

TRANSPARENCY IS NOT JUST THE ESSENCE OF CORPORATE GOVERNANCE IT IS THE ONLY WAY TO RESTORE CREDIBILITY OF MARKETS

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Just days ago Bank of America, Citigroup and J P Morgan propped up the markets by announcing numbers that signalled green shoots of recovery only to have their faces blotched up with big eggs. Last week saw Bank of America stock sink by 14%. U.S. [stocks](#) fell, ending a six-week winning streak for the Standard & Poor's 500 Index, as concern grew that credit losses at banks are worsening and drugmakers slid following disappointing earnings. Who will ever trust the credit figures of US banks or for that matter any bank? It is the crisis of transparency that is turning into a vicious crisis of confidence.

In her interview with Margaret Popper of Bloomberg, the noted short seller of banking stocks, Meredith Whitney (See "From Wall Street to Crawl Street" in the last issue of Corporate Governance) said "Underlying credit is deteriorating at a faster rate. As banks are shrinking they have been cutting their credit lines."

Whitney, 39, has become a legend her own lifetime since she started working with Steve Eisman and shorted the subprime pools. She was an obscure analyst until on October 31, 2007, when she predicted that Citigroup had so mismanaged its affairs that it would need to slash its dividend or go bust. It's never entirely clear on any given day what causes what in the stock market, but it was pretty obvious that on October 31, Meredith Whitney caused the market in financial stocks to crash. By the end of the trading day, a woman whom basically no one had ever heard of had shaved \$369 billion off the value of financial firms in the market. Four days later, Citigroup's C.E.O., Chuck Prince was chucked. In January, Citigroup slashed its dividend.

The market meltdown has no economic basis other than the loss of investor confidence which is feeding itself with daily exposures of the kind of John Thain, Bernie Madoff and Ramalingam Raju. Investors have been alarmed by seeing all their gods and demigods falling off their majestic heights. Almost everyone has been found swimming naked. Hence no one trusts any one. The strategy to restore trust in such a crisis is not doling out bailouts but changing the culture that has led us into it.

The Power of the Blogosphere

With 40,000 blogs and similar number of home videos uploaded everyday on YouTube and other internet sites, we have no alternative but to vigorously promote candour in conduct. Marketers have turned bloggers started taking revenge. Marketers could not let the likes of Jimmy Cayne, John Thain, John Mack, Richard Fuld, Angelo Mozilo, Phil Gramm and Hank Paulson – all named as "The Architects of Destruction", in a special report by Wealth Daily Investment Research of Baltimore, get away with their booty coolly. So each has been skinned. The strobe like glare of public scrutiny has melted the veil of secrecy and unmasked their misdeeds and exposed the culture of cosiness, conceit, concealment and corruption that has characterized the financial markets. The cat was let out of the bag by the long queues outside a seemingly robust British Bank – Northern Rock over 18 months ago. Soon thereafter the French Bank, BNP Paribas froze withdrawals from three of its funds.

Citigroup which in 2003 was a behemoth with \$250 billion of assets is only a fraction of that at \$38 billion. Despite all the help from Phil Gramm, a US Presidential hopeful, or perhaps because of it, UBS, his benefactor Swiss bank, had to write down \$19 bn debts resulting in the sacking of UBS's boss. UBS is currently being investigated for a massive tax evasion. The manipulators and fraudsters have nowhere to hide in this economy of strobe like glare. Markets were waiting with bated breath for holding the guilty accountable. With insider knowledge markets are using the same instruments to bust the last refuge of scoundrels – shorting the sub-prime and the property market to pulverise their asset values.

Market's retribution to the architects of meltdown

Within a span of next 12 months the heads of the world's 5 biggest investment banks - James Cayne of Bear Stearns, Richard Fuld of Lehman Brothers, Blankfein of Goldman Sachs, John Thain of Merrill Lynch and John Mack of Morgan Stanley lost combined personal wealth to the tune of \$2.2bn. Other fraudsters have been given the boot. Markets are in turbulence only because there are several still at large. They will not calm down until all have been held to account.

Perfecting the art HNTGC – (How Not To Get Caught)

Mr Henry Paulson, the outgoing Treasury Secretary, worked in the office of President Nixon in the early seventies. Mr Nixon who was successfully impeached for Watergate Scandal used to say "You can disobey all Ten Commandments as long as you follow the eleventh one: "thou shalt not be found out". This maxim created a breed of business school executives whose success depended not on doing the right thing but manipulating success at all cost by perfecting the art of HNTGC (How Not To Get Caught). As the rules got more and more complex you needed young executives who were brighter and communicative enough to master the art of HNTGC. So these financiers queued up outside best business schools to recruit such executives at remunerations that were a King's ransom. Hence today's financial world is replete with Harvard and other Ivy School MBAs. It is these bright MBAs who used their creativity and innovation in designing mathematical models to unleash an insatiable appetite and turned into weapons of massive destruction.

All governments play hostage to the monied class

The problem was that western governments themselves play hostage to the big financiers and are scared of regulating them lest they move their assets to lightly regulated territories. This is precisely what happened to Wall Street and New York Stock Exchange. Scared of the draconian effect of Sarbanes Oxley Act many companies who delisted from the New York Stock Exchange were coaxed by the London Stock Exchange saying they did not believe in such draconian regulation and UK corporate governance laws did not make the regulation binding and gave the opportunity to the firm to explain why they could not comply with a particular regulation. There was as such a race to the bottom by regulating authorities to invite investment.

Clamor for Transparency

Satyam's main contribution should be the unfolding of a sordid state of insider trading - a hush hush word - in all the bourses. The investigations reveal the large scale selling of the company's shares by institutional investors days before Raju's confession of cooking books. US must be given credit for putting an icon like Martha Stewart behind bars for a year for lying in a case of insider trading. Yet insider trading on Wall Street is starting to look as troubling as it was in the time of Ivan Boesky in the 1980s, the head of enforcement at the US Securities and Exchange Commission warned recently. Linda Chapman Thomsen, the SEC's director of enforcement, said she had been "quite dismayed" at the nature of the commission's recent insider dealing actions.

Self-regulation of human greed has rarely worked

Ms Thomsen shocked at the magnitude of insider trading when she saw the "multiple incidences" of insider trading and cases involving "tippers and tippees" who were both professionals. Recently a former Ernst & Young partner was charged with allegedly passing insider trading information to an investment banker friend ahead of seven deals involving the accounting firm's clients. In one of the most high-profile cases recently, 13 people, including a Morgan Stanley compliance officer and a UBS executive director, were charged in relation to an insider trading scheme.

The market crash therefore was long in coming. In an interview to Wall Street Journal, Eliot Spitzer, the much defamed former Attorney General of New York, said: "The honour code among CEOs didn't work. Board oversight didn't work. Self-regulation was a failure". Even a staunch defender of free capital markets as Joseph Ackerman, Chief Executive of Deutsche Bank says "I no longer believe in the market's self-healing powers."

Why do you really need transparency?

Knowledge economy has changed the way people buy and behave. Knowledge is the only resource which increases when shared. Transparency helps companies share the knowledge and achieve multi

fold results. The challenge of change today so ferocious that whatever made you successful in the past wont in future. This means you have to constantly innovate. Innovation is a risky business. You have no perfect model. You are always improvising - seizing the unknown imperfectly knowing you don't have all the answers. And you cannot succeed all the time. But if you fail and that fear puts you into hiding think where the world would have been had Thomas Edison gone into hiding after failing to produce incandescent lamp. The other person would have had to start from the scratch. Today the public scrutiny is so intense that unless you can celebrate your failures the media will give you depression. In any event there is no place to hide. Further the punishment for being found out by media is much more than being candid in the first place. You have to learn to love failure under and the communication skills to talk about them unabashedly as both Mahatma Gandhi and Barack Obama have done.

Back to Basics

To restore trust in the market we have to start with basics. What are we being taught in schools? Good old days schools used to compete with each other on the quality of their mission statements – truth alone brings victory” or “if health is lost, nothing is lost, if health is lost something is lost but if character is lost nothing is lost”. Today’s schools and more importantly our Business Schools compete only on the packages drawn by their alumni. A journalist who studied in Harvard Business School described it as “a factory of unethical practices”. Students use educational loan to buy flashy cars and fall into debt trap well before they graduate. Our challenge is to make them aware of the ethical context and sharpen their moral compass. We have to change our metaphors of success "winner takes all" and "success at all costs" and develop a value system that prides in ethics, morality, equity, legitimacy, transparency, value dissent and diversity. Transparency requires courage to say: "We are sorry we made a mistake". That is the only statement that tells your client you are earnest.

The Role of Training

There are no classes, no courses, no seminars on how to build moral courage, ethics and self-pride. Pride in becoming truthful of who you are – the kind young Barack faced when the teacher asked whether they could all call him “Barry”. We need classes and credits for how often we acknowledge, own and atone our failures. We should have credits and rewards based on the quality of our apologies. We have a policy that aims to reward those who own mistakes and punish those who hide them. Markets must know that there is a greater punishment for concealment than failure itself. As Einstein said it is not the mistake that causes the serious damage. It is the mistake that you make of defending the first mistake that causes the greatest damage.

These mindsets can only be changed through training. Because denial, double-speak, self-deception and hypocrisy are an inherent part of our organizational life, we cannot get rid of them without proper training. People all over the world are asking what were the boards doing when their companies were being sucked? Warren Bennis the legendry guru of leadership and James O’Toole created a diagnostic tool to identify the unique behavior characteristic of the company, profiling the type of individuals who get ahead in the organizations. One of the questions was “What is the company’s joke that no one would tell the boss?” It is eventually the values of leaders that drive the organizational culture, any process that aims to surface those will help in establishing the climate of candor. Only when the boards honestly and objectively ask themselves “What do we really cherish and hold dear – power, money, quality, excellence, morality, ethics” can organizations take a useful step to bring transparency and candor.

We need training at all levels – boards and investors both. The training should widen the outlook and make business feel global in outlook. A business is different from a political person because the former’s constituency is global. Businesses need to steer clear from blame games between communities, regions and nations. Also unless the governance moves to a global platform it will remain ineffective. The training should be to challenge people to reach beyond their grass – to value failures as building blocks of success and learn to talk about them proudly. The purpose for the training should be to excite the spirit of enquiry, spark innovation and develop holistic, integrated and independent thinking. As Scot Fitzgerald said “The test of first rate intelligence is your ability to hold two opposing views in your mind and still retain the capacity to function”.

Wear your embarrassments as badges of honour

Today's corporations are facing many challenges. The biggest is the challenge of change. There are two certainties. First is whatever made you successful in the past wont in future. This means you have to constantly innovate. Innovation is a risky business. You have to recognize you cannot succeed all the time. But it is no good hiding when you fail. There is no where you can hide. You are under the constant glare of public scrutiny. The second certainty is that if you try to hide failure, you are bound to be found out. The punishment for being found out is more than being candid in the first place. In order to succeed you have to learn to love failure under and learn to talk about them unabashedly as both Mahatma Gandhi and Barack Obama have shown. But admitting failure requires courage. It took a long while for Gordon Bowne to apologies for the affront Damian McBride had caused to Tory leaders by undermining their reputation through a website which propagated nasty stories about these leaders. The worst none from his party or opposition had expected the apology. They buried the story in shock. So the lesson is wear your badges of embarrassment as badges of honour.

“The Whole World is Watching”

As Thomas Friedman writes in his New York Times column of June 27,2007 , “The Whole World is Watching”: “We are all public figures now.” Anyone has the ability to tilt is cell camera in our direction and catch us in our most embarrassing moments – squabbling with a sales clerk or shouting at your spouse. Negative information can be spread much more rapidly and once committed to the internet will stay there forever. We have to reconcile to all that until the internet protocols become more forceful in vetting, verifying and authenticating information. This is the price we pay for the huge promise of transparency. No other issue has so much potential to transform the future of our children not just for bringing back to order. We do need to reskill our boards to face the challenges of the new transparency and its role in inspiring commitment, confidence, collaboration, creativity and build company wide competence and competitiveness. This alone will enable your companies to access flood springs of domestic and global capital hidden underneath the arid drought tand bring back the market alive.
