

Corporate Governance Conference

Wrong theories, language and heros

Prof. Krzysztof Obloj

Kozminski University 2010



Trust, Reputation and Integrity

- Lack of confidence and trust in business is an old problem. S. Lipset and W. Schneider , The confidence gap, 1983 reported e.g. a huge increase of anti-buisnes attitude in the USA in 1965-1975.
 - Public demanded large firms division, limitation of power of CEOs, control over companies profits
 - Both politicians and managers were not trusted, but managers at least get things done, and politicians did not - in public opinion

Trust, Reputation and Integrity

- Following Enron, WorldCom and Vivendi collapses and corporates' problems in 2001-2002 boards were overhauled.
- New regulations (Sarbanes-Oxley Act, Codes of good practices etc.) were proposed and institutionalized. Independent directors became a norm. Compliance became high priority.
- And boards of the most important institutions – banks, failed again in 2007 in many countries, like they did many times before

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- The simplest explanation, that should not be ruled out, is that these are „normal accidents” that occasionally must happen
 - COMPLEXITY: Firms became increasingly complex and large, hence difficult to understand and monitor (see latest Toyota problems which is a classical example of complexity challenge!)
 - JUDGMENT: Accounting and finance is a ‘judgmental science’ (GM in 2006 reported a loss of 3bn which was transformed by one time adjustment into 1bn profit; in 2008 net loss of 30.8 bn was transformed into pro forma loss of 16.8 bn etc)
 - RISK: Risk factors are always underestimated (we are not capable to think in terms of Bayesian probabilities)

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- The more complex explanation is indicating the logic of public company as a culprit:
 - Shareholders demand financial results and they do not care about long term viability of institution. Shareholders are investors not owners, hence they behave as investors
 - Managers are hired guns and they migrate from one firm to another – so they also do not care for long term viability; why should they?
 - Other stakeholders (social pressure groups, governments, media) have conflicting demands which cannot be met in the same time by firms

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- Three add. tendencies reinforced problematic nature of public companies in last decade:
 - Stretched goals (BHAGs)
 - EVA - creation of shareholder value as a major metric of performance plus compensation systems based on shares
 - Celebrity status of CEOs that performed a role of 'cost killers' - Frank Lorenzo (Texas Air, that merged with Eastern Airlines, Continental Airlines, People Express), Roberto Goizueta (Coca Cola), Jack Welch (General Electric), Percy Barnevik (Asea Brown Boveri), Carlom Ghosn (Renault/Nissan)

Trust, Reputation and Integrity

- Wrong theories, wrong language, wrong heroes replaced trust, reputation and integrity
- Where is the solution:
 - More regulations?
 - Courses in ethics and sustainability?
 - Different composition and compensation of boards to improve quality of decisions?

Trust, Reputation and Integrity

- I do not have a good answer to the fundamental question of public company but I know one thing
 - Because our theories guide our actions and our actions produce reactions of others, we create the behaviors
 - Therefore in order to bring back trust and integrity into business we would have to change our theory of the firm and its expected performance metrics. And this is a very improbable change indeed.
 - So most probably normal accidents are bound to happen in complex organization - again and again in spite of all regulations and incremental adjustments