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The C-Suite Shift

Editor's note: This is the first in a series of articles discussing the long-term governance implications of the Sarbanes-Oxley movement.

by Michael W. Peregrine

Season's Greetings…but perhaps not the one you've been thinking about. For we've just entered the "governance season," i.e., the unique period of time beginning with the 10th anniversary of Enron's bankruptcy (October 2011) and ending with the tenth anniversary of the enactment of the Sarbanes-Oxley Act (July 2012). And an excellent way to celebrate that season is through boardroom education focused on the lasting governance lessons of the corporate responsibility movement. Ten years can be a long time, especially in a boardroom.

One of the most fundamental of these lessons is that Sarbanes prompted a profound— and necessary—shift in corporate leadership and control from the chief executive to the governing board—a shift that reverberates to this day. Of course, that's the way it had always been drawn up on the corporate chalkboard. That the governing board is ultimately responsible for the affairs of the corporation, but delegates day-to-day organizational responsibility to executives, supervised by the board on behalf of the corporation's constituents. But by the time of Enron, WorldCom, and the rest, that wasn't the way it was working.

As astute observers noted, the loci of corporate control in many organizations had by then shifted hard to the C-Suite. The reasons were many. Some board members became excessively reliant on the executive officers and their natural, more detailed familiarity with the issues of the day. Other board members failed to "put in the time," especially as they were spread too thin by other responsibilities. Other directors became too deferential to executive leadership, and adopted a passive boardroom persona. Too many directors became too beholden to management. Whatever the cause, the result was pretty much the same—for many organizations, senior executive leadership set an aggressive boardroom atmosphere, in which directors played a diminished oversight role.

As directors retreated from their traditional roles, they became far less effective in their monitoring of management. A reduced information flow to the board was tolerated. Familiarity with corporate strategy—both the actual plan and the underlying rationale—decreased. Questions to executives became less probing. Incomplete responses to those questions were tolerated, and unclear responses were not pursued. Red flags went either unrecognized, or under-appreciated. Internal, and auditor based, checks and balances declined. Controls on executive conflicts, and compensation, were weakly applied, if at all. The legal and reputational risks to certain transactions were not fully

understood. The framework by which management supported the board in the exercise of its fiduciary responsibilities broke down. And the cost to the organization was great.

So the “anniversary present” is part lesson, and part challenge. The lesson is that the Sarbanes movement worked to correct this “C-Suite Slide.” The balance between the proper roles of the governing board and executive management was restored. Lines of authority between governance and management are more clear. Constructive skepticism is the reigning attitude in most boardrooms. The “challenge” is to keep it that way. Sarbanes (the law) is not the end-all, be- all cure for corporate governance deficiencies. Nothing in Sarbanes prohibits that conduct, and nothing prevents it from occurring again. That’s the job of a vigilant and informed board, mindful of these key history lessons. It’s an ongoing and critical responsibility.

This “anniversary season” can work to raise leadership consciousness of—and respect for—the discrete roles of corporate management and of the governing board. It’s the perfect board “educational” gift. And that’s a reason to celebrate!

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