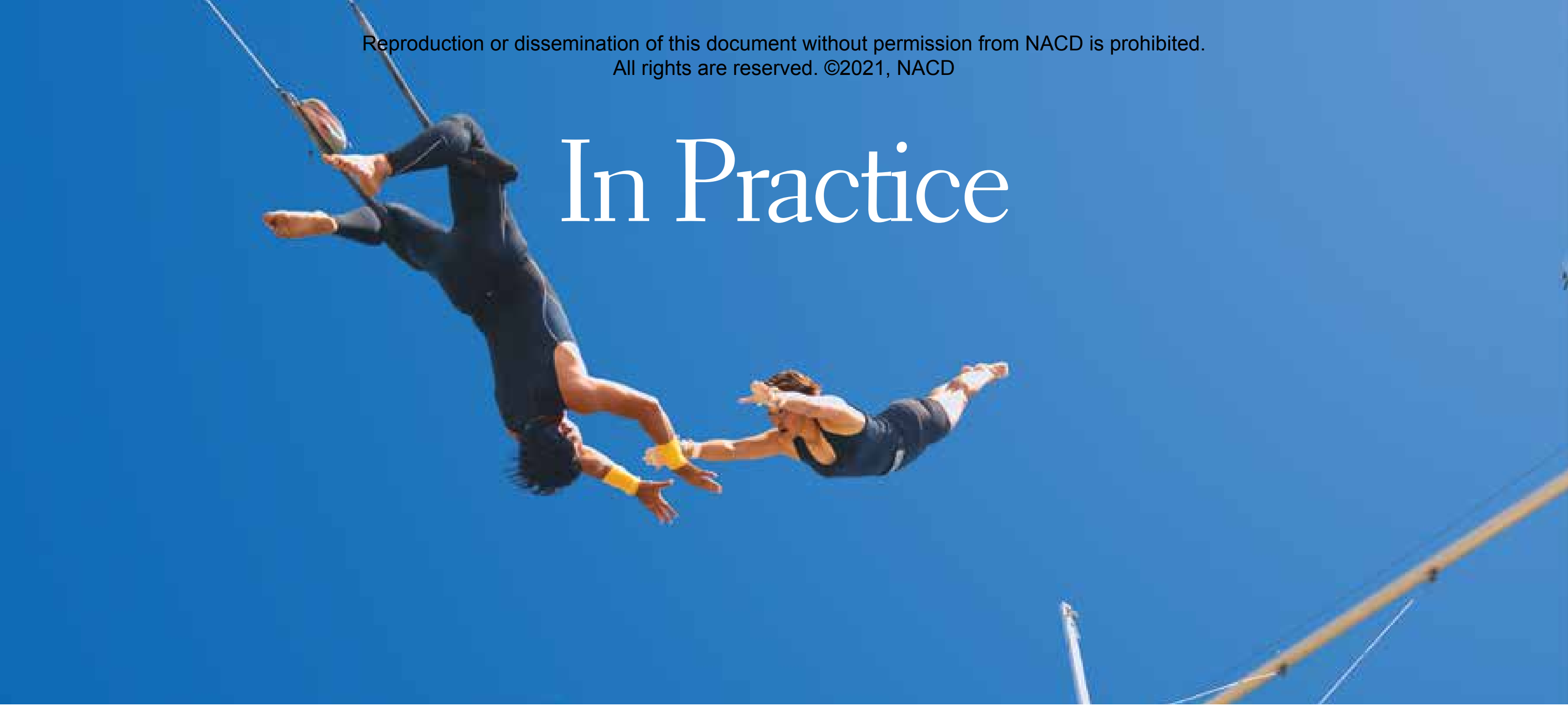

How Boards Can Help Build Trusted Companies

By Sandra J. Sucher and Shalene Gupta

In June, hedge fund manager Christopher James, with just 0.02 percent of company stock, convinced Exxon Mobil institutional investors to vote in three handpicked board members who will press the company to respond more directly and with greater speed to the strategic imperative of climate change. James' victory is an example of moving from theory to action on the principle of stakeholder capitalism. This idea represents the foundation of trust against which companies and their boards are judged.

Corporate leaders have a responsibility to craft and implement strategy—that's their job—but the board stands for the interests of the corporation as a whole, and thus is the place where the navigation between the outside and the inside is expected to take place. Boards are the linchpin between interested parties outside the corporation (investors, regulators, the public, nongovernmental organizations, government) and the leadership inside the corporation.

The board's guidance to Nokia during its restructuring remains an enduring example of how a board must straddle both the internal dynamics of the company while being cognizant of the demands of the external world. In 2008, Nokia shut down a plant in Bochum, Germany, laying off 2,300 employees, shortly after announcing a 67 percent increase in profits. The outrage was so great that Nokia ended up paying 80,000 euro ($95,000) per employee to close the plant. Fast forward to 2011, when Nokia was facing losses for the first time in its history. The board knew that Nokia would have to restructure because it was being out competed in smartphones and was losing share to lower-cost phones from Asia. The scope was huge, affecting 18,000 employees spread across 13 countries. But the board was committed to avoiding the mistakes of 2008. It charged senior executives with the task of coming up with a way to better manage the impending layoffs.

The result was the Nokia Bridge program, which was essentially a bet on trust: Nokia asked employees to stay on at the company—some for as many as two years—while it managed the restructuring. In exchange, Nokia promised employees a soft landing. The Bridge program gave employees a choice of paths to a new future: find a new job at Nokia, find a new job outside Nokia, get funding to start a new business, train for something new, or receive financial support to do something else entirely.

The senior leaders who created the program insisted on obtaining board approval. They explained that during the restructuring they would prioritize the interests of employees over the company's, and they intended to be transparent about the program and its aims. The bet paid off: 60 percent of affected employees knew their next step the day they left the firm. And Nokia didn't suffer from the departures and disengagement that usually follow a layoff announcement. In fact, employees brought in 33 percent of revenues from new products, the same proportion they'd brought in before the layoffs were announced. Eventually Nokia's program was adapted by the Finnish government as a best practice for managing layoffs.

Embracing the goal of building a trusted company—and regain-

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ing lost trust—provides a lens through which this kind of navigation and prioritization of interests can take place. Nokia's shareholders expected actions that would shore up the company's shaky foundations and return it to profitability, while Nokia's employees expected job security. Managing trust is in the familiar terrain of managing relationships. What makes it complex in companies is that the interests of groups are unique and at times can conflict; these interests need to be understood, prioritized, and balanced.

We've developed a four-element framework that explains why people choose to trust: competence, motives, means (or fairness), and impact. It provides a structure for understanding the actions that need to be taken to build trust.

Competence refers to a board's overall ability to make good decisions and offer effective guidance to a company. Earlier this year, in the wake of the 737 MAX crashes in 2018 and 2019 that killed 346 passengers, shareholders of The Boeing Co. sued the board. Their list of grievances was 120 pages long and included a critique of the board's competence. The filing pointed out that four of Boeing's board members were former government officials with no engineering experience. It also pointed out that the board had no designated safety committee, a huge oversight for an aircraft manufacturer. To be judged as competent in managing trust, board members need to have the domain knowledge to advise on industry- and company-relevant strategic issues, and must be willing to bring in experts in areas where they lack knowledge. Structurally, board committee mandates must include industry requirements and new areas of focus, such as environmental, social, and governance (ESG) considerations.

Motives are revealed by the actions that boards take to advance the interests of different constituents. Managing compensation is one of the most important ways that boards influence CEO and company behavior, and boards are increasingly holding CEOs to account for a range of impacts, reflecting a broader understanding of actions that influence financial performance. For example, there is a movement to hold CEOs accountable for measurable progress on D&I initiatives: one-third of S&P companies use diversity as a measure in compensation structures, while at McDonald's and American Express 15 percent of annual bonuses are shaped by human capital measures including annual incentives to increase the share of women and racial minorities in leadership roles. The motives of boards will be judged by the interests they insist that management attends to, and compensation will continue to be an area where trust will be built (and can be lost).

Means refers to how stakeholders perceive the fairness of a board's and company's actions. People judge fairness within specific contexts, whether it's the size of Boeing CEO Dennis Muilenburg's $800 million exit package after the plane crashes, or CEO pay during a pandemic in which millions of people lost their jobs when companies decided to lay off workers. Boards may need to consider when exceptions to standard practice should be made, as Honeywell's board had to do when then-CEO David Cote refused to accept a bonus during the Great Recession and while issuing furloughs in which thousands of workers would have to forgo pay. Interestingly, Cote's entire senior leadership team followed suit, as did many of their direct reports. Information fairness is another area for board oversight, ensuring that investors and other constituents have access to the relevant information they need to assess the performance of the company and its board. Sustainability reports on ESG factors are now an expected best practice. The best ones include rich information about the views of stakeholders on the importance of different aspects of ESG in helping the company, and the board, to prioritize areas of focus.

Finally, boards must monitor the impact of the company's actions, both intended and unintended. When shareholders sued the Boeing board, at the bottom of their 120-page filing was a larger question: How had the board allowed Boeing to create the 737 MAX jet whose flaws led to 346 deaths? While Boeing had not set out to create a faulty plane, the board was still held accountable for the unintended impacts of the flawed design process Boeing used to create the aircraft. As with the companies they oversee, boards may not intend their guidance and actions to negatively affect stakeholders, but they will be held accountable for all impacts, intended or not. Monitoring impact is different from monitoring risk. Rather than a probabilistic exercise of identifying areas of potential vulnerability, impact monitoring focuses on the actual effect of company actions as experienced by different constituents. Boards can do the most good by ensuring that companies respond to the impacts they create. Trust is gained when companies respond to adverse events quickly—the world is watching.

Boards have an incredibly complex job. They must serve as both the north star to guide a company's strategy and the moral compass that holds company leaders accountable. In the event of a crisis, they are the ultimate arbiters that can steer a company out of a wreck—or drive it deeper. In addition, boards work within an ever-changing context where social mores and expectations around ESG have become increasingly stringent. By bearing in mind that their job is ultimately to gain and maintain trust with stakeholders, boards can focus on the most important question of all: how to ensure people want to keep interacting with their company.

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