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**Only the Right CEO Can Create a Culture of Integrity**

By: Ben Heineman, Jr.
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*Corporate Counsel* recently ran an article entitled "Bringing Compliance to the C-Suite," based on a Rand Corporation conference of a similar name and previewing a subsequent report-out. The focus of the conference, as reflected in papers presented there and referenced in the article, is that a variety of pressures cause CEOs to act badly or, at the least, to be indifferent to issues of corporate integrity. This is, of course, an important perspective.

But, despite the headlines, many CEOs, supported by boards of directors and top company leaders, are trying to do the right thing. Indeed, how a corporation fuses high performance with integrity—from the CEO to the shop or trading floor—is a venerable topic. And, despite important roles for the board and top company leaders like finance, legal, compliance, and HR officers, the profound reality, in my view, is that only the right CEO can create a robust culture of integrity.

Given the often-dour public perception of CEOs and given the contrasting reality of their centrality in a company's fusion of performance with integrity, I thought it worth re-emphasizing core principles of private-ordering that can serve as practical ideals for CEOs and for companies seeking to do the right thing. These core principles should be kept in view as various discrete problems about aberrant CEO behavior are discussed in venues like the Rand conference, and it is helpful to think of them as arising in two dimensions of corporate governance.

First, and most importantly: How does the CEO govern the company? And second: What is the right-sized relationship between the board of directors and the CEO? (I put to the side in this comment the third dimension of governance: The relationship between the shareholders and the company.)

I have long believed that the "governance" movement has spent far too much time and effort on the shareholder/company and board/management dimensions of governance—and not nearly enough, to my way of thinking, on the most important aspect of governance: Why and how do the CEO and top business and staff leadership govern the company itself in order to create high performance with a high-integrity culture?

"Why" and "how" a CEO and top company leaders should adopt these two most

fundamental goals of business has not changed over the years. (See my book, *High Performance with High Integrity* [Harvard Business Press 2008]). In a nutshell, the "whys" are a) to avoid risks of a major integrity miss (legal actions, cost, loss of market cap, loss of top management, etc.); and b) to create affirmative benefits in the company (high standards, high morale among employees), in the marketplace (sound relations with customers, suppliers, partners, competitors) and in the broader society (with communities, regulators, NGOs, media).

I strongly believe that "integrity" is a more robust and apt concept than compliance (important though compliance is). For me integrity means: adherence to the spirit and letter of the formal rules (legal and financial); adoption of ethical standards beyond the formal rules that bind the company and its employees; adoption of proposed changes in public policy based on a fair account of key facts and an appropriate balance between private and public interests; and an employee population that exemplifies the fundamental values of honesty, fairness, candor, trustworthiness, and reliability in both internal and external relationships.

At the end of the day, performance with integrity creates the fundamental trust that is essential for the sustainability of a strong business.

As noted, I also strongly believe that, as a practical matter, directors and subordinate staff and business officers don't "bring compliance" to the C-suite (although their role is important) but that, in the world of the practical ideal, integrity flows outward from the CEO and her office. Without a deeply committed and constantly consistent CEO who leads the performance with integrity enterprise there can never be the requisite high-integrity culture. Such a culture is based on shared principles (values, policies, and attitudes) and shared practices (norms, systems, and processes) that influence how people feel, think, and behave.

This is not an add-on to the CEO's job: it is the core of the CEO's job. CEOs must follow this mantra rigorously: "Do it, don't delegate it; live it, don't preach it." She both leads (adapts to change) and manages (adapts to complexity) the high-integrity culture.

As I described in *High Performance with High Integrity*, the CEO, aided by both top business leaders and top staff, must implement the following core principles through creation of systems and processes embedded in business operations, through provision of necessary resources, and through selection of top personnel who care about both performance and integrity. Without such "operationalizing" of high performance with high integrity, tone at the top is mere eyewash:

- The consistency and commitment in words and in actions of the CEO and top corporate leaders to a high-integrity company.

- Embedding integrity practices in business operations in the core areas of prevention, detection, and response—through risk assessment of business processes, appropriate risk mitigation techniques, constant monitoring and

review, and appropriate discipline and remediation when wrongdoing occurs.

- Systematic and periodic processes for assessing and adopting ethical positions beyond what the formal rules require, including consideration of sound and fair public policy.

- Establishing early warning systems on legal, ethical, and other integrity risk areas out in the future (such as geopolitical), which allow systematic consideration of possible actions that put the corporation significantly ahead of the curve.

- Integrity education and training that is merged with a company's business education, which engages employees, which is culturally appropriate, and which employees retain.

- Giving employees voice through various mechanisms, including ombuds systems, compliance reviews, and employee polling, which are treated with management respect and which are all free of retaliation.

- Encouraging key staff (financial, legal, compliance, HR) to function first as partners in the corporate enterprise but, ultimately, as guardians of the corporation.

- Devising compensation systems for employees that reward not just performance but performance with integrity.

It is in this context that the "right-sized" role of the board emerges. We should be under no illusions: a board meeting 8-10 times per year cannot create a robust culture of high performance with high integrity inside a company—only the CEO can do that. Again, in service of those fundamental goals, I believe strongly in clear and straightforward board principles, with important but discrete functions that provide critical standards and oversight for business leaders. Such a framework helps cut through much of the clutter and confusion that today surrounds discussions of what the board should do. I have tried to set out that framework in a monograph, "Restoring Trust in Corporate Governance: Six Essential Tasks of Boards of Directors and Business Leaders."

In brief summary, the board of directors has six core interrelated and seamless tasks:

1. Define the mission of the corporation in the three critical areas of economic performance, integrity promotion, and management of both economic and integrity risks—far more complex and disaggregated than maximization of shareholder value (which will follow from implementation of the proper mission)

2. Ensure that leadership development of businesspeople involves integration of the three critical dimensions of performance, integrity, and risk—and doesn't just focus on how to achieve market success in different settings.

3. Conduct the most important board task—selection of a CEO—according to the redefined mission of the corporation to ensure that the candidates and the ultimate choice have skill and experience in economic performance, integrity promotion, and risk management.

4. Define annual and rolling three-year, fine-grained, and high-priority operating objectives for the CEO and top business leadership—and thus for the whole company—in all three of the critical areas: performance, integrity, and risk.

5. Establish a compensation system for the CEO and top company leaders that translates those operating objectives into present and deferred cash and equity structures relating to near-, medium-, and longer-term results in all three dimensions—and that provides for holdbacks or clawbacks if the CEO or senior officers seriously underperform or are guilty of bad acts.

6. Ensure that board oversight during any particular year focuses rigorously both on the highest-priority risks and opportunities and on the secondary, but important operating objectives outside those priorities.

These six tasks—mission; leadership development; CEO selection; operating objectives in dimensions of performance, integrity and risk; compensation systems that reward, over time, achievement of those objectives; and critical and constructive oversight of the objectives—is a clear and doable core agenda for boards of directors.

With a good CEO and a good board, the challenge in a complex corporation of fusing high performance with high integrity is still great—and never ending—but is provides a great setting for committed staff officers to do interesting and important work. With a bad CEO and a good board, corporate staff officers can speak to the board about need for change but may find that, unless the board fires the CEO, their relationship with the CEO is impaired and an honorable exit is best. With a bad CEO and a bad board, high integrity staff officers may need to exit on their own (even if that entails financial loss) and, as allowed by professional rules, to speak to regulators about issues.

At the end of the day, staff officers should conduct diligence before accepting major responsibilities in a corporation. The place to work is, obviously, a company with a good CEO and a good board because, as I submit here, only the right CEO can truly create a high performance with high integrity culture.

For readers of Corporate Counsel, the operative question is the role of key corporate staff (finance, legal, compliance, HR) in working with the CEO and top business leaders to integrate these principles into business activities as both partners of those leaders and guardians of the company. (For my take on the partner-guardian tension see "Caught in the Middle.") Financial, legal, compliance, and HR leaders bring invaluable substantive and process skills and experience to the quest for high performance with high integrity. But we should never underestimate that our success in this core task depends mightily on having the right CEO with the right values, energy, and

commitment truly to lead the company.

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