Harvard Business Review

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Citigroup: A Symbol of Board Resurgence?

By: Ben W. Heineman, Jr.

November 5, 2012

At the center of the corporate wreckage of the past fifteen years — the accounting scandals, the outright fraud, the environmental disasters, the financial meltdown — sits the boards of directors. Their failure to choose the right CEO and to provide appropriate oversight on core risks and opportunities has, in my view, reflected a broad failure of the corporate governance movement and its reliance on directors to effectively to oversee the corporation and its business leaders.

Yet, the recent fall of Vikram Pandit, Citigroup CEO, underscores a basic truth: Independent boards of directors are still the best mechanism — or the least worst one — for holding business leaders accountable, even if many boards have failed in their attempts to do this, often in spectacular fashion.

Much of the Citigroup commentary has focused on the behind-the-scenes campaign of Citigroup board chair William O'Neil to oust Pandit and his stark ultimatum during a one-on-one confrontation: resign now, resign at the end of the year, or be fired.

Many have criticized O'Neil for his ham-handedness, saying this was rude to Pandit, demoralizing to essential Citi leaders, lacking in clear public rationale. A minority, however, has said such CEO separations are invariably messy, bringing to mind Lady MacBeth's advice to her husband about murdering the king: "If it were done when 'tis done, then 'twere well, It were done quickly."

But the tactics surrounding the decision should not obscure the potential importance of the decision itself. Are boards of directors now more than in the past focusing on their fundamental task — critically evaluating the leadership and the management of the CEO? Are they now much less hesitant to force changes at the top of the corporation due to performance on fundamentals, not just scandal or stock price variation?

This task goes to the fundamental question of public policy and private ordering about the corporation: how shall its leadership be held accountable and to what standards? The board's duty is to ensure a balance between wealth creation, financial discipline and risk management; to make the fusion of high performance with high integrity the firm's foundation; and to choose and reward a CEO who has the vision, motivation and skills to effect that essential balance and critical fusion. When boards don't succeed but

fail, as so many have, the terms of the debate shift from how companies can best govern themselves to how regulators and other actors should become more deeply involved in governing them.

Ironically, if there is a resurgence in this critical accountability task of the board of directors, it is due, in important respects, to the egregious non-performance of boards in the towering Enron and Worldcom accounting scandals of a decade ago, the Siemens bribery debacle, the environmental disaster in the Gulf and financial meltdown of 2008, among many other disheartening events.

The prescriptions of the governance movement on substance (e.g.independence, financial literacy) and process (majority votes, no staggered boards) — at times adopted in listing requirements, case law or regulation — are less important, in my view, than a simple human motivation among directors: avoid the embarrassment and public shaming for failing to do their most essential job. Or, put more positively: have a much stronger sense of duty, independent of the CEO, actually to do what corporate law says directors should do — really oversee the management of the corporation at a fundamental, not micro, level.

Ironically, too, it is these searing scandals and momentous corporate failures which have spawned fierce debates since Enron about other mechanisms for corporate accountability from shareholders to rating agencies, state courts to federal regulators — on a variety of issues from executive pay to proxy access, from public descriptions of risk management process to substantive capital and liquidity requirements. (All this in addition to stiffening of long-standing regulation of markets [e.g. antitrust and securities laws] and externalities [e.g. environmental, health and safety laws]).

For the millions of words spilled on governance and the hundreds of public policy and governance proposals debated, far more important than all the formalistic prescriptions is the human dimension: corporations must have a strong, experienced board and a strong, capable, high-integrity CEO — to make the right stuff, to do the right thing. Yes, there needs to be other forms of accountability; yes, there needs to be additional checks and balances. But, without a good board and a good CEO, those restraints can only prevent negatives. They cannot create the exciting positives of a high-performance with high-integrity enterprise.

And that is why I found the Citigroup decision so intriguing as a possible symbol. The board made what it felt was a decision on the merits about who should lead the company. Vikram Pandit had items in the plus column: e.g. he had prevented the company from going bankrupt; created a bad bank for the bad assets; cut employees by about 25 percent; helped Citi emerge, to an extent, from the shadow of federal support. He also had items in the minus column: lack of operational drive; over valuing Smith Barney in its sale to Morgan Stanley; having his stock buy-back plan rejected by the Feds; suffering the greatest decline in stock price (89 percent) of any major financial institution still standing.

But, it was for the board to look hard at these — and doubtless many other factors — and make the most difficult decision of all: to evaluate the fundamental condition of the corporation and move forward with new leadership. And, the flip side is just as important: with tumultuous, irrational markets and looming geopolitical risks — not just straight commercial ones — good CEOs need strong boards of directors to understand, to support and to adjust (but not abandon) their strategies long enough to see if they can reach home port, rather than being blown off course by every squall or storm.

Let us not over-praise O'Neil. He came onto the board in 2009, two years after Pandit became CEO, and became chairman in April of this year. Pandit was not his choice and a number of other board members were relatively new. He could thus avoid the problem of many directors in fairly evaluating someone whom they have chosen and in whom they are invested. We shall see whether the new Citigroup board is as stern in holding the new CEO, Michael Corbat, to account. More importantly, O'Neil failed to articulate the fundamental mission of today's Citigroup and to explain why a new CEO was needed in carrying it out. This is perhaps understandable in the very near term. But it is a failing that he, or the new CEO Michael Corbat, must remedy soon in public. It is one of the most important steps in making themselves accountable.

Nonetheless, to my mind, the changing of the guard at Citigroup by the board of directors is important as a good, concrete reminder that boards of directors are, and must be, the first line of defense in assuring corporate accountability. I hope it is also a harbinger of a real secular change in many more boardrooms.

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