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Accountability and Responsibility: Some Perspectives

Simon Davies, Managing Director, The Blackstone Group International Limited, London, UK

One of the stark realities made clear since the start of the 'credit crunch' has been a phenomenon regularly described as the 'one way bet' many money managers have taken with the cash of the masses (or even the select few) in carrying out their business. The disassociation between the individual and his or her employer and the lack of accountability and responsibility that person assumes for his or her actions is not limited to the finance industry (but it was certainly prevalent), but if we know that it exists, how do we fix the problem?

As a first step, we need to analyse the extent of the problem. This can be done in a number of ways, but throwing mud is fun, so we should try that and see what we uncover. If we play the blame game, we can find good reasons to hold lots of people partially responsible for contributing to the severity of the current downturn. Let me offer some suggestions, staying away from the traditional targets of regulators and rating agencies.

Executive management

Starting at the top of the corporate organisation, executive management – for they are supposed to be ultimately responsible for the enterprise they manage (responsibility flows upwards to the top, not down to the scapegoat). This is not limited to the executive management of banks, financial institutions or other establishments of 'systemic importance', but to all executive management. Fred Goodwin has been painted as the face of the credit crunch in the UK, but his personal gain looks a paltry sum when compared to the pay-offs received by many – Richard Grasso's USD 140 million headline for instance when he and the New York Stock Exchange parted ways (although at least in that case, the pay-off was challenged).

There is so little accountability and responsibility required by their contract of employment (a function of negotiation), or by any legislation or regulation, that an outgoing, poor performing – even potentially negligent – CEO can take enormous amounts of value away from an enterprise at the time they leave and often for long after they have gone. It can actually be far more rewarding to leave the job than to stay in it. While the split can be acrimonious, there are many cases where an outgoing CEO has held onto rights that any normal person would view as outrageous fortune – all the way down to family dental insurance for life ...

Non-executive directors

The non-executive directors cannot be free from blame. Their role has often been seen as having two principal components: monitoring executive activity and contributing to the development of strategy.[1] They contribute to many of the committees which are formed as a subset of the board of directors. The requirements of a person sufficiently skilled to be a non-executive director include '[the] need to be sound in judgement and to have an inquiring mind. They should question intelligently, debate constructively, challenge rigorously and decide dispassionately. And they should listen sensitively to the views of others, inside and outside the board.'[2]

The requirements go on and, if carried out diligently, a non-executive director's role is likely to be time-consuming and, from time to time, a thankless task requiring a company's executive management to justify rigorously the decisions that they wish to make. Nowhere does it suggest that the job is one of playing patsy to the executive management, being little more that a mere observer at the board and casting the requisite votes. So why does it feel as if that is exactly what has happened on more than one occasion? And on boards of institutions we now realise were 'too big to fail' – which seem to have been too big to manage effectively?

I believe that a non-executive directorship, if carried out effectively, is truly a thankless task (but a necessary role) – the only time when an important decision is made and actually noticed is when it is a preventative move. The executive directors will take the plaudits

Notes

1 See Derek Higgs, *Review of the Role and Effectiveness of Non-Executive Directors* (London, BIS, January 2003) para. 6.1.
2 *Ibid.*, para. 6.10.

for a successful company strategy and the responsibility carried out by non-executive directors probably goes less noticed. They participate collectively in the accountability associated with failures of corporate policy and only really get noticed when seeking to block the execution of the executive's stated strategy.

However, that should not prevent the spotlight from being shone when we are handing out blame – to decide to allow an executive board member to 'retire' rather than dismissing him or her provides a transfer of value away from the company to the individual which should be challenged – something sadly lacking when times were good (and even when they had turned bad).

Shareholders

Shareholders have a contract with the company, one which provides to them the ultimate power over its destiny. As a company grows in size and takes on a public shareholder base, the power of the individual diminishes, but the power of large shareholders (or of the collective) remains. A company with questionable strategic direction is always open to challenge from its shareholders – as the activist funds have shown. During a rising equity market, we have often been quick to dismiss activist funds as troublemakers with dark intentions – how do we feel now?

There are also checks and balances in place (in the UK, and elsewhere) to allow shareholders to receive guidance as to whether a company is being run in accordance with best practice guidelines. While this does not protect against best practice not being good enough (the expense claims of politicians have shown that mere adherence to the rules on a strict reading does not mean that you are doing the right thing), a general meeting (or even an extraordinary one) provides a chance for the shareholders to register their approval or disapproval as they wish.

Yet how many shareholders, especially those who manage other people's money (so should have a responsibility to earn a return on that money), have actually voted on principle in the recent past and challenged a company and its board? The emotive issue of executive pay has caused a (non-binding) 'no' vote in various cases, but that is about as good as it gets – even in a time of such turmoil. There is the occasional public noise about disapproval and then, magically, the vote is passed without trouble.

Individuals who manage their own money are accountable to themselves for gain or loss. Those who manage other people's money have pooled capital which, in a number of cases, will make them significant shareholders – one whose voice will be heard if it is used. They must feel a sense of responsibility for managing other people's money and must be accountable for their actions in seeking to balance risk and reward. Their track record in approving deals which have 'gone bad' very soon after completion suggests that there is some blame to be shouldered here too.

The dissociation of the individual from the corporate

A sole trader is an entire business and responsibility for success and failure are absolute. As a business grows in size, the association of the individual with the business shrinks. The rate of shrinkage can be mitigated with strong corporate culture and brand identity, clear core business beliefs etc. but generally, the bigger the institution, the greater the risk of dissociation between the employees and the institution. Many of the factors that have contributed to the explosion of global business in recent years – transport and shipping, information technology and broadcast media, more open international trade agreements to name but a few, has increased that risk.

The increase in 'job mobility' of the individual and decrease in the existence of the 'job for life' has changed the dynamic of the corporate form. The 'home grown' CEO is a far rarer sight than historically and many view their career path as one which does not depend upon a particular company or business – this is particularly true of the services industry. This places a potential issue of dissociation all the way to the top of the corporate hierarchy.

Dissociation is an important issue and cannot be avoided. It contributes to a lack of feeling of responsibility for success or failure, a dangerous 'privilege' for decision-makers to be granted. That is where regulation steps in – it needs to 'manufacture' a balanced system which creates responsibility by making people 'in a position of responsibility' accountable for their failures as well as beneficiaries of their successes. We must avoid the 'heads we win, tails you lose' situations being available.

Enforcing responsibility and accountability

We need to make an examination of the level of accountability that should be assumed by a person in a position of responsibility. It is clear that the majority of the world's population (who are collectively shouldering the burden of paying for the turmoil) feel that there is a massive imbalance in the profit taken by the few when compared to the lack of recourse against those same people for the loss now occurring. I will not cover here the subject of compensation or incentives (while it is an emotive – and relevant – subject, it requires an examination all of its own to do it justice), but rather will consider the role of regulation in requiring a person to be responsible and accountable for their actions.

Who is a person 'in a position of responsibility'? Some are easy to identify, others less so, and it isn't clear

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how far down a chain of command one must travel. We would like to be able to start with simple rules to calculate who is or is not responsible, as cumbersome prescription may not provide a helpful solution. Can we put rules together for this purpose?

There are good starting points already evident in regulation for those in the financial markets. For instance, the FSA in the UK regulates people it considers to be 'in a position of responsibility' – whether advisers, arrangers, managers or others. These people are already required to maintain professional standards of conduct – if they 'back themselves' then surely they would be happy for this to be extended to make them accountable for the success and failure of the product of their job? Why not? Equally, executive and non-executive directors could be held responsible and accountable through the current best practice being extended.

If I put someone in charge of investing my money and they lose it all, why should they not be accountable for that – merely waving a 'get out of jail free card' under the banner of having maintained a professional standard of conduct doesn't cut it – I invest with them because they back themselves to make a return, not because they are professionally correct. Such an approach could also weed out another dangerous part of the financial system – people creating, selling or investing in financial instruments that they are inadequately qualified to understand. I would not ask my dentist to design a new nuclear power station, so why were so many people involved in structuring financial products when they were not equipped to understand the risks?

Capitalism requires a new framework

While finger-pointing doesn't solve the problems, it can help to plan for the future establishment of a framework for us to make capitalism 'work'. What we need is a set of rules which allows us to be content, even confident, that if a person is making a profit, it has been made in a manner which is consistent with the risk assumed by the person in that context. Any imbalance that exists will only be exploited over time – this is only natural – a 'free ride' to profit without responsibility is one reason for much of the mess of today's financial markets and those markets do not currently reflect a balanced risk to the individual for the actions that they take.

The issue of accountability and responsibility is part of the heart of the debate relating to the evolution of capitalism. Financial stability is largely a function of confidence in the financial system – confidence in corporations of systemic importance. People will feel a sense of injustice about a person's financial success if they feel as if (with the benefit of hindsight) the success has been improperly 'earned' – for example, if they feel that the person is not responsible and accountable for their success *and* failures.

A part of the cause of the extreme nature of the global financial crisis has been the freedom provided to individuals in positions of 'systemic importance' to take risks. This combined with the lack of accountability and the reduction of the responsibility that a person feels for their job helped create the perception of a fickle nature they supposedly had for their employment and employer's continued success.

The evolution of capitalism in the near future will be significantly affected by a change to the system of regulation within which capitalism works. That system must encourage competition and innovation. It must also provide a framework for ensuring proper accountability of individuals in a position of responsibility. However, to do that through draconian technique which limits the potential financial success of an individual is likely to create market imperfections which will reduce the incentive of the individual to compete in that market. The regulatory system must allow a person to succeed, but to do so in a way which is, and is perceived to be, a 'real' success brought about in a responsible manner.

The answer, to my mind, is simple. If you back yourself to succeed, you must be prepared to accept the consequences of failure – and those consequences should be made clear through regulation. Limiting the upside is a simple, but foolish, ill-conceived way to regulate – stifling profitable invention and innovation rather than giving it a framework within which it could flourish.

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International Corporate Rescue

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