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Recommended Citation
Marina N. Whitman, Corporate Governance and Sustainable Peace: An Insider's View, 36 Vanderbilt Law Review 723 (2021)
Available at: https://scholarship.law.vanderbilt.edu/vjtl/vol36/iss3/1
Keynote Address: Corporate Governance and Sustainable Peace: An Insider’s View

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ABSTRACT

The Author brings her 30 years of experience as a member of numerous corporate boards of directors to bear on the relationship between corporate governance and sustainable peace. In the Author’s experience, over the last three decades corporate boards have become more diverse not only in terms of race and gender, but also through a greater focus on international participation. This diversity has led to concern for a broader set of stakeholders and, in many cases, these boards are presently conducting the affairs of their corporations in a more socially-responsible fashion. Despite these gains, however, the Author concedes that recent corporate scandals should trigger another round of self-evaluation by corporate boards. The Author remains hopeful that through this process it is at least possible for responsible corporate governance to contribute to sustainable peace.

In my comments, I take as given the connection between corporate governance, democracy, and world peace that was the focus of discussion during last year’s Conference and in several of the papers presented this year. Rather, I will take a closer look at the four types of corporate contribution to this linkage cited in the Article by Timothy Fort and Cindy Schipani.1

First, companies can assist with economic development, and help raise income and living standards.2 Second, by displaying incorruptibility, transparency, and the rule of law in their own behavior, companies can transmit these concepts to the countries in which they operate.3 Third, corporations can create genuine communities—both internal communities that give employees a voice,
and external communities that invest in the people of the host countries where companies operate.4 Finally, time permitting, I will talk about what Tim Fort and Cindy Schipani call “track-two diplomacy,” that is, the role of private firms in mediating between governments in a crisis.5

I will focus on these issues, not from the academic point of view, but from a personal perspective; one that grows out of roughly three decades of serving as an outside or independent director of several major multinational companies. I joined the board of what was then the Manufacturers Hanover Bank in 1973. Between that beginning and my retirement from the Board in the Spring of 2002, I was a director successively of the Chemical Bank, the Chase Manhattan Bank, and JP Morgan Chase. I never moved, but the Bank changed its name three times as a result of three successive mergers.

As I discuss the contribution that corporations can make, I will be speaking from my experience with the companies with which I have been personally associated, not the companies that have recently received so much attention in the press. Whether this was perspicacity on my part or just good luck, or some combination of the two, I would like to think that I made some wise choices as to which boards I did and did not join.

As background, let me say something first about the evolution of corporate boards in general. As large institutional shareholders began to hold more and more of the stock of public corporations during the 1970s, 1980s, and 1990s, they began to exercise “voice” as well as “exit.”6 It used to be said that if a shareholder did not like what a company was doing, the only recourse was to sell the stock.7 Because “exit” was unsatisfactory to many institutional shareholders, they began to voice opinions on how companies were managed.8

In general, their direct focus was not on corporate management, but on the boards of directors—especially outside, independent directors—because institutional shareholders saw these boards as primarily responsible for resolving what, in the academic literature, is called the principal-agent problem.9 That is, how does one get professional managers, who probably do not own much of the company, to act in the interest of the shareholders? This

4. Id. at 384.
5. Id. at 387.
8. Black, supra note 6, at 886-87.
responsibility was placed squarely on corporate boards of directors. As these boards became increasingly visible, and their performance increasingly held up to public scrutiny, board members also became increasingly conscious of their fiduciary responsibilities. In fact, this trend spawned a cottage industry to grade the corporate governance of corporations' boards of directors. All of this has led to significant changes in the selection and function of corporate boards. I will describe only a few of the most significant developments here.

The first major development is a change in the makeup of the board. When I first joined several corporate boards in the 1970s, I was always the first woman that had ever sat at the board table. My colleagues were, almost without exception, white males, either friends or business associates of the chief executive, and they had been effectively selected by the chief executive. These were conscientious boards of responsible corporations, but CEOs still wanted board members they could trust. They wanted people who had experience with the same kind of problems CEOs were facing in their own businesses.

Today, at least in the companies I am most closely acquainted with, the boards look quite different. Functioning chief executives still constitute the majority of most Fortune 500 boards. It is also still generally true that a candidate will not be elected to a board without first being interviewed in person by the chief executive. But at the same time, that nominee will have been vetted not simply by the chief executive, but also by the nominating committee of the board. Although that committee is not likely to force a nominee on the CEO against his will, the nominating committee does have a great deal to say about who is chosen. When that committee, the CEO, and ultimately the full board discuss potential new directors, they consider a number of characteristics that were not part of the calculus 30 years ago.

One example is diversity. I mean not only diversity of gender and race (though I am no longer the only woman on any of my boards), but also diversity of occupation and age. Diversity of age is particularly difficult to obtain, however, because it often takes decades for a nominee to acquire a sufficient portfolio of skills and experiences. But the CEOs of even quite large businesses are

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10. Id.
11. Matthew P. Quilter et al., Duties of Directors: Venture Capitalist Board Representatives and Conflicts of Interest, Practising Law Institute, CORP. L. & PRAC. COURSE HANDBOOK SERIES, No. BO-01DJ 1101, 1123 (June 2002).
12. Id.
younger and younger these days, and the average age on these boards
has gone down markedly.\textsuperscript{13}

In addition, boards now look for a particular portfolio of skills. I
chair the nominating committee at Proctor and Gamble (P&G), and
when we are considering a new board member we ask, "What kind of
skills does this company need that it does not have on the board at
the moment?" For example, we thought it was very important to
have someone from the communications industry, someone from the
technology sector, and someone from a high-end consumer products
business. The four most recently-elected directors meet that set of
requirements.

It is also increasingly essential to have a director, or preferably
several directors, who come from other countries than the United
States. As companies go global, they need someone to give voice to
the interests and points-of-view of other parts of the world. This sort
of inclusion can be logistically difficult because most boards meet six,
eight, or nine times every year, and directors are expected to attend
most, if not all, of the meetings. Clearly, traveling from Tokyo or Rio
to a board meeting in the United States is more arduous and time-
consuming than traveling from Detroit or Houston, so international
board members face unique difficulties. We are very fortunate to
have as a member of P&G's Board Ernesto Zedillo, the former
president of Mexico, who is credited with Mexico's first truly-honest
and democratic election in modern history. Subsequent to that
election, his party was defeated and the logistical problem for P&G's
board was solved by the fact that he has now moved to the United
States to become the director of the Yale Center for the Study of
Globalization. But we did not know that his move was in the offing
when he joined the board.

A second major change is in the training that directors receive.
When I joined my first board, I knew very little about how the
company actually worked. So I asked if the management could set up
training sessions for me, where I could meet with the heads of the
business units and the major staff functions and learn something
about the company's operations. They were glad to do it, but they
were somewhat surprised. Apparently I was the first new board
member who had ever asked. At that time, board members were
apparently supposed to learn by osmosis and keep quiet until they
figured things out on their own. Now, not only do most of these
companies set up internal training programs for new directors, but
there is a whole industry of consulting firms and universities,

\textsuperscript{13} Janette Bennett, "Young Ones" Take Charge, SUNDAY TIMES (SOUTH
AFRICA), May 06, 2001, available at http://www.suntimes.co.za/2001/05/06/
particularly law schools and business schools, that run programs for corporate directors. The whole process has become quite professionalized.

Finally, there has been a great change in the conduct of board meetings. When I first joined corporate boards, their meetings tended to consist of endless presentations. Directors sat and listened to the presentations, asked a few polite questions, and voted. The votes were almost always unanimous. For example, at the Bank board meeting there was an incredible amount of mundane material that, by law, had to be approved by the directors, and this process was incredibly boring. Consequently, directors regularly voted on matters that they did not completely understand.

Again, all this has changed tremendously, but this change has not come easily. Directors have worked hard to make board meetings today less formal, and incorporate less presentation and more discussion. Challenges to a statement by the CEO, if made diplomatically, are accepted in a positive spirit. The directors also meet in private, usually several times a year, without the CEO. The outside directors evaluate the CEO’s performance annually. No one could have conceived of these developments when I first started to join boards.

All this is general background, but it is easy to see how these changes link to some of the issues discussed today. Furthermore, there have been significant changes inside corporations themselves. First of all, there is increasing recognition—and this was the point of an earlier talk at this Conference by George Siedel—that success for shareholders results from satisfying other stakeholders, including customers, employees, and the home and host communities where companies operate. In most cases, although not all, these are not trade-off relationships, but complementary ones. One major exception is when a company downsizes or lays off people in order to reduce excess capacity or increase its productivity and thus its profitability. Such actions are generally taken to benefit shareholders, but they inevitably have a negative impact on the welfare of at least some employees. Proctor and Gamble used to take pride in never having used an involuntary layoff. A few years ago, they found that they could no longer sustain that commitment, but they still are very careful about how they treat employees during layoffs, and try hard to be fair in that process.

Second, democratic principles are increasingly at work within a company’s internal community. A corporation is not a full democracy and never can be—the buck still has to stop somewhere in a way quite different from the way it stops in a totally democratic institution. Nonetheless, changes have taken place that create a more democratic environment. For instance, employees are much more diverse in many dimensions; not just with respect to race and
gender, but also in terms of lifestyle. I read recently that J.P. Morgan Chase is regarded as the best employer for gays and lesbians to work for.\textsuperscript{14} The notion of that kind of favorable publicity would have been unthinkable 30 years ago. When I first worked at General Motors, employees who were previously divorced were uncomfortable taking their "significant others" to company parties because such relationships were not quite socially acceptable.

Furthermore, there has been an increase in employee "empowerment." That is, corporations are making a real effort to give employees more information about the company's vital statistics and more autonomy in taking action to satisfy customers. These changes are neither universal nor complete. There is, after all, a reason the Dilbert books sell well. I would say, rather, that the best companies have made significant progress toward this sort of empowerment, but it is by no means universal. The worst companies presumably have not made any progress at all, or have even regressed. But I am more acquainted with companies that have made some progress in this direction.

The prevailing view of effective leadership has also changed. Current books on leadership no longer refer to hierarchical command and control, but focus much more on a coaching or team-work style of leadership. A number of companies with which I am or have been associated now actually use so-called 360 degree evaluations. This means that executives and managers are evaluated not only by their superiors, but also by their peers and by the people who report to them. That can be quite a sobering experience, in terms of how you interact with people. Many companies have also tried holding what are called diagonal-slice discussions. These "slices" consist of groups of somewhere between eight and twelve people who come not only from different parts of the company but also different levels in the hierarchy, brought together for hopefully candid discussions of their views and concerns.

It has also become increasingly fashionable for companies to articulate statements of principles and values and disseminate them broadly, both internally and externally.\textsuperscript{15} Of course one can be cynical and say, "Writing this stuff down is all very well, but what counts is not words but behavior." But committing these ideas to writing does alert employees to watch the management and see if it "walks the talk." Nothing creates cynicism and lack of loyalty faster

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than the impression that management is not practicing what it preaches. Although some cynicism may be justified, the fact is that an explicit values statement can make everyone conscious of appropriate corporate behavior. Finally, well before they were mandated by law, many companies instituted telephone hotlines for employees to voice their concerns about the company. Anonymity is guaranteed because the hotlines are generally run by an independent third party, not the company itself. In fact, most of the calls that come in are not about alleged malfeasance, but concern individual personnel issues.

Despite all this, there are still basic characteristics of firms that undermine trust. There is still hierarchy. There are still layoffs. There is still hostility between management and labor in collective bargaining. But the most forward-looking companies are trying to listen to their employees and act on what they hear.

Equally important are companies’ relationships with external communities. Once again, companies have become much more aware of, and self-conscious about, their behavior in relation to the environment and to the people in the countries where they operate. Not surprisingly, corporations tend to focus most on the topics of greatest local concern. Alcoa, for example, has undertaken a significant number of major projects in its host countries to protect or restore the natural environment.\(^\text{16}\) It has won numerous awards for planting forests and is working very hard to develop new methods of aluminum production that are less energy-intensive and less polluting.\(^\text{17}\) Unocal, on the other hand, has set up a tremendous number of people-oriented programs—not only in connection with its highly controversial investment in Burma (now officially Myanmar), but also with investments in Indonesia and Malaysia.\(^\text{18}\) It has built schools and hospitals, and underwrites the teaching of skills, such as shrimp farming, that promote economic self-sufficiency.\(^\text{19}\)


\(^{17}\) Id.


\(^{19}\) Id.
Multinational firms in general are much more engaged with local communities. Many have appointed corporate officers with specific stewardship for corporate responsibility. General Motors has recently created the position of chief environmental officer at the vice president level. General Motors, Officers: Elizabeth A. Lowery, GM Vice President Environment and Energy (Feb. 2002), at http://www.gm.com/company/investor_information/stockholder_info/corp_gov/bios/lowery.html.

Unocal has a director of corporate responsibility, who previously had a career with USAID and, before that, with the Peace Corps. Companies vary—some like to hire experts from the outside, while others prefer to take people who have had line management experience within the firm and, therefore, will have more credibility with the line managers. There is some tradeoff there between expertise in dealing with these issues and credibility with the profit-making units of the business.

Another shift that, frankly, I would never have predicted 20 or 30 years ago is that companies have come to feel responsible and accountable not only for their own behavior toward employees and communities, but for the behavior of their suppliers as well. That is a development in which activist non-governmental organizations (NGOs) took a tremendous amount of initiative. The negative publicity (sometimes fair and sometimes not) that resulted from the reports of NGOs as to supplier behavior led major companies to take a very hard look at their suppliers' employment practices. Today, the arguments on college campuses and in the press are not about whether companies should take this responsibility, but how it should be implemented, how it should be monitored, and so forth. Whether it is clothing or rugs or soccer balls, the discussion has moved from issues of child labor to issues like the right to collective bargaining and the most controversial one, the so-called living-wage issue.

Finally, there is this question of transparency and adherence to the rule of law. It is clear that good works are not enough. Enron was a major contributor to all kinds of worthy activities, particularly in Houston. A more ambiguous case is that of Phillip Morris. Phillip Morris has probably made larger contributions to cultural activities, art exhibits, and such than any other U.S. company. At

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the same time, they still manufacture cigarettes, and it is clear that for many years they, along with other tobacco producers, misled the public when they had information that they did not reveal about the harmful effects of cigarettes.\footnote{26}

How do those two aspects of the company's activities balance out? I have my own views, which is why I say good works are not enough. It is critical to have honesty—that is, avoidance of corruption and self-dealing. Honesty is absolutely crucial for societal trust. That trust of course, has been tremendously undermined recently. What do you need for that trust? Well, you must have exemplary behavior by top executives. But that is not enough. You also need to train employees in the standards of legal and ethical behavior. Unocal, for example, has set up interactive training.\footnote{27} The company, like many others, used to put out guidelines on legal compliance and ethical principles and required employees to read them.\footnote{28} Then it went a step further and not only required employees to read them, but also required them to sign a statement that they had read them.\footnote{29} Now, Unocal employs an interactive computer program that requires every employee to work her or his way through the legal and ethical standards.\footnote{30} Not surprisingly, that is a much more effective way to get people to absorb the compliance and ethics rules.

Of course, there is also an obligation on corporations to engage in honest reporting to the outside world in order to create transparency. Companies are putting more and more information into their annual reports or corporate social responsibility reports, or both. General Motors pioneered such social responsibility reports back in 1972. By now, under various titles, they have become quite widespread. There is even something called the Global Reporting Initiative, started by an environmental NGO called the Coalition for Environmentally Responsible Economies (CERES) but now a free-standing operation, that is trying to standardize environmental and social-responsibility reporting around the world.\footnote{31}

Today we are dealing with the impact of the current wave of scandals that has severely undermined social trust. It has made every corporate board engage in another round of self-examination and changes in governance. At P&G, we had to change the definition

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  \item \footnote{26} See id.
  \item \footnote{27} See Unocal Corp., With Responsibility Comes Accountability, at http://www.unocal.com.
  \item \footnote{28} Id.
  \item \footnote{29} Id.
  \item \footnote{30} Id.
  \item \footnote{31} See Coalition for Environmentally Responsible Economies (CERES), About Us Overview, at http://www.ceres.org.
\end{itemize}
of an independent director to make it conform to a new, stricter
definition, and alter some committee assignments to match the new
definition. There has now been, inevitably, a wave of rather complex
legislation that will have some very good effects, but these laws have
already begun to demonstrate the operation of the law of unintended
consequences as well. If Congress could, I believe it would go back
and clean up some of those unintended effects, but the scandals are so
high on the political horizon that Congress is unlikely to do so at
present.

The United States has also, to some extent, lost its position as
the “gold standard” of corporate governance. A couple of years ago, it
was generally believed that the world should converge toward U.S.
standards of corporate governance. There is significant debate about
that view now. A more serious effect is that the scandals may have
undermined respect for free-market capitalism in some developing
countries. They have certainly, and not surprisingly, generated more
skepticism about some aspects of free-market capitalism. On the
other hand, I know of no other country in the world that would have
jumped on this scandal issue and responded as quickly or as
forcefully as did the United States. Japan has had this kind of
scandal since time immemorial. Many of the European countries
have had similar scandals, and there has been no such prompt and
vigorous response by the political system or the press or the public as
there has been here.

I believe a great deal has been achieved in the direction of
meeting criteria for corporate governance articulated by Tim Fort and
Cindy Schipani. But there are huge differences among publicly held
corporations, and even the best still have work to do toward these
goals.

In addition, we must bear in mind the importance of creating
win-win situations, as emphasized in George Siedel's talk. For
example, when P&G went into Eastern Europe, its managers very
quickly discovered the importance of this principle. At that time, the
region was still communist and very closed to the outside world.
Trade with the West was severely limited, and there were important
permissions P&G needed from the governments of these countries.
For example, if it was going to set up plants in these countries, it
needed the right to import some of its products to create a market for
these consumer goods before building manufacturing plants.

P&G's managers in these countries found that they were more
successful when they helped a government with some of the problems
it was confronting. Even in the communist days, but particularly
when the nations were experiencing political transitions, these
countries had no idea how to create the appropriate environment for private business. Proctor & Gamble found that it could be helpful, for example, by building a plant in an area where there was a particularly high unemployment problem. It found that whenever it could create these win-win situations, it was much more successful in accomplishing its objectives.

To take another example, when I first went to work for GM in the late 1970s, the attitude toward NGOs was almost universally adversarial. They were regarded as the enemy. Since then, not only GM, but many other companies as well, have found that they can work quite productively with some NGOs. Many companies, for example, have now signed on to the CERES principles relating to environmental issues. General Motors also found that it could work productively with the Environmental Defense Fund if they agreed to disagree on certain issues but to work together on others. As a matter of fact, CERES recently published a sort of “scorecard” on GM that required GM's cooperation.33 The scorecard was mixed.34 CERES applauded what GM has done in reducing pollution from its plants while still deploring GM's hostility toward tighter requirements for fuel efficiency.35 GM did not agree at all with the latter assessment, but the cooperative relationship continues.

Companies are also focusing increasingly on actions that benefit both shareholders and other stakeholders. Again, this is a point that has been made more than once at this Conference. I have been quite amused by conversations with some of my Public Policy School students. They are bright, committed people, who often respond to the concept of win-win with a belief that if a company takes an action in its own self-interest than that action is somehow tainted per se. Because the motives are mixed, they believe, the action cannot possibly constitute a model of good behavior. I try to convince them that it is only when everyone can gain that such actions are sustainable.

My experience over these 30 years, seeing and being part of all of these changes, is that the role of the board of directors is crucial to ensuring that, in the words in the old Tom Lehrer song (which most of you in this room are probably too young to remember), companies “do well by doing good.” Only then will their actions be truly sustainable.

34. See id.
35. See id.