager, rather than a dealmaker. CEOs used to be measured by the size of their deals. In February 2000, UK phone operator Vodafone paid €175 billion for Germany's Mannesman in a deal described as visionary at the time. Even then, though, paying £10 million to chief executive Chris Gent just for doing the deal seemed like monstrous hubris. With Vodafone's market value slashed—the company's shares are off 40% this year—that looks like even worse business.

* A listener, rather than a talker. "Much more communicative than the previous lot," is how one middle-ranking BT manager describes the regime under Verwaayen. He says not a week goes by without communication from the top. "I spend a lot of time with people in the organization or with customers," says Verwaayen. Even once-sour relations with UK telecom regulator Oftel are now much sweeter.

* A risk-manager, rather than a risk-taker. No one, shareholders least of all, wants a CEO paralyzed by fear or indecision. But now, more than ever, they want chief executives who assess the downside as well as the upside of any strategic move. ■

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Non-Executives: No Longer Non-Combatants

It's not just the CEO's seat that has suddenly gotten a lot hotter in UK board rooms. A non-executive directorship was often seen as a cozy slide into retirement for the successful manager, providing stimulating–but not over-taxing daytime employment. If that picture were ever true, it's certainly not now.

In late April Prudential chairman Robert Hurn was forced to resign because of his involvement as a non-executive director in the ailing British telecom group Marconi. Insurance group Equitable had earlier begun legal proceedings against 15 former directors, including non-execs.

"It's time for a rethink on the role of non-executive directors," said Alan Rubenstein, chairman of the investment committee of the National Association of Pension Funds (NAPF), at the UK trade body's annual meeting in mid-May.

That feeling has spread right to the top: Lord Young of Graffham, a former head of the UK's Institute of Directors (IOD), thinks non-executive directors contribute little if anything to the running of a public company. That's not a conclusion shared by the IOD, says Daniel Summerfield, a corporate governance executive at the top bosses' trade body, but there's little doubt that uncertainty over the role of non-execs is doubly sensitive at a time of welling crisis in confidence in corporate management. Indeed, a whole series of reports on UK corporate governance throughout the 1990s stressed the value that independent directors could bring.

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"Non-executives need to remain independent, but they also have to be even more knowledgeable than before." –Peter Brown, Independent Remuneration

What those reports have failed to do is define the exact role a non-exec ought to play. Should part-timers help shape strategy? Hard, when most CEOs think that's their game. Or should they just exercise oversight, acting as a prudential check on gung-ho dealmakers? Maybe, but they still rely on information from those they're overseeing.

"Non-executives need to remain independent, but they also have to be even more knowledgeable than before," says Peter Brown, chairman of Independent Remuneration, a consultancy that advises companies on compensation for non-executive directors.

What's clear is that in the current environment few can expect to escape from the consequence of their actions–or inaction.

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DOs & DON'Ts
Non-Executive Directors

- Do get yourself directors' and officers' insurance. The IOD's Summerfield points out that UK law doesn't distinguish between executive and non-executive directors.
- Don't think you know it all already. The duties of a non-executive differ from those of a CEO, and even the most experienced manager can benefit from some training.
- Don't take on too many directorships. Hermes, an activist UK fund manager, recommends four as a maximum or just two if the role is chairman of the board.
- Do ask for more money. "On the whole non-executives have been undervalued," says Independent Remuneration's Brown. "And until recently, too little was expected of them." He points out that UK non-execs get between £18,500 and £34,500 per year–usually less on a daily rate than a junior law partner at a City firm charges.
- Do get to know your company independently. The NAPF recommends meeting company executives in the field, visiting company sites and talking directly to outside parties such as suppliers and auditors.