interview

Why is a Corporation Like a Stray Cat?

A conversation with Bob Monks about responsible ownership as the path to corporate accountability.

A stray cat, an abandoned car, a multinational corporation: What they have in common is that they all need owners. So says Bob Monks, grandfather of the responsible corporate governance movement, who for the last 30 years has been encouraging large stockholders to act more like owners. He believes this is a key way to make corporations more accountable for their social and environmental impacts.

Monks seems to have invented the term "corporate governance." And he had a hand in creating some of the field's leading institutions. He was a founding trustee of the Federal Employees' Retirement System, appointed by Ronald Reagan in the 1980s. He served in the U.S. Department of Labor, overseeing the entire pension system. With Nell Minow he founded the Corporate Library, a research firm providing corporate governance data and analysis, including board effectiveness ratings. And he founded Institutional Shareholder Services, which today is the premier proxy voting advisory service. Along the way, he sat on many corporate boards, was chief executive of an oil company, partner in a law firm, and co-author of a leading textbook on corporate governance. Monks has also written many other books — including, most recently, a novel: *Reel and Rout,* a novel of corporate intrigue.

Speaking with editor Marjorie Kelly from his home in Maine, Monks talked about his early days in shareholder activism, why he would abolish the SEC, why shareholders should nominate directors, why the mania for independent directors is wrong-headed, and how he's working to develop a language for environmental accountability, using — yes, you heard right — accounting.

Bob Monks at his home in Maine.

Marjorie Kelly: *I've been reading your biography,* A Traitor to His Class, *which is an amazing title for a book, and I want to talk about how you got into corporate governance work. You come from a wealthy family, you're on a lot of corporate boards, and yet as your biographer put it, you're waging a "guerilla war" on big business. What drives you?*

Bob Monks: Back in 1972, I was running for the U.S. Senate and spent the night at a motel on the Penobscott River in Brewer, Maine. I remember waking up in the middle of the night feeling my eyes tear over, and I looked out to see a mountain of fluff on the river. At the desk they told me it happened every night. It's how paper companies get rid of their effluent.

After I lost that election, I became chairman of Boston Company, a bank, and one day a proxy came across my desk from that paper company. The penny dropped. I saw it was possible to restore business responsibility by addressing institutional investors, who owned a majority of stock. I set out to design my life around corporate governance. No one had heard of it. As far as I know, the phrase had never been uttered before.

PHOTO BY: DEBORAH MESA-PELLY

Is that right? You invented the phrase "corporate governance"?

I don't know for sure, but I'd never seen it used. It's a concept that I'm glad occurred to me at age 39. I'm 72 now. It takes a long time to appreciate what it means.

I understand you taught CalPERS, the big California pension fund, how to do shareholder activism, and they're a leader in it now. In the early days, did people look at you like you had two heads?

It was very difficult. I knew a lot of money managers and was able to presume on friendship, so they didn't think I was totally insane. But even today there aren't many institutions prepared to associate themselves publicly with shareholder activism.

Why is that?

It's rare to have a pension fund that is educationally, culturally, and financially able to commit time and energy to this. They delegate it to agents, which means money managers. And money managers have a conflict of interest, since having a reputation as an activist against companies raises concern with potential customers.

If pension fund managers are reluctant to step in, I wonder if other stakeholders — employees, for example — might be in a better position to take a governance role.

I'm not at all worried about having an employee on the board. But I am worried it wouldn't do any good. The supervisory boards in Germany are often held up as a better way. But I don't believe labor representatives on these boards can point to a single event where they successfully influenced corporate conduct. The reason is that boards are structured to have an even interview

number of shareholder and employee representatives, and the chairman casts the deciding vote.

So the real issue is majority control.
Another issue is, who nominates the directors? The American governance system is dominated by the fact that boards are self-perpetuating. Until there is some kind of outside access, the board's ultimate concern will always be the institution. You can spend millions, as the New York Stock Exchange has, defining the ideal independent director. But someone produced by a self-perpetuating system is not independent.

An example is when you were an independent director at Tyco — before CEO Dennis Kozlowski was indicted for his lavish perks — and you raised the issue of excessive pay for a previous CEO. What happened?
I got thrown off the board. Here was an independent director doing what was needed. I wrote the CEO letters for years, pointing out things I thought were wrong, and the board decided I was a pain in the ass.

That's a great story. Because it shows that an independent director is powerless as long as there's no appropriate mechanism for getting people on and off the board. If you had been elected directly by shareholders and could only be thrown off by shareholders, you would have had more power.
Absolutely. Trying to make boards function is like squaring the circle. You can huff and puff all you want, but you cannot make a legitimate governing institution out of a self-perpetuating body. We must allow shareholders to nominate directors. That would include employees, who have a lot of ownership through pension funds. You don't have to change much else, really. There aren't a lot of magic formulas beyond transparency and genuine accountability.

You've said that you can't blame individuals, it's the institution of the board that's malfunctioning. If you were going to list signs of board malfunction, what would you list?
The inability of owners to remove directors. Second, the inability of owners to nominate directors. Third, the inability of owners to advise directors.

We need a federal law that gives owners the ability to get rid of directors. A certain percentage of shareholders should have the right to call a meeting to fire one or all directors, with or without cause. This is already the law in many countries.

Another problem you point to is that owners can't effectively advise directors.
Yes, because the SEC runs a censorship shop, influenced by corporate lobbyists. A case in point is the shareholder resolution I brought last year at Exxon Mobil, which got 27 percent of the vote, yet was disallowed from the proxy this year. It asked the company to listen to its owners as to separating the office of CEO and chairman. Hardly a call for political assassination and radicalism.

Why did the SEC disallow it?
They don't have to give a reason.

Let's say you were the new chairman of the SEC. What would your agenda be?
I would liquidate the SEC. The people who started the Securities and Exchange Commission were informed by a particular theology about how government and business should work. It lasted about 70 years. But now it doesn't work. The person who's doing 95 percent of the enforcement is Eliot Spitzer, and the SEC is running after him with a dustpan.

The SEC had to accommodate the Commerce Clause in the Constitution, which gives the federal government authority only over corporate activities that are interstate. So the SEC founders said, if we can't monitor how corporations are organized — since that's state law — we can monitor transactions: the issuance and trading of stock. The SEC is about regulating stock trading. There's an axiom that says, the SEC doesn't prevent you from making a fool of yourself, but it can prevent others from making a fool of you. It's all about disclosure.

Yet stock transactions are only a small part of what corporations are about. You're suggesting we need a more fundamental reshaping of governance, and you've written that a key issue is the conflicting functions of the board. In some cases board members need to be collegial, in some cases confrontational.
If you compiled an index of the conventional wisdom about board duties, you would find yourself writing the Book of Genesis. The board is responsible for everything. And directors say, well, we only meet six times a year for three hours at a crack, how in the name of all that's holy can we do all this? They can't. Different boards pick up various pieces. But they're always concerned with the health of the business, and with accountability of the business.

Part of the health of the business is getting company strategy right. For that, it's better not to have discordant viewpoints. It's better to speak a common language.

But accountability is the opposite. Take CEO pay. To deal with that, you need someone who's not part of a club. You need someone willing to be confrontational.

You've said CEO pay is a smoking gun that proves boards can't hold top management accountable.
Yes, and we fixate on independent directors as a solution. We believe we need a compensation committee composed entirely of independent directors. And they've got to hire an independent pay

> The question as to whether Exxon is the parent or the subsidiary of the U.S. government is not an idle one. But it's bloody clear that BP is the subsidiary of the British government.

consultant. But consultants worry about who's going to pay their next bill. And no pay consultant got hired a second time by suggesting a CEO's pay go down. So boards retreat to formulas, yet whatever mechanical system you set up, it's going to be gamed. People will be scandalized by this, but independent directors aren't the answer.

The solution is that you have to make owners be responsible. And they want to avoid being responsible. As one said to me, "Bob, you're telling me that I'll make the same amount of money but I've got to spend a lot of time monitoring these companies I invest in." And I said that's right. It's like trying to subcontract bringing up your family. It doesn't work.

I'm wondering if you're not suggesting we go back to the past. With dispersed share trading, we have a separation of ownership and control, and the old unity of ownership is gone. Maybe we need new mechanisms of accountability.

The cost of bureaucratization is too high. We have to invent surrogate owners. It has happened by sheer fortune that we ended up with these pension fund trustees, who are majority owners of public companies.

If I was president — and I've promoted myself now from head of the SEC to president — I would call agency heads into the Roosevelt room. I'd call the head of the SEC, the head of the Federal Reserve, and the secretary of labor overseeing pension fund trustees. I'd say look, responsible ownership is the law of the United States. It's in the public interest that owners be intelligently involved in companies whose stock they hold. We need a simple, unitary federal policy that will inform the administration of these various departments. You don't need any new laws whatsoever.

Have you outlined this hypothetical, ideal federal policy?

I'm aware of what a deep and complicated process this is. It's not wise to purport to have an answer.

But as you said, it takes a long time to steep in this stuff and understand it. We need ways to accelerate that process for a broader public.

Language has always been the problem. We need a language about power —- which is more to the point in the U.S. than the U.K. The question as to whether Exxon is the parent or the subsidiary of the U.S. government is not an idle one. But it's perfectly bloody clear that British Petroleum is the subsidiary of the British government.

Yes, the British are ahead of us in many ways. You recently bought a 25 percent stake in Trucost, a London-based environmental research firm, which you've said is gauging environmental damage in financial terms. Are you looking for a way for firms to internalize their externalities?

I'm trying to use accounting to create a more holistic vocabulary. "Internalizing externalities" is bad language. Many people talk about "triple bottom lines," but it's misguided. You need single accountability.

> You have to make owners be responsible. And they want to avoid being responsible.

I'm trying to have traditional accounting produce a language of accountability.

Trucost has come up with a potential shortcut to the unwillingness of companies to disclose environmental discharges. It uses GDP data. The government has broken down industrial functioning into 700 identifiable processes, and every company is a compendium of these. Trucost takes GDP data and derives the effluent implications of each process. They do the multiplication and can say a company is putting so much carbon dioxide into the atmosphere, it's putting so much what-not into the ground.

Let's say you find Exxon-Mobil is putting out pollutants that represent $10 billion in damage. Then what?

Hopefully journalists pick it up, the public picks it up. People begin to say, You know, we live in a country where Exxon has $20 billion of profit and creates $10 billion in environmental damage. Is this fair? Having the number gives you a language which can become the language of discourse, and ultimately the language of law.

Isn't Trucost's research also valuable because environmentally well-managed firms will be better investments?

Some studies suggest that, but I'm not convinced. I talk about shareholder return because I'm communicating with people who make a living investing money. I have to use their language. I don't give a rat's what-not whether anybody makes 5 cents more a share. I care like hell about having some kind of societal mechanism so we can be sure power is exercised in large corporations consistent with the human welfare.

Yet you write about how pursuing shareholder ends will work out to the benefit of society. Don't shareholder interests and the public interest conflict sometimes?

You bet. The reason I focus on shareholders is because I needed something I could get my hands around. A nice idea would be a pluralistic decision-making process for accommodating the corporate good with that of society. But I had to start with something real. It's not that shareholders are more important, but they're easier to deal with. Hopefully, my work with shareholders will enable others to go way beyond shareholders.

This has been your life work for 30 years. Do you see enough people in the field now to carry it on?

I do, yes. I spend all day every day, seven days a week, answering the telephone or the email. Nell Minow and I used to joke we could hold meetings in a telephone booth. Now we go to the International Corporate Governance Network in London and there are 600 people. I find that very gratifying. On the other hand, I find the progress I've made virtually nil.

Now there, Bob, I'd definitely have to disagree with you. BE

Find more about Bob Monks' writing and work at his web site, www.ragm.com/.