NEWS

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
(202) 272-2650

FOR RELEASE: October 31, 1980 8:00 A.M., EST.

PERPETUATING PRIVATE ENTERPRISE: THE RELEVANCE OF THE AMERICAN EXPERIENCE

An Address By

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October 31, 1980

Thank you Al for a beautiful, flattering and generous introduction. I always have a problem with a meeting such as this. I come with some thoughts that I would like to share. Usually, it would take me longer to present them to you than the alloted time. But, then life becomes much more complicated after sitting through a day and a half with a few brief breaks for other activities. I find that I would like to spend this time, at least in part, in commentary and response to some of the observations of the day. So, I will try to do both and still try to compact it into a reasonable time frame. Oh, I might note that in talking with my office this morning, you might be interested in knowing, if you have not already heard, that Tom Clausen, President of the Bank of America, has been designated as the President of the World Bank. You might also care to know that the erstwhile Chairman of the Senate Oversight Committee of the SEC, Senator Harrison Williams, has been indicted as part of the Abscam activity.

Now the work. Some observations -- scattered on some of the points of the last day and a half. Self-regulation -- those of you who have heard me and with whom I have talked to in the past know of my commitment to self-regulation. And yet, I have a very real concern that self-regulation, without some form of oversight, or tension created by external pressure or discipline, basically, does not work. Now perhaps it can be made to work, but the concept of self-regulation on the part of those who do not want to be regulated, absent some accountability mechanism, is basically doomed to fail. And, unfortunately, then it is more likely to be substituted by some rather comprehensive and probably oppressive governmental scheme which may or may not resemble the SEC.

I was fascinated by the commentary yesterday when we were discussing voluntary forecasts. The observation that the risk is higher when forecasting is voluntary than it would be if forecasts were required may well be true. But if you scrape below that, there is a very troublesome concept underlying that. It is what I call "lawyers' thinking" which then leads you basically to say "do not volunteer" -- which then leads as a next step to a government requirement to forecast. It is the standard syndrome that lawyers in our society create -- reluctance to move forward progressively which, in turn, then, generates a governmental reaction. I talked to the accountants about internal accounting controls and what is going on in corporations. Firm after firm has told me that we are pushing for voluntary disclosure and for comprehensive disclosure. The lawyers say "you better not, because if you start disclosing you might have to ultimately disclose something you do not want to disclose." If that is the dynamic that occurs within three years, you will have a regulation from the SEC that will be very oppressive that will say you have to disclose. Then everybody will complain about more governmental regulation, and how oppressive it is, and how arbitrary it is. It is very troublesome.

Disclosure of material information. Impact on behavior. I would suggest to you that so long as the concept is indeed one of disclosure of material information, and that is the objective, perhaps one of the best manifestations of the materiality is that it does indeed have an impact on behavior. In many instances, it is the very materiality of disclosure that will influence individuals to engage in ways to avoid the conduct that needs to be disclosed or whatever. So long as the motivation is legitimately one of disclosure of material information and the impact on behavior, if any, is a consequence rather than a purpose, I think that is clearly proper and appropriate, and it is a desirable regulatory approach.

Milton Cohen, in describing the rulemaking process of the SEC, was his usual perceptive self, and I appreciate it. There are not many people in the States, and less so elswhere, who are, in a sense, students of the regulatory process and who appreciate what happens in the rulemaking process. To me, rulemaking is a part of a broader process -- a process of dialogue between the SEC and those it regulates. The objective is, indeed, to stimulate dialogue. One should, in the proposed rule, lay out the conceivable approaches, blanket the sensitive dimensions of the issue, and should then generate a very healthy response, I must say we have generated some healthy responses in the last three and a half years. That is tremendous. Because of that, you get a lively dialogue going and then you can look at the consequences of how you slice the regulatory process, how you move in a regulatory concept, and to what extent there is reason to believe that progress can be made in a nonregulatory mode. I think much more progress and much more sensible and sensitive progress can be made in a nonregulatory context, but often generated by the dialogue that comes out of the rulemaking process as well as other forms of jawboning, etc.

Next point. There may indeed, as Tom Watts indicated, be a very real conflict between accounting for stewardship purposes and accounting for the marketplace -- and, indeed, a third dimension -- accounting for political purposes. Our focus at the SEC is accounting for the marketplace. As far as we are concerned, stewardship per se or the protection of a creditor's concept is not the basis for securities law financial disclosure. We are trying to assist the marketplace in officially allocating capital. That, then, calls for looking at it from the standpoint of managerial performance, providing information on future cash flows and providing it to all relevant users of financial information.

In that sense, I agree completely with Tom, but Tom and I have an ongoing disagreement on the subject of peer review. So long as a significant part of financial results reported in consolidated statements by United States companies or companies listed as actively-trading in the United States are audited by non-U.S. auditors, as indeed they are in some fashion, U.S. investors are entitled to the same level of assurance as they receive from U.S. auditors. I do not believe that our concerns about U.S. auditors that led to the peer review and self-regulatory concept, are any the less valid in relation to auditors and the audit process in other countries. That does not suggest that the only way to deal with that is through U.S. auditors coming over and conducting peer reviews. There might be any one of a number of approaches to assure that the quality level, integrity, quality control and the discipline of the audit process in other countries is what it ought to be. That is the objective that we have to reach for, and in some fashion achieve, hopefully, near-term rather than far-term. We are not at all prescriptive in terms of how, but there is an objective that we feel needs to be achieved.

The discussion of dividends yesterday afternoon, particularly in the context of inflation accounting, is one that I find to be one of the most interesting and one of the most troublesome areas at this time -- particularly in an inflationary economy, and particularly in light of the results we see in FAS 33. To me, the issue is not at all the legal right to pay, and that goes back to stewardship and some of the other dimensions. The issue is, in the light of perspective cash flows and in light of the need for the company to maintain its capital position and to be able to be healthy in the future; whether the company does indeed have enough excess with which to pay dividends. I would suggest to you that there are many companies in the United States who, in effect and in fact, are paying dividends out of capital. The most troublesome part of it is, in many cases, they do not know it, their managers do not know it, their directors do not know it and their shareholders do not know it. But you begin to see it when companies in the steel industry and some others (and there are good examples of it in the States and perhaps elsewhere too) that are in the process of liquidation. That is <u>very</u> troublesome. It is troublesome in terms of the basic health of the economy, and it is not a matter of law and it is not even a matter of good accounting. It is a matter of good managerial sense which does not prevail in many cases.

I was fascinated, I had not realized that you have, in some of your countries, at least, a limitation on the right of companies to repurchase their shares. I used to think that was a great idea. I sat on a number of boards at one time, and at least in two situations I can take personal credit for having blocked a management effort to begin repurchasing their shares. I was of the view that if you cannot find anything better to do with your money, we ought to change the management, and that in too many cases it was really a way of trying to inflate earnings-per-share without earning anything more by shrinking the capital base.

My mind has been changed by another totally uneconomic development and that is the takeover routine. Most takeovers today serve no valid, economic purpose. They do not deliver what they promise. The synergy is not there. They are really largely financial maneuvers, in more cases designed to achieve what the management may aspire to rather than real economic growth and real contribution to the future of the economy and the society. Yet, I would think that a viable alternative, that in many ways would make more sense, would be to distribute that money to shareholders in one fashion or another, and let them make their own reinvestment decision.

It is appropriate, at a meeting such as this devoted to the legal requirements for generating capital for the private sector, to spend some time in examining the serious concerns regarding the future of private enterprise itself. The import of these concerns goes well beyond any immediate financial stake in maintaining the status quo among those of us whose livelihood is linked to the corporate community. Rather, it relates to the significant contribution that a strong private sector makes in relation to a free and libertarian society.

Theoretically, you could draw a continuum and each nation could be placed along. At one end (the theoretical end, at least) is the the totally unregulated economy, in which government, at most, is assigned a role of promoting business interests. In the middle, in the area of a mixed government-private sector cooperation, would be clustered the democratic nations of the world. And, in those nations with a healthy, private enterprise sector, the principles of democracy and the principles of individual liberty have flourished best. At the far end, in contrast, would be the state controlled economies in which government exercises rigid control over virtually every aspect of production and consumption, and individual liberty has been unable to take root. That coordination or coincidence of individual liberty and private enterprise sector is not coincidental.

The two, in my judgment, go clearly hand-in-hand. The direction in which nations are moving -- or should move -- along this continuum may be the most significant political question of our times.

Over the last several generations, there has been a marked movement, in both the United States and Western Europe, towards greater governmental control over business. Yet, the results of this governmental intervention have been less than compelling. As a regulator, government has often tended to mandate requirements which are expensive to comply with, of questionable value and efficacy, and uncoordinated -- or, at times, even conflicting -- with other regulatory objectives. And, in government-operated industries, government has not shown itself to be any more effective, if as effective, as its private sector counterparts.

The question, therefore, is -- given this undistinguished record of governmental intervention -- why do we still hear arguments for an even greater governmental role in the economy? I would suggest to you that the reason is that many in the public, indeed most, fail to appreciate the long-term erosion of their own freedom which is threatened by further restrictions on private enterprise and, instead, respond only to the immediate and short term which arise from the impact of unaccountable business behavior or the decline of major industries.

Tensions between a free market economic system and humanitarian ideals have always characterized democratic societies. The genius of the free market economy is that it is value-neutral, responds in theory at least, and identically to equal buying power or talent or creativity wherever it comes from. On the other hand, the market is an impersonal decisionmaker which operates without any notions of social justice. Much of the work of the political systems in all of our countries during this century has been devoted toward using the law and government to temper the power and efficiency of the free marketplace with humanitarian principles.

As a result, government has been endowed with the authority and means to intervene in the market and, to a greater or lesser degree, to regulate the activities of its participants. Indeed, government has become the premier institution in society -- sufficiently powerful that, in confrontation with private institutions, it will always prevail. Yet, notwithstanding decades of ever-increasing governmental intervention into the workings of the private sector, the perception -- whether correct or misinformed -- is that the business community is failing to act with adequate regard for the business interest, and this perception is growing and not diminishing. The public is exposed to a continuous litany of alleged corporate malfeasance -- including inferior products, consumer deceit, questionable payments, self-dealing and poisoning the environment. Now comes the ultimate in malfeasance and disillusionment -- the loss of ability to remain competitive in the marketplace and the failure to any longer discharge the most fundamental task with which the private sector is charged and its reason for being. In a period marked by troublesome unemployment levels and -- in some instances -- diminishing real income, billions of dollars in scarce capital are being diverted from productive purposes to be squandered in a seemingly unending cycle of corporate takeovers. As a consequence of all this, there is an increasing pressure to further address, in the political arena, the role and responsibilities of business.

But what is most unsettling about this, as I noted earlier, is that when the fate of the private enterprise system becomes a subject for political determination, government -- acting under the mandate of a public consensus -- has virtually unbridled power. Government's prerogatives, including its potential to cripple a viable private sector -- and thereby jeopardize society's libertarian character -- is unbounded and, in fact, is rarely exercised with prudence or precision.

Recently, the impact of these social and political forces on the economy has become a subject of increasingly greater attention and concern. There is a broadening consensus that the political forces that democracy lays on top of the economic achievements of Western society have begun to exert too great an influence. And, it would be ironic, indeed, if -- in the name of advancing democratic principles -- we are risking the vitality of the economic institution which has historically provided decentralization of economic power and decisionmaking, freedom of choice, and the real wealth necessary to satisfy our national aspirations -- in short, the very foundations upon which libertarian democracy must stand. What we need to achieve is an equilibrium between the enormous energies of private enterprise and the compassion and social justice associated with democracy in such a way that we do not fetter the market and prevent it from continuing to provide the healthy, growing economy necessary to effect our democratic ideals.

How do we achieve this? The answer, to a large extent, involves returning to the private sector a much greater degree of initiative and responsibility in running its own affairs. That means the ability and the opportunity to make decisions, set standards, take risks and -- perhaps, most importantly -- the right to make mistakes and fail.

But to achieve this new equilibrium business also must better understand its responsibilities as a citizen in the larger society. In a free society, persons or institutions cannot be allowed to operate in an autocratic or arbitrary manner, or without responsibility to the public good. Democracy is grounded in the belief that anyone who exercises power needs to be accountable to someone for his stewardship. The essential principle, therefore, is that only an institution which operates with effective accountability mechanisms will be afforded the deference necessary to operate, over time, without intrusion by government into its daily affairs.

While the specific character of these mechanisms may vary somewhat according to the legal and political contexts of particular nations, the essence of such a meaningful accountability system may be identified and applied wherever the corporate structure exists. The keystone is the quality and vision of corporate decisionmaking in both its short- and long-term contexts -- that is, decisionmaking which effectively can harmonize the corporation's needs for immediate profitability with its longer-range institutional responsibility. To be accountable, the business community must appreciate the corporation's status and role in society. A corporation is not only a creature of society in the legal sense, but the continuing existence of the private enterprise sector itself depends upon the extent to which society believes that it is private enterprise which best serves its socio-economic needs.

I believe that the processes and concerns which I have just described are common, to a greater or lesser degree, to all the industrial democracies, and have as their genesis similar perceptions of the adequacy of accountability. Of course, the character of the mechanisms necessary to restore or assure the public's confidence in the private sector will vary according to each nation's laws and practices. Yet, the analysis of one nation's experience in this area -- both achievements and shortcomings -- may be instructive to others who may be facing questions of corporate accountability in the particular context of their own corporate and legal systems. Accordingly, I will devote a few minutes this afternoon to an examination of the American experience and an identification of some areas where, in my opinion, the business community needs to more effectively meet its responsibilities. I will assume that those of you who represent other corporate and legal systems will distill from this discussion those processes and concerns which are common to all corporate entitites, and will determine how much of the American experience may be applicable to your specific situation.

THE BOARD OF DIRECTORS

Because the threshhold requirement of a meaningful corporate accountability process is a credible decisionmaker, no element of the corporate accountability process is more important than an effective board of directors. That means ideally a board which can bring the best, most informed and most objective judgment possible to bear in addressing the complex problems which confront the entity. If directors are timid or feel compelled to compromise rather than advocate their views forthrightly, if they have other interests which are conflicting or more compelling, or if they do not fully inform themselves of the critical issues facing the corporation, then in the long run, they harm both the particular corporation and the standing of the private sector.

We are experiencing today, a heightening of interest in the composition and structure necessary to make a board of directors effective. But, a board's contributions are largely determined by the attributes of its members and by the attitudes, ethics and dynamics which pervade the board room. And, neither the personal qualities of directors nor the sociology of the board room can be predicted unerringly according to the composition or organization of the board.

Nonetheless, there are some identifiable structural characteristics whose absence seem to impede a board's effective functioning. In my view, the burden of justifying these apparent impediments should fall on the corporate board that permits their existence. It is, therefore, most important that a board consciously consider the issues which these potential concerns raise, as well as their implications and relevance to the particular board's operations.

Board Composition

First, it is important to consider board composition, in the contemporary environment. The board, in many ways, is a mini-society, with all the forces of cooption and cooperation, desire for compatibility, and distaste for divisiveness, which characterize any group. Moreover, the board environment is not particularly conducive to nurturing challenge or evaluating management performance when the majority of directors are themselves part of the corporation's managment or are, in one capacity or another, beholding to management -- such as are personal friends, employees, or suppliers of goods and services. Meaningful corporate accountability requires a countervailing force that works against this natural tendency towards comfort -- that is, it recognizes the benefits of differing perspectives and creative tensions in striving to meet the common objective of corporate viability over time. And, the actor most likely to provide the corporation with such viewpoints and dynamics is the outside director. Accordingly, the role and numbers of outside directors on the board takes on paramount importance.

Outside representation means individuals who are neither employees of the corporation nor otherwise dependent upon it economically. That definition raises questions as to the status of many persons in addition to management who have traditionally served as directors -- such as corporate counsel, underwriters, bankers, major customers and major suppliers. I am not suggesting that these individuals are, by definition, ineffective as directors or that self-interest invariably clouds their judgment. However, the "second hat" which these persons wear with respect to the corporation raises an issue of whether their ability to contribute to both the reality and perception of accountability is diminished. Stated differently, directors who have business links to the corporation impose a cost on the accountability process, and, particularly when a conflict of interest is created, the burden should shift to that director and the board to justify his presence on the board.

In making this analysis, the board must appreciate that, independent of questions of obvious self-dealing, a corporate supplier's participation in the board -- and the particular perspective it brings -- may have an important impact on a corporation's operations. To explore this concept further, there are two particular groups where the U.S. and European experience differs most markedly: the board roles of banks and labor unions. While in some European countries it is common to find one or more of these organizations participating on the board, in contrast, the American practice has been for a much lesser role for commercial banks and, with a recent notable exception, virtually no such role for labor unions. That is not to say that these institutions cannot exert major pressures in the United States in formulating corporate policies -- bank lending agreements, for example, oftentimes place very material financial and managerial restrictions on corporate borrowers and the nature of the labor-management relationship may have a significant effect on corporate policy. But, in the United States, this influence typically springs from an arms-length negotiating process, rather than from participation in the corporation's decisional mechanisms. And, it is most instructive to look at some of the possible consequences which arise in comparing these different relationships.

In some countries, the perspectives of banks have come to be an integral part of the corporate decisionmaking process. Often large shareholders themselves, they do not typically favor diluting present ownership by issuing additional stock, they have an interest in being lenders, and they may have have consciously or unconsciously influenced corporate policy accordingly.

These relationships, however, also should be viewed in the context of -- and as enhancing the effects of -- a larger financial picture which is, in part, shaped by the integration of commercial banking and investment banking within a single firm. It is a picture which may have an important impact on the nature of a nation's public equity markets. That impact may determine the extent to which public equity markets are a viable alternative to raise needed capital or whether a company will choose, or be limited to, meeting these needs through borrowing. And, it may mean that a privately held corporation's shareholders do not have a meaningful equity market in which to sell its shares and, hence, to provide its shareholders with a means to cash in their investments, the corporation must resort to being acquired.

One consequence of such a financial environment may be reflected in the higher debt to equity ratios which characterize these corporations and which, in turn, raise the question of whether the 1:1 to equity ratio acceptable in the United States is realistic. Other dimensions are less quantifiable. For example, while the public markets are often more risk-tolerant and more willing to accept the newcomer than are major bank lenders, a lender is more likely to appreciate a long-term management orientation than are equity investors, who are too often obsessed with short-term price movements and quarterly earnings reports.

The participation of labor representatives as directors raise somewhat different concerns. Employees have an obvious stake in the corporate enterprise and, in turn, the corporation's achieving the productivity levels necessary to be competitive and profitable depend, to a great extent, on its labor relations. Moreover, this interdependence is further heightened when, through their pension funds, unions become a major shareholder in the private sector and in specific companies in which they may be a major labor factor. The issues raised under the American system by these relationships -- particularly in an unstable economic environment -- have not not yet been fully understood or addressed. Although the United Automobile Workers recently took one seat on the Chrysler board, my perception is that these issues eventually will be addressed in more fundamental ways than a largely symbolic board seat -- and that the Chrysler experience does not foretell a widespread pattern of labor representation on boards in the United States.

The CEO/Chairman

The second subject which board members need to examine is the role of the corporate chief executive officer as chairman of the board. The ties which board members feel to the CEO and their basic desire to be supportive are compelling. The consequences of adding to that power the powers of the chair and of the agenda process must be weighed cautiously. The chairman's role is to create an open, contributing and questioning environment. The CEO's role is to speak for management. These roles and the talents to discharge them are not the same and can conflict.

Board Responsibilities

The final broad issue which boards must consider is the specific responsibilities which the board needs to discharge and how best to approach these tasks. Board committees comprised of outside directors may have an important role to play in the board's satisfying these responsibilities, especially when there are a significant number of insiders on the board as a whole. Special function committees -- such as audit, nominating and compensation committees -- are particularly critical. Audit committees are critical because of the fundamental role which the independent auditor plays in corporate accountability -- a role which necessitates direct access to the board and, particularly, its independent members. With the wide acceptance of the concept of the audit committee, the question which must now be faced is how to facilitate their effectiveness.

Possibly the most significant special function committee in developing effective corporate boards is the independent nominating committee. An effective nominating committee will ensure that board composition and dynamics are not dominated by management -- either through undue authority in appointing board members or by dictating its structure. In this regard, the nominating committee is the vehicle to address the trade-offs between the benefits of, for example, counsel or bankers on the board and the costs of those participants to the board's credibility and effectiveness. More broadly, the most important responsibility of the nominating committee should be to develop a process to assess how well the board is functioning, to evaluate the board and its members, and to select criteria for board candidates which mesh with the board's needs. These functions are part of the board's responsibilities to ensure the adequacy of its operations as a body independent from the corporation's management.

Moreover, an effective compensation committee will also strengthen accountability. Although an on-going business has both a short-term and long-term perspective, many boards wrongly rely exclusively on current performance figures to evaluate and reward management. This situation compounds management's own frequent tendency to have a short-term, bottom-line oriented focus -- a myopia often has a severely negative impact on the corporation's future.

A reliance on short-term performance standards may be inconsistent with the interests of the corporation as a continuing enterprise. Current outlays for research and development, equipment maintenance, new machinery, advertising and personnel development diminish the corporation's current earnings -- a standard yardstick of short-term performance. Similarly, milking a product may make the corporation look good for the present, but it may also injure the corporation, over time, by encouraging potential competitors to enter the market and by leading consumers to switch to substitute products. And, most disturbingly, in some corporations the excruciating pressure to meet profit goals is so severe that some managers have committed illegal acts to induce sales, and falsified corporate books to conceal improper accounting entries designed to improve earnings or put a better face on corporate performance. In essence, racing on a treadmill of never-ending "todays," managers laboring under an unduly short-term orientation may have neither the time nor the interest -- and, indeed, have some real disincentives -- to be concerned for the future direction of the corporation.

Another aspect of the compensation committee's mandate should be to consider the level of director remuneration. The nonmonentary rewards of these posts, such as the prestige and the desire to do the board or its chairman a "favor," are not now as compelling -- particularly when weighed against the increasing time demands and risks of liability and other legal entanglements.

Additionally, depending upon the corporation and the particular circumstances, there may be need for other special function committees -- sometimes, even on an <u>ad hoc</u> basis. For example, when a corporation is the target of a takeover attempt, there may not be a unity between the interests of incumbent management and those of the corporation and its shareholders. Indeed, there may not even be a unity of interest <u>among</u> a corporation's shareholders. For example, one wonders, as a matter of fundamental fairness, whether the interests of speculators -- who move in and out of large positions with little interest in, or concern for, the underlying corporation -- should be allowed to subordinate those of the long-term shareholder, who behaves as a corporate owner. There is need in such situations for a special committee of independent directors to address the offer in terms of its economic sufficiency for <u>all</u> the corporation's shareholders. Who exercises responsibility of ownership? If no one, then government will.

But, such a dollars-and-cents analysis should not end its inquiry. The committee should also look at the reasonable interests in the corporation's independent existence of persons other than its shareholders -- its customers, suppliers, employees and the communities in which it operates. I will return to this point later. Another important, but often overlooked, role of such a committee would be to monitor the statements and actions of its own management and counsel in response to the offer in what is often a very stressful period.

Finally, regardless of the other structural safeguards and accountability mechanisms that may apply, a board which functions without adequate information assumes an unacceptable and unjustifiable risk of failure. Thus, an important board responsibility is to continually assess the quality and adequacy of the information available to it.

As a corollary to this principle, the adequacy of its information has become a necessary element in justifying a board's decisions in the face of challenge. A board which does not receive adequate information is in a position which should be as uncomfortable to its members as it is detrimental to the corporation's welfare. As public institutions -- such as government and the courts -- have reconsidered and rearticulated their expectatons of directorial performance, a subtle -- but significant -- modification has occurred in the evidentiary burden that applies to legal proceedings in which board decisions are challenged. A venerable principle of American corporate law -- the business judgment rule -- has long instructed courts to avoid intervening in a corporation's internal affairs or imposing liability on its directors for good faith judgments dutifully made. More and more, however, when the protections afforded by this precept are claimed, the burden is, in reality if not in law, shifting to the directors who claim their applicability to affirmatively show that the board was, in fact, not impaired by conflicts of interest or loyalty, or by lack of adequate information or deliberation, in the discharge of its duties. In sum -- both for the corporation's welfare and their own -- it is incumbent on directors to regularly examine the adequacy of the information flow available to them as well as the independence of its members.

THE ROLE OF MANAGEMENT

I want now to turn to the second element in meaningful corporate accountability, an effective corporate management, without which no corporation can long survive. In its most fundamental terms, management's ability to generate profit is the key to the success of any corporation.

How can managements reconcile their profit objectives and the need for the kind of accountability of which I spoke earlier? Simply stated, good management, concerned for the future of the company, achieves a harmony of profit-making and other goals; indeed, there is a correlation between companies which think and respond in terms of longer-range corporate responsibilities, including social and political overtones, and those with the best performance records over time.

This connection springs from the unique role that profitablity plays in rewarding and perpetuating businesses which succesfully meet these responsibilities. The profit factor is, in a sense, the ultimate societal regulator of the private sector. Let me explain this concept further. The only justification for the corporate existence lies in its ability to satisfy public needs for goods and services in a competitive market and in a socially responsible manner. Businesses which efficiently satisfy these obligations are commensurately profitable. Adequate profit, in turn, supplies and attracts the capital needed to maintain and build facilities, bring new products to market, advertise, and develop its personnel -- in short, it allows a business to continue, and possibly to grow, as a viable economic enterprise in a competitive environment. On the other hand, businesses which are unsuccessful in meeting such responsibilities are penalized by unprofitability. And, with an almost Darwinian logic, unprofitability, over time, dooms to extinction the business which has failed to satisfy its justification for existence.

Top management must also set the tone in any organization and it must personally see that the staff remains on course. If the standards of top management are high -- indeed as well as word -- the chances are excellent that the standards throughout the organization will be equally high. But, if those at the top do not have high standards it is to be expected that persons below will be influenced by the attitudes of those above them, and the organization's tone will reflect it.

This is the core of the discussion over corporate accountability. If an individual is in a business setting in which every action is justified on purely immediate economic grounds, and in which rewards and punishments are based on short-term economic performance, then, quite naturally, he will shape his conduct to maximize the immediate economic returns of the entity, even at the expense, if need be, of other social values or even the longer-term interests of the corporation and its shareholders.

The result may be positive in the short run. Over the longer term, however, business will destroy itself if it pursues that course. I do not believe society will tolerate permanently a major institution in its midst which justifies itself solely in economic terms -- particularly short term. Nor do I believe that people who staff the entity will be able indefinitely to pursue conduct in their business relationship which is not consistent with other dimensions of their lives.

CORPORATE RESPONSIBILITIES

This leads us into the third standard for meaningful corporate accountability -- an understanding and appreciation by the business community of the status and role of the corporation in society. It is a reasonable assumption that society is unlikely to tolerate, indefinitely, business behavior which the public does not regard as consistent with its own interests.

It is, of course, much easier to speak of corporate public interest obligations in the abstract than it is to apply them to concrete situations. Indeed, what are a a corporation's obligations and to whom? Their essence is, most of all, a recognition of the fact that a corporation is more than the aggregate of its tangible assets and more than the equity of its shareholders. It is an institution with a complex of interpersonal and contractual relationships which create legitimate interests in the corporation's policies and activities among -- not only shareholders -- but also employees, suppliers, customers, communities, and the economy and society at large. It is the board's responsibility to consider all of these interests in the course of its decisionmaking -- not as directors representing any particular causes or constituencies, but as directors who appreciate the societal importance and significance of their decisions.

If the private sector is to retain the freedom which has given it vitality, the board must not abdicate this role, for it is the only entity other than a governmental institution in a position to strike such a balance. Much advocacy for an increased governmental role in the economy may be seen as a consequence of the public perception which I mentioned a moment ago that the private sector does not adequately appreciate and appraise the social significance of its actions. At this point, there is little profit in debating the degree to which that perception is accurate. The task now is to correct both the reality and the perception in order that further governmental intervention will be avoided.

When one talks of adequately appreciating and appraising societal significance, it obviously means neither *pro forma* approval nor rejection of management's programs. It means a balanced, meaningful consideration of the public as well as economic, consequences of a particular business decision. This viewpoint, I believe, is most likely to be a characteristic of independent directors,-- men and women whose perspective goes beyond the parochial concerns of the particular corporation and who are more likely to be immune from the subtle pressures and conflicts which managers still feel when they don directors' hats.

A broad definition of responsibilities does not preclude a board, which has given proper consideration to the societal significance of the corporation's actions, from determining that the corporation's interests require it to act in a particular way even though the interests of some who depend upon the corporation will be unavoidably hurt. Indeed, almost every significant business decision the board must make involves striking a balance between the various groups whose interests are linked to the corporation's.

Indeed, in my opinion, there is no inconsistency between societally responsible behavior and corporate profitability over time. It is too easy merely to look at profitability in its most short-term perspective of economic returns to those persons who happen to be shareholders at a particular moment in time. To condone business conduct by focusing attention only on profit-maximization for the benefit of the corporation's momentary mix of shareholders -- and shareholders can be a very transient clientele -- may be to severely impair the future of the corporation as an institution and the interests of the corporation's shareholders over time. Moreover, it ignores others who have legitimate interests linked to the future of the corporation as an institution.

In many respects, the interests of a corporation's shareholders should be considered in the aggregate -- although recognizing that their individual identities may continuously change -- as an ever-changing body of people and institutions collectively anticipating a future income stream from the corporation. If the corporation fails to meet its larger public responsibilities, almost inevitably its body of shareholders over time will suffer -- either by experiencing future negative bottom line consequences that may, in extreme cases, even lead to bankruptcy or, by seeing potential profits or opportunities diverted to defray the impact of social and political reaction in the form of legislation, increased governmental regulation or judicially imposed liabilities. Absent a decision to liquidate, no corporation reasonably would distribute liquid economic resources to maximize profit for current shareholders without retaining adequate resources to assure its continuing economic viability and development from which future shareholders will profit. Similarly, the corporation should not disregard or dissipate its resource of societal goodwill to maximize short-term profits at the expense of its future viability and shareholders over time. Poor societal or political judgment can be just as destructive to the viability of a particular corporation -- and the corporate institution as poor economic judgment.

CONCLUSION

I opened my remarks by noting the correlation between private enterprise and a free society. But, the future of the private enterprise system, in turn, will be shaped to a significant extent by the public's perception of whether it is accountable to rational, objective decisionmakers who are acting according to publicly acceptable norms. And, while these norms must recognize the importance of the profit factor, they must also consider that, over time, the profit factor cannot be divorced from societal considerations.

I recognize that the challenge of continuing to find solutions to the concerns which I discussed today and preempting an erosion of the private enterprise system is one which will demand the time, commitment and talents of many throughout the industrialized world. But, such an allocation of our resources is necessary because the future of the private enterprise system will affect -- if not determine -- the future of freedom itself.

Thank you.