



Robert A.G. Monks, a pioneer of shareholder activism, takes stock of his odyssey through the rough terrain of corporate governance.

In the early 1980s, the flood of money into private pension plans gave institutional investors enough clout to influence corporate behavior. At the time, Robert Monks, a name that is now synonymous with shareholder activism, was only awakening to the potential of their powerful involvement. He cast a rueful eye around him and surmised that on issues of corporate governance, American companies rated a mere 2 on a scale of 1 to 10. Since then, he has spent his career pressuring executives to manage their companies in the interest of shareholders and persuading investors to shoulder their responsibilities as owners.

Twenty years later, amid headlines screaming of corporate excesses and other scandals, Monks says that he can't assign any American companies a positive rating. Sometimes, it seems as if his uphill struggle has taken him only to the bottom of a mountain.

PIONEER

THE PATH OF A

BY SUSAN TRAMMELL, CFA

Bob Monks has described the path of his life as a series of unintended inputs. A bad night's sleep was only the first.

Was there a defining moment when you realized that shareholders have it in their power to influence management's thinking on their companies' internal operations?

Yes, there was. In 1972, I was a candidate for the United States Senate in Maine. I was in a motel next to the Penobscot River. I woke up in the middle of the night with my eyes burning. When I looked out, I saw a remarkable site. It looked like a pile of foam about two feet high covering the river.

The next morning, the river looked like the river. I recounted what I thought I had seen to the front desk manager, and he said, "Oh, yes! That happens every night." I said, "What are you talking about?" And he said, "How do you think the paper mills get rid of their filth?" And I said, "I never heard of such a thing!" He said, "Welcome to the real world, kid."

I began to reflect on this because I had been, in earlier incarnations, the owner of an oil distribution business [CH Sprague] that sold the fuel that ran these utilities and paper companies on the river. So I knew the people who owned the mills, I knew the people who worked there, and I was pretty familiar with the area. I knew that there wasn't a single constituency who wanted the Penobscot River to be full of that filth at night. Not a person! Yet, here we were. It was almost as if we were locked in a Frankenstein myth by creating something that was going to destroy us, and nobody could stop it.

I lost the Senate election, so I went back to Boston and ended up as the chairman of a trust company called The Boston Company. About a year later, a series of proxies for one of these paper companies came across my desk. I suddenly thought, "My God, there are 50, 100 people just like me, sitting at their desks, and we own these companies. We are the people who have the authority and the responsibility to make some kind of determination as to what these companies do." When I sent in my proxy, that was my waking moment.

Monks has repeatedly spoken out about the break between ownership and control in today's companies. With ownership so diffused, he argues, it is difficult to hold anyone accountable for companies' behavior. It is up to institutional investors to take an activist stance.

How did the passage of Employee Retirement Income Security Act (ERISA) of 1974 [a federal law setting minimum standards for private pension plans] impact the evolution of corporate governance?

The impact of ERISA was vast. It was only three or four years old when I became chairman of The Boston Company, and it was one of our greatest frustrations. ERISA contained provisions that weren't understood and for which no regulations had been written. Instead of many owners, you now had a few owners/shareholders. When you had many owners, it wasn't in any particular individual owner's interest to do something.

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It's the so-called collective action problem: What is in the interest of the group as a whole is not necessarily something that is cost effective for any single member. However, with large institutions, the calculus becomes less minatory.

ERISA described a class: employee benefit plans nationwide. And that class was by far the largest individual shareholder, having perhaps 20 percent of the total outstanding stock. That's a huge piece. If you could energize that piece, you would have "someone" for whom the inhibitions of acting as owner were somewhat reduced. Above all else, the obligation of the ERISA trustee was susceptible to being defined by a single law. Subsequently, what an ERISA trustee was expected to do with respect to the companies whose common stocks were held in their portfolios was codified with some specificity.

Now you and I, as individuals, if we get a proxy in the mail, we're perfectly free to throw it away. ERISA made possible a process whereby you could deal with a class of owner who, unlike individuals, had an obligation to act. That's because a trustee must manage (and this is ERISA language) plan assets in such a way as to preserve and enhance their value. So ERISA owners are legally obligated to function as "owners."

The great revelation was that there are people who had a legal obligation to act. And it has been trying to enforce that obligation that has been my work of the last 20 years.

Shareholder activism has been criticized as meddling in the running of a company's operations. How could outside stakeholders possibly improve the value of their investment any better than insiders?

Shareholders have no business running a company. They don't know enough to do it. Also, they hire somebody else to do it. You've got to be some kind of idiot to be paying for someone to do it and then do it yourself.

To make the position of the shareholders even more clear, I turn to the board. And the board in an American company, I feel, is largely a fiction that is convenient to everybody. It cosmetizes the fact that absolute power rests in a CEO. In an American company, the board, no matter how credentialed, is chaired by and its agenda is set by and its meetings are presided over by the principal person whom the board is supposed to monitor. All the information that board members have to take into account to make their decisions is channeled through that same individual.

If you stop and think about it, you would have to say, “But what could you possibly expect such an instrumentality to produce?” The only thing we can expect of shareholders is that they hold the managers accountable for running the business for their account.

In Hilary Rosenberg’s biography of Monks, *A Traitor to His Class*, Monks confronts accusations of taking a short-term view by advocating that fiduciaries vote in favor of takeovers whenever they maximize current share price.

We’ve seen many examples of mergers and acquisitions that have ultimately destroyed shareholder value. How do you reconcile your views with reality?

If my work in corporate governance has taught anything, it is humility. The other lesson I’ve learned is, if you want something, you’d better be careful because you may get it. With that in mind, let me say three things.

First, our work in The Corporate Library indicates that as many as 70 percent of corporate mergers are value-destroying for the acquiring company. So you’re almost at the position where there’s a very strong presumption that a merger is not going to create value for shareholders.

Second, some very coherent finance law was developed in the ’70s which focused on the discipline of the marketplace — namely, if you didn’t perform, you were taken over. Finance economists viewed this marketplace discipline as being extremely beneficial. But it was naive on my own part not to carefully think this through.

This brings me to my third point: Value is really the critical open question here. Everybody that I know in the finan-

cial world realizes that generally accepted accounting principles followed (or not followed) in the United States are an inadequate measure of corporate performance, or corporate value. The way the numbers are now organized, they’re producing answers that are not related to the real world. You still hear people talk about P/E ratios and things like that. It’s so beguiling to think that one can quantify what’s important in life. The horror of it is, the nasty truth is, that anything that is important isn’t susceptible to being quantified.

In order for “value” to be an acceptable concept for corporate conduct, we need to have an overall accounting revision that takes a holistic approach, or what I call long-term economic value rooted in the social good. Only after that point can you stick with the single bottom line as a basis for mergers and acquisitions.

Between 1985 and 1994, Monks served on the board of directors of Tyco International, which is now embroiled in several corporate scandals, including charges of excessive executive compensation. Monks was a member of Tyco’s compensation committee.

According to your own standard, you should be held accountable for what has taken place at Tyco. What happened back here?

It’s a question I ask myself a great deal. And I will be continuing to ask myself that over the next months, since many of my former colleagues are in the dock. I was a director at Tyco for nine years, and I think the board was clearly outmatched. So what else is new? If you have part-time people coming in, and they’re only furnished information from one source, in hind-



sight, everything looks pretty clear.

I must say that I was very uncomfortable. I would ask if we could have an executive meeting of the board without the principal officers, and nobody would leave the room. I'm 6'6" and 230 pounds, and absent physically removing them, what are we going to do?

Nell Minow [Monks' long-time collaborator] and I wrote a case book called *Corporate Governance*, now in its third edition, and we include suitably edited letters to the CEO of Tyco over the period of time that I was a director. As I left Tyco, I literally danced out the door for reasons that became sadly clearer after four or five years. But the ultimate question remains, and it's one I can't answer: Why should people who have been paid enormous sums of money want to jeopardize all that by trying to get three times as much? I have no answer to that. It's just sadness.

If management's peers are not the best judge of an issue such as senior management compensation, then who is?

The way you ask the question assumes the legitimacy of the process by which the CEOs got the pay they presently have. In my view, the process is fundamentally corrupt. First, the Business Roundtable, comprised of CEOs, was a leader in bullying the accounting profession to drop its proposal that the cost of options be included as a corporate expense. At that point, managers began saying to compensation committees, "Look, you can give us options and it doesn't cost anything. So we ought to have a lot of them." You began to have mega-grants and mega-mega grants, followed by huge increases in corporate pay. Not entirely coincidentally, that is exactly when the worst kind of fiddling with the numbers began.

"Why should people who have been paid enormous sums of money want to jeopardize all that by trying to get three times as much?"

Would you want to put yourself out there with a proposal to replace the current executive compensation system?

I think that we're sitting here with the whole reality of the power of CEOs. Business people aren't bad people, but they certainly use their power to enrich themselves. If this is genuinely thought of as being a problem, you can't get a solution by having a better compensation committee. You've got to *do* something. The problem has got to be considered important enough that the owners get together collectively. The government can even be involved.

In England, there's a simple provision in the Companies Act [the principal law regulating business entities] that is in the corporate law of virtually every country in the world outside the US. And this provision states that a percentage of the shareholders (in England, it's 10 percent) can call a special

meeting of shareholders at which a majority can get rid of any or all of the directors, with or without cause. However, this provision is not part of the corporate law of any one of the 50 [US states]. There's no question but that under our corporation law, shareholders are virtually without rights.

That's why [Security and Exchange Commission] Chairman William Donaldson's initiative to get shareholders involved in nominating directors is such an important one.

Am I correct that mutual funds are now required to disclose how they vote their proxies on stocks they hold?

Yes, the SEC was responsible for that. Mutual funds and other investment companies are required to disclose their actual proxy votes. The first filings are due by 31 August 2004.

Monks has gone on the record of accusing the principal officers of publicly held American companies of transferring approximately US\$1 trillion of corporate wealth from shareholders to themselves. Such a development, if true, casts doubt on the effectiveness of corporate governance.

You were quoted as saying that you are particularly aggrieved by the latest rounds of corporate scandals and excess. Given your long-standing involvement in corporate governance issues, why should today's news be any worse?

In 1990, an absolutely charming, erudite human being named Graef Crystal wrote a book called *In Search of Excess: The Overcompensation of American Executives*. "Bud" Crystal said CEO pay was vastly excessive at that time. Between 1990 and the year 2000, CEO pay increased 6.6 times (which is *Business Week's* number) or 10 times (which is a more common view), and it was excessive to start with.

I have never seen a justification for why CEOs should suddenly be worth 6 to 10 times as much as they were worth in 1990. Ratios to starting-level pay and ratios to pay of CEOs in other countries that are utterly unprecedented — I haven't seen anybody say they're more productive or that they're rarer. It is simply that they have, under the American rule, more power.

Over the past few years, Monks has been collaborating with William Lerach, a prominent, though controversial, litigator on behalf of shareholders.

One can't help but make the observation that perhaps there is just so much that an active shareholder can do. What are our readers to think?

About two and a half years ago, I came to the conclusion that I had been given a fair amount of praise for presumably having accomplished something. In reality, we had accomplished very little. There continues to be utter inadequacy of boards or compensation committees or any other governance device to monitoring or disciplining CEO pay. So I've been affiliating myself with a shareholder law firm [Milberg Weiss Bershad

Hynes & Lerach] in settlement negotiations. We've been able to get companies like Sprint and Hanover Compressor to actually change their bylaws. In the case of Hanover Compressor, shareholders may now nominate three directors. That's become real.

Is your work with William Lerach's law firm more gratifying?

You know, it isn't really. It ought to work. I feel I'm reduced to a position that is on the edges. You're talking about a whole different thing when you're talking about shareholder litigation. The only reason I did this is that I'm not as young as I used to be. [Monks is 71 years old.] I don't feel a loss of energy, but I just have to look at the actuarial tables to know that I don't have an infinite number of five-year plans ahead of me.

So I say, "If I'm going to get anything done, I had better cut out the nicety." We spent all this effort to set up ISS, LENS, The Corporate Library, and all these things. But at the end of the day, when you look at what CEOs pay themselves, you have to say, "Folks, sorry about that, but this just ain't working."

In the early days of ISS, the major issues were the board's use of greenmail and poison pills. Today, it's executive compensation. Were there any shareholder resolutions that you sponsored but later regretted?

The only thing I regretted was that I did not speak out loudly enough against at-the-money options. They are such a one-way street that they are really an evil. ISS did some very good work in the sense of developing two formulae for dilution and creating a framework within which options could be accepted or not accepted. But the trouble was that it presumed the legitimacy of options, if you follow me.

You have suggested that Harvard Management Company generates enough fees from managing Harvard's endowment to support a corporate governance staff. Is there a practical approach for money managers who don't have HMC's resources?

It may be that some kind of collective organization should be organized. I lay out in the appendix of a book I wrote called *The Emperor's Nightingale* a scenario for what I call special purpose trust companies [independent entities charged with voting the shares held by pension funds and other fiduciaries]. But it is yet to come. What is important is to realize that it is possible, and probably desirable, that people delegate this responsibility the same way they delegate other special investment needs to specialist organizations.

What is your prognosis for the future of shareholder activism?

The government has laws that say you've got to act in the interest of the shareholders uniquely. If the government enforces the rule, I'm very optimistic. If the government doesn't enforce it, I'm very pessimistic. People will continue to be activist only when they find it convenient. ▀

Susan Trammell, CFA, provides business plan writing and market research services through her New York, NY, USA, consulting firm.



Robert A.G. Monks is the publisher of www.ragm.com, a website devoted to global issues in corporate governance. A graduate of Harvard Law School, Monks began his career as an associate and later a partner in a Boston law firm. He served as vice president of Gardner Associates, an investment management company, and later became president and chief executive of CH Sprague & Son Company, a coal and oil concern. Monks was subsequently appointed a board member and chairman of the board of The Boston Safe Deposit & Trust Company and The Boston Company.

Monks spent part of his career in public service. He became a director of the US Synthetic Fuels Corporation through appointment by President Reagan, who also appointed him one of the founding trustees of the Federal Employees' Retirement System. As administrator of the Office of Pension and Welfare Benefit Programs in the Department of Labor, he had jurisdiction over the entire US pension system.

In 1985, Monks founded Institutional Shareholder Services, Inc. Now the leading corporate governance consulting firm, ISS advises shareholders on how to vote their proxies. He stepped down as ISS president in 1990 and subsequently founded the investment fund known as LENS, which has developed the institutional activist mode of investment. In 1998, the same investment principles were brought to the United Kingdom with the founding of Hermes LENS Asset Management Company, for which Monks currently serves as deputy chairman.

In addition to having served on the boards of 10 public corporations, Monks is the author or co-author of several books on corporate governance. Excerpts or full-text versions of his writings may be found at thecorporatelibrary.com, which he co-founded in 1999.