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Fear and Regret—Or Trust?

From "Transparency as a Way to Control" to "Radical Transparency to Empower"

Peter Verhezen

Pushing the boundaries of common practices, Peter Verhezen recommends a radical form of transparency that indicates a very different type of board governance - where top management and the firm's employees are trusted to always do the right thing, and where there is a "no secrecy" context, based on trust instead of fear. Boards' servant stewardship and compassionate transformative leadership should empower people to achieve a meaningful enlightened purpose.

Foreword

Nell Minow, one of the pioneers of American corporate governance, once remarked caustically that "Company directors behave like sub atomic particles—they behave differently when observed." That's why so much effort has gone into encouraging and forcing quoted companies to practice ever-greater transparency—on executive pay, on audit, on governance, and on social and environmental issues. Indeed whole industries of professionals and an alphabet soup of organizations have now joined accountants in helping companies define what they should measure, and whom they should report those measures to.

In this radical piece, Peter Verhezen asks us to consider the value of this practice, and whether it is encouraging the right behavior. He advocates a standard of "radical transparency," growing from a fully trusting relationship between those who report and those who monitor. He offers this as part of a paradigm shift in corporate governance from rules and structures, which he suggests are based on fear, to trusting relationships based on full accountability.

About IFC Corporate Governance Group

The Group brings together staff from investment support and advisory operations into a single, global team. This unified team advises on all aspects of corporate governance and offers targeted client services in areas such as increasing board effectiveness, improving the control environment, and family businesses governance. The Group also helps support corporate governance improvements and reform efforts in emerging markets and developing countries, while leveraging and integrating knowledge tools, expertise, and networks at the global and regional levels.

At this point, some of the more hard bitten of us may struggle with the utopian nature of the vision. But we would do well to heed some of the fundamental questions that Verhezen is raising about the value of information.

Over the last generation, the corporate governance movement has pressed for ever more data, the idea being that the greater the volume of information the better outsiders can understand and evaluate company behavior. But what we have all too often forgotten is what Nell Minow said. Asking companies for information is not like taking the temperature of a patient; it is more like setting the curriculum for an exam. The patient's temperature is not affected by being measured. But a student's behavior is profoundly altered by the sorts of questions that will be in the test. So for companies, if you ask for quarterly results, you will get behavior based on hitting that target. If you ask for remuneration to be reported, you may have CEOs competing to see who can make the most. If you ask for thousands of rigid rules to be applied to accounting numbers, or risk controls, you can bet your bottom dollar that someone will be looking to find a loophole in them.

Yet our systems of reporting are dangerously blinkered to these problems. Take for example that noble experiment, the attempt to create International Financial Reporting Standards. Nowhere in its mission does the International Accounting Standards Board mention that the first purpose of accounting is to ensure that companies are properly managed, not just to pass on information to investors. The reason we observe companies through the lenses we do is because they will behave differently when that observation is made. Get the wrong measures and you get the wrong results.

And ultimately, Verhezen is right to remind us that no system of reporting and no set of contracts can enforce good behavior. As investors, we depend on being able to trust that corporate executives will look after their owners' interest. Openness and transparency can help with that. But they are part of a much larger governance ecosystem, whose objective is to ensure the proper use of entrusted (not just contracted) power.

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> *No problem can be solved from the same level of consciousness that created it.*
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> *—Albert Einstein*

Most organizations are engaged in an ongoing quest for more transparency and accountability in an effort to comply with the more stringent regulations that were put in place after the financial crisis and corporate ethical debacles. However, we suggest being more mindful of why a board imposes more transparency, and we recommend a more *radical form of transparency*. This kind of transparency indicates a very different type of board governance, where top management and the firm's employees are trusted to always do the right thing, and where there is a "no secrecy" context, based on trust instead of fear. If transactional leadership is about mobilizing people to achieve a purpose through control,[1] then servant stewardship or compassionate transformative leadership means empowering people to achieve a meaningful enlightened purpose.

1. FEAR, REGRET, TRANSPARENCY—CONTROLLING THE ORGANIZATION

What happens when investors expect a company to deliver continuously growing or persistent earnings per share—and the company thinks that's normal? Often, the company's response is a frantic effort to satisfy the investors' relentless appetite. And that—not surprisingly in a competitive business environment—can lead to cutting corners or taking the easiest route to profits while avoiding accountability. The result is almost inevitably a loss of trust and confidence in the company.

However, a company can begin to turn that situation around by 1) improving corporate responsibility on an institutional level and 2) practicing candor aligned with integrity on an individual level. Although those "best" governance practices[2] will not restore trust and confidence overnight, they can substantially reduce, though not eliminate, the likelihood of corporate crises and/or corrupt behavior. Best practices that help steer corporations away from disasters include securing the rights of majority and minority shareholders alike, verifying duties, and performing authority checks and balances.

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1 J. Nye, *The Powers to Lead* (Oxford: Oxford University Press, 2008).

2 Asymmetric information between the owners and the more informed executives is assumed to create agency challenges, especially in larger companies and in more advanced economies. In many emerging markets, the corporate governance challenge is related to the protection of minority shareholder rights against the greater powers of majority shareholders, whether a family or state. Top executives are much less powerful and thus less of a typical agency challenge.

As captains of governance, boards have a central role in building and maintaining trust in their companies. Instead of feeding fear and distrust among top management and employees, boards can embrace scalable entrepreneurial solutions that better align and integrate profitability motives with social and ecological goals. Profitability in the interest of shareholders is never the only major benchmark for judging an organization's performance; and believing that it is—and focusing on it—is a gross misrepresentation of what drives successful businesses.

To elucidate this point, it makes a lot of sense to distinguish *good* profit from *bad* profit. Bad profits arise when companies save money by delivering a lousy customer experience—in effect, extracting value from customers instead of creating value.[3] Managers, in an effort to spike short-term "bad" profits to enhance their own remuneration, may reduce the value proposition to customers either through 1) unjustified price increases or reduction in the quality of their products and services, or 2) slashing costs, for instance by laying off employees. They are, in essence, transferring value from customers to the firm, and ultimately to themselves through bonuses.

And so when a corporation focuses only on creating shareholder value—even if that means extracting value from customers or employees—it will likely create dissatisfied customers or employees who may become *detractors* or *disengaged*. The damage to such a corporation can be dramatic, since those detractors are customers who not only cut back on their purchases but also may switch to the competition if they can, and may even warn others to stay away from the company. Boards and senior management that have such a focus on creating shareholder value are inviting a possible addiction to bad profits, and that can demotivate employees and other critical stakeholders. Despite some possible very short-term windfalls, shareholders should be wary of such bad profits, since the resentment by other stakeholders may further undermine the company's prospects in the future.

"Good" profits, on the other hand, have a strikingly different effect. A company earns good profits by delighting its customers, creating loyalty in the process. These customers not only willingly come back for more purchases, but they also *promote* and recommend the company to friends and family.[4] And we can easily assume that the best-known and most reputable companies have generated a high degree of loyalty among their customers

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[3] F. Reichheld, "The microeconomics of customer relationships," *MIT Sloan Management Review* 47, no. 2 (Winter 2006): 72–78.

[4] If the distinction between "bad" and "good" profits clearly shows differences in long-term profitability, why then are most companies not following the good advice by embracing this "Golden Rule"? Accounting procedures cannot yet fully distinguish a dollar of good profit from a dollar of bad. And financial accounting revenues and margins—not necessary real economic profitability—determine how managers fare in their performance reviews. See the interesting book by Fred Reichheld, *The Ultimate Question: Driving Good Profits and True Growth* (Cambridge, MA: Harvard Business School Press, 2006).

and employees, and likely among their investors as well. Some examples are Vanguard in the mutual funds industry, Amazon.com in the online business, Southwest Airlines in the budget airline segment, and Singapore Airlines in the premium-class airline segment. All of those companies can count on loyal customers and proud employees, who carry the firm. And the result is impressive sustainable or consistent profit levels.

However, accounting results are largely indifferent to good relationships and only "care" for profits, bad or good. And yes, the importance of these customer promoters is overlooked, because they do not show up on anybody's profit and loss statement or balance sheet. We all know that what gets measured creates accountability, though accountability and responsibility for building and preserving good relationships with customers and other critically relevant stakeholders get lost in the shadows of those accounting figures.

2. A QUEST FOR MORE TRANSPARENCY AND ACCOUNTABILITY

Global competition and recent corporate disasters have brought to the forefront pressure for improved corporate governance[5] and, in particular, transparent leadership. The centers of authority are supposed to function as "stewards" and "guardians" of information, for the sake of their owners and ultimately for the sake of the public at large.

Guarding corporate information versus transparency in an open society

We often hear that not all corporate information can or should be shared with all stakeholders, competitors, or the public at large. Obviously, organizations have a legitimate interest in withholding and guarding from competitors certain information about innovations, original processes, secret recipes, or corporate strategies as well as sensitive information about human capital. However, the need to be sensible and reasonable about keeping certain information from the outside world should not be used as an excuse for secrecy—the main characteristic distinguishing corruption from ethical corporate behavior.[6]

At one extreme of information disclosure is *secrecy*, which corresponds to traditional loyalties and hierarchies. At the other extreme is *radical transparency*, based on fundamental respect for individual autonomy while acknowledging growing interdependencies of the global participants. (See Figure 1.)

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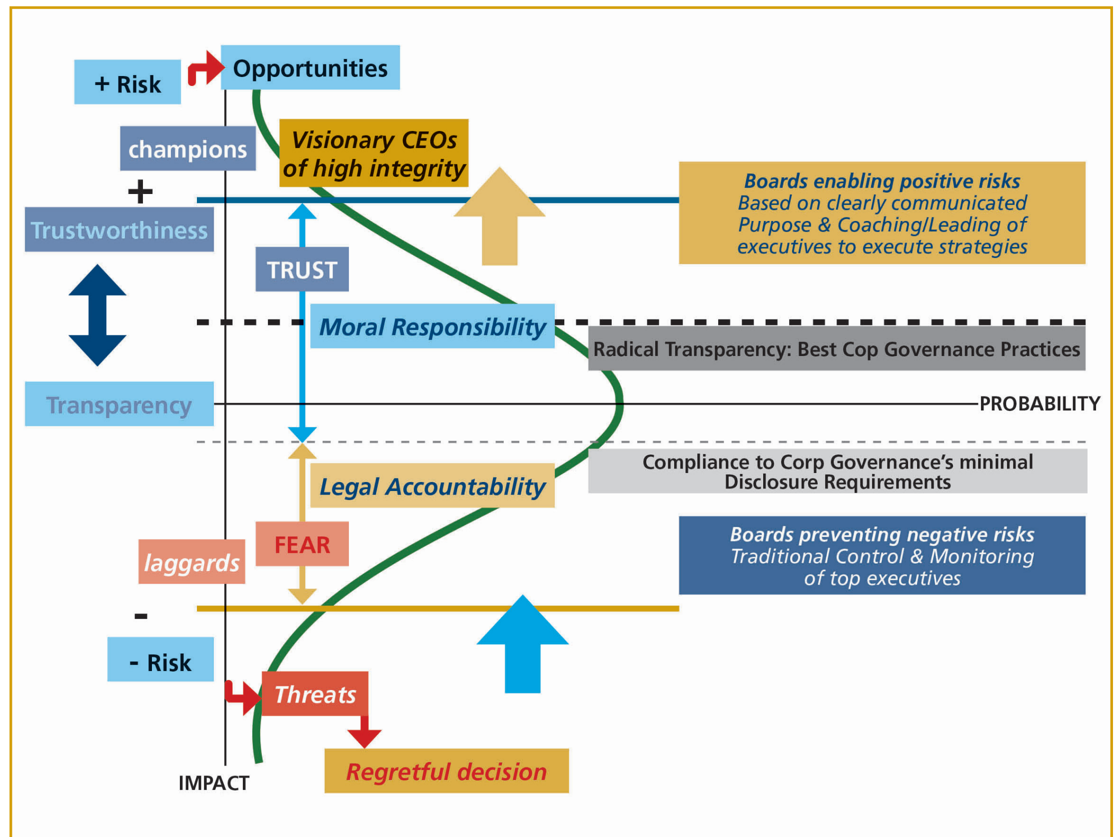
[5] A. Zattoni and F. Cuomo, "Why adopt codes of good governance? A comparison of institutional and efficiency perspectives," Corporate Governance 16 no. 1 (January 2008): 1–15; and B. Holzner and L. Holzner 2005, Transparency in Global Change: *The Vanguard of the Open Society* (Pittsburgh, PA: Pittsburgh University Press).

[6] K. L. Ho, ed., *Reforming Corporate Governance in Southeast Asia: Economics, Politics and Regulations* (Singapore: ISEAS Publications, 2005); B. Kogut, "Country capabilities and the permeability of borders," *Strategic Management Journal* 12, no. S1 (Summer 1991): 33–47; C. Millar, T. I. Eldomiaty, C. J. Choi, and B. Hilton, "Corporate governance and institutional transparency in emerging markets," Journal of Business Ethics 59, no. 1-2 (June 1, 2005): 163–74; and P. Verhezen, "Giving voice in a culture of silence," *Journal of Business Ethics* 58 (Spring 2010): 249–59.

Figure 1: Radical Transparency versus Minimal Disclosure Requirements



Source: Framework developed by Peter Verhezen.

The ideal of transparency assumes that more information about the functioning of a publicly listed corporation reduces the likelihood of corporate misbehavior and increases the chances that it will perform better. However, only if a firm is fully investigated by a regulator or institutional authority is it truly possible to verify the information it provides. Enron and Parmalat are by now infamous cases that prove this point. Both disclosed massive amounts of data as required under their respective capital market regulators, and both were able to deceive the public. Despite ostensibly being transparent about their internal financial data and codes of conduct, they did not tell the truth. Conversely, it is easy to imagine that there are corporations with stellar performance that are not fully transparent.

Transparency is linked to the value of "respect for individual autonomy" that often leads to a form of *generalized trust* in an open society. Moreover, such an attitude of transparency logically requires access to needed information, based on the assumption that the public at large has a reasonable claim to assess that information. This is in contrast with the notion of *secrecy*, which limits individual autonomy and is linked to hierarchies, obedience, and discretion, resulting in some form of *particularistic trust*[7] within a closed circle only.

[7] See E. M. Uslaner, *The Moral Foundations of Trust* (Cambridge: Cambridge University Press, 2002): "Generalized trusters presume that most people they meet share their values, whereas particularistic trusters view the outside world as a threatening place over which they have little control."

Secrecy—hiding information intentionally—should be distinguished from *opacity*,[8] which is the absence of information and a lack of transparency. Opacity and secrecy are ancient tools of authority, long used in most, if not all, societies. Calling for more transparency can easily appear to be an onslaught against tradition, identity, and security as well as against the established authority and power of the governing elite. But it can also be seen as a fight against corruption, inequity, and authoritarianism, and for freedom, openness, civil rights, and personal autonomy. The key to any good investment is clarity, while the lack of transparency and candor erodes trust and discourages collaboration.

Despite legitimate moral and legal limits on disclosure, leaders should aspire to a policy of "no secrets."[9] The emergence of innovative Internet and communication technology has led to profound changes in our global culture; the ever-present "Internet eye" scrutinizes any possible shady (corporate) behavior and immediately blares it in the openness of Twitter, YouTube, or Facebook. Moreover, since brands are using social media, you can now "friend" a brand; so when you are "friends" with a brand, you expect it to behave like a friend. Openly publishing the recipes and operations data of the organization proves that there is nothing to hide. Transparency is no longer simply desirable; technologies[10] and changed expectations have made it unavoidable.

Genuine seasoned leaders of global corporations[11] encourage honest sharing of information, endorsing good corporate governance that creates a reputation of candor underpinned by trust and respect. Moreover, such transparent policies, supported by appropriate risk management, may enable corporations to be better prepared to face risky events, which are sometimes more fierce and unexpected than could be imagined. For those in power to be accountable, the value of trustworthiness must inspire a *culture* of transparency, candor, and individual responsibility, thus providing the "glue" for a new, more effective phase of governing in organizations. A "trust but verify" attitude can emerge only when there is greater transparency and enhanced accountability.

Ultimately, a company with good governance structures in place will attract talent, skilled management and investors who are willing to pay a premium for stockholding in a well-managed and transparent corporation.[12] Research suggests that firms with higher

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8 J. Kurtzman, G. Yago, and T. Phumi wasana, "The global cost of opacity," *MIT Sloan Management Review* (Fall 2004): 38–44; and J. Kurtzman and G. Yago, *Global Edge: Using the Opacity Index to Manage the Risks of Cross-Border Business* (Boston, MA: Harvard Business School Press, 2007). The opacity index analyzes five areas of concern: corruption in business and government; ineffectiveness of its legal system; negative aspects of its economic policy; inadequacy of its accounting and governance practices; and detrimental aspects of its regulatory structures.

9 W. Bennis, D. Goleman, and J. O'Toole, *Transparency: How Leaders Create a Culture of Candor* (San Francisco: Jossey-Bass, 2008).

10 A. Pentland, "With big data comes big responsibility," *Harvard Business Review* (November 2014): 100–04. The "New Deal on Data," as suggested by MIT Professor Alex "Sandy" Pentland, rebalances the ownership of data in favor of the individual whose data are collected.

11 See http://www.gmiratings.com. Governance Metrics International (GMI) maintains ratings on the corporate governance practices of over 3,200 global companies, evaluating them based on 1) board accountability and independency of directors; 2) financial disclosures and internal control; 3) executive compensation; 4) shareholder rights and minority rights; 5) ownership base, ownership concentration, and takeover provisions; and 6) corporate behavior and responsibility. Such metrics are used not only by institutional investors but also by credit rating agencies, lenders, and even regulators.

12 A McKinsey survey in 2001 proved that foreign investors are willing to pay considerable premiums (20 percent to 30 percent above the market stock value, depending on the country of origin of the investment) for companies in emerging countries that implement internationally recognized "minimum" governance standards.

transparency and disclosure practices are valued more highly than comparable firms with lower transparency and disclosure practices.[13]

We expect a much greater propensity of policymakers to mandate and enforce transparent corporate reporting in countries where investor's rights are well protected. In the absence of a viable judicial system to enforce contracts, relationship-based arrangements, and private social capital, there is a need for enforcement mechanisms that consequently rely less on publicly disclosed information.[14] Powerful, centralized, closed governments will likely constrain the financial development of disclosure to maintain power and capture wealth through politically connected interest groups. Such regimes may thwart financial development to maintain their economic advantage by suppressing competition.

In other cases, where economic institutions may not be sufficiently developed for private banks to play a crucial development role, state ownership may take over that development role. Given the propensity for autocratic regimes to limit freedom of the press, it is arguable that those less open political regimes could easily suppress corporate transparency, hence the quest for more open or less opaque regimes. Business transparency could even be dangerous in a regulatory environment with poor quality and uneven enforcement. In such situations, firms that disclose profits can still be subject to arbitrary government audits and expropriation by corrupt public officials. When the state is directly involved in the economy, as is still the case in a number of emerging countries, it may suppress firm-specific information to hide expropriation activities by politicians and their cronies.[15]

Institutionalized transparency

Institutional transparency[16] is firmly entrenched in financial reporting and should be distinguished from individual *transparent leadership*, which is closely related to the notion of accountability. Both transparent-leadership (encompassing efficient compliance and reporting requirements) and compassionate-integrity strategies are necessary to create a better and more effective market system that optimizes resource allocation. In other words, it is not greed, ignorance, or neglect but rather *institutionalized transparency* and *individual candor* that function as compasses to guide boards and top management in steering the corporate ship away from murky waters. Communicating the core values of

[13] R. La Porta, F. Lopez-De-Silanes, and A. Shleifer, "Corporate ownership around the world," *Journal of Finance* 54 no. 2 (April 1999): 471–517; R. La Porta, F. Lopez-De-Silanes, A. Shleifer, and R. Vishny, "Investor protection and corporate governance," *Journal of Financial Economics* 58 (2000): 3–27; W. D. Crist, "Corporate governance, public policy, and private investment decisions," in *Corporate Governance and Capital Flows in a Global Economy*, P. K. Cornelius and B. Kogut, (New York: Oxford University Press, 2003): 383–400; and S. A. Patel, A. Balic, and L. Bwakira, "Measuring transparency and disclosure at firm-level in emerging markets," *Emerging Markets Review* 3, no. 4 (2002): 325–37.

[14] A. Dixit, "On modes of economic governance," Econometrica 71, no. 2 (2003): 449–81; and P. Verhezen, "Guanxi: Networks or nepotism?" In *Europe-Asia Dialogue on Business Spirituality*, L. Zsolnai, ed. (Antwerp: Apeldoorn, Garant, 2008): 89–106.

[15] A. Shleifer and R. Vishny, "Politicians and firms," *Quarterly Journal of Economics* 109, no. 4 (1994): 995–1025; and R. M. Bushman, J. D. Piotroski, and A. J. Smith, "What determines corporate transparency?" *Journal of Accounting Research* 42, no. 2 (2004): 207–52.

[16] Millar, Eldomiaty, Choi, and Hilton, 2005: 166: "Institutional transparency is the extent to which there is publicly available clear, accurate information, formal and informal, covering accepted practices related to capital markets, including the legal and judicial system, the government's macroeconomic and fiscal policies, accounting norms and practices (including corporate governance and the release of information), ethics, corruption, and regulations, customs and habits compatible with the norms of society."

an organization plays a major role in promoting a transparent culture, and some authors suggest that continuously doing so will improve the efficiency of relationship building.[17]

Institutional transparency, either mandatory (as for financial information relevant to investors) or voluntary (as found in ecological and ethical information relevant to stakeholders), is a necessary but not sufficient condition to guarantee responsible and accountable behavior. It is not enough to disclose large volumes of information. Rather, it is important to understand the perceived value of voluntary disclosure items as they relate to the needs of individual stakeholders.

There seems to be a growing demand for more (voluntary) disclosure on ecological and socioethical topics, whereas a corporate desires to guard and keep sensitive strategic information as private as possible. Nonetheless, empirical evidence suggests that voluntary social and environmental reporting—or any form of CSR (corporate social responsibility) or ESG (environmental, social, and governance) reporting—is often the result not only of increased pressure on firms to be more accountable but also of its success as a risk management tool and public relations management to legitimize the firms' sustainability credentials.[18] The sport shoes manufacturer Puma's radical ESP&L (environmental and social profit and loss) reporting suggests that a new trend is potentially taking hold in the corporate world.

Improved disclosure and dissemination can have a positive effect on the efficiency of obtaining capital[19] or can enhance the firm's reputation.[20] Some firms in countries with weak investor protection and disclosure standards may choose to cross-list in countries with stronger standards and requirements, aiming to attract and protect additional (minority) shareholders.[21] In a nutshell, the main reason why corporations adhere to a high level of transparency is threefold:

- improvements in information disclosure, which usually result in better recommendations by financial analysts and thus lessen risk (because of reduced information asymmetry), resulting in increased institutional ownership and broader analysts' following;
- improvements in stock liquidity also due to less information asymmetry, and thus a higher share price; and

[17] G. Markarian, A. Parbonetti, and G. J. Previts, "The convergence of disclosure and governance practices in the world's largest firms," *Corporate Governance* 15, no. 2 (2007): 294–310.

[18] D. Hess, "Social reporting and new governance regulation: The prospects of achieving corporate accountability through transparency," *Business Ethics Quarterly* 17, no. 3 (2007): 453–76; D. C. Esty and A. S. Winston, *Green to Gold: How Smart Companies Use Environmental Strategy to Innovate, Create Value, and Build Competitive Advantage* (Hoboken, NJ: John Wiley & Sons, 2009); and R. Henderson, "Making the business case for environmental sustainability," Working Paper 15-068 (Boston: Harvard Business School, February 2015).

[19] D. Uren, *The Transparent Corporation: Managing Demands for Disclosure* (Crow's Nest, NSW Australia: Allen & Unwin, 2003).

[20] Bennis, Goleman, and O'Toole, 2008; C. J. Fombrun and M. Shanley, "What's in a name? Reputation building and corporate strategy," *Academy of Management Review* 33, no. 2 (1990): 233–58; and C. J. Fombrun, *Reputation: Realizing Value from the Corporate Image* (Boston: Harvard Business School Press, 1996).

[21] M. Reese and M. Weisbach, "Protection of minority shareholder interests, cross-listings in the United States, and subsequent equity offerings," *Journal of Financial Economics* 66 (2002): 65–104; M. Grüning, "Drivers of corporate disclosure: A structural equation analysis in a Central European setting," *Management Research News* 30, no. 9 (2007), 646–60; and R. E. Verrecchia, "Essays on disclosure," *Journal of Accounting and Economics* 32, no. 1-3 (2001): 97–180.

- reduced capital costs because of lower information risk through increased stock liquidity as measured by a narrower bid-ask spread.

Although prompt disclosure of news may generate greater volatility in the short term, it should produce a stronger market following and on average a higher share price over a longer period.[22] Well-established markets do not like delayed bad news, and therefore it is good to develop a reputation for being candid, forthcoming, and open.

Also, if there were an increase in the quality of available information—the result either of more stringent reporting or of better analysis by institutional investors or media—we could expect CEO salaries to increase and the rate of CEO turnover to be much higher. The substantial increase of remuneration in the 1990s is to a large extent attributable to the demand for more complex management, partially as a result of the higher level of press scrutiny and investor activism.[23] In other words, rightfully pressing for more transparency is not without costs: 1) higher remuneration to CEOs, who in return are willing to succumb to the increased market pressure and potential liabilities; and 2) shorter average CEO tenures.

In a highly uncertain environment, such as the one we faced in the recent financial global crisis, better outcomes may sometimes result when some "tentative" information is withheld. For example, voluntary disclosure of managerial earnings forecasts could produce more uncertainty in asset markets.[24] Unless the publicly disclosed information is sufficiently precise, more transparency could create a risk that coordinated expectations may diverge from fundamentals, leading to suboptimal solutions or even unreasonable panic reactions. Demanding more transparency without strengthening or changing the foundations may be counterproductive, especially in volatile situations.

3. RADICAL TRANSPARENCY: MORE PURPOSE AND TRUST; LESS FEAR AND REGRET

Individual candor and institutionalized transparency become part of the organizational culture when corporate leaders agree that openness is valued, and individual responsibility and institutionalized accountability are rewarded accordingly. Whereas transactional agency theory assumes self-interested opportunism as a given of human nature, resulting in the presumed need for monitoring and control, a focus on responsibility and integrity points to a more complex view of causality, in which top management motives are themselves conditioned by governance processes and relationship building. One step further would stipulate that boards and transformative top executives focus on providing or creating meaning and purpose in an organization that likely alleviates employees' motivation and consequently their efficiency and productivity.

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[22] G. Boesso, "How to assess the quality of voluntary disclosures? An index to measure stakeholders reporting and social accounting across Italy and US," 2002 AAAF Conference New Orleans, *Journal of Accounting and Financial Research* 1 (2003).

[23] B. E. Hermalin and M. S. Weisbach, "Transparency and corporate governance," NBER Working Paper 12875 (Cambridge, MA: National Bureau of Economic Research, 2007): 1–25.

[24] L. F. Ackert, B. K. Church, and A. B. Gilette, "Immediate disclosure or secrecy? The release of information in experimental asset markets," *Journal of Economic Literature* 13, no. 5 (2004): 219–43.

The typical interpretation of the fiduciary duty of loyalty and care is for the company to maximize shareholder value or profitability, for which top executives and employees are held accountable. However, we suggest fine-tuning this fiduciary duty of loyalty and care to suggest a more deeply ingrained form of decision making, where *meaning* and *purpose* play a central role and profitability is the consequence of such behavior.

A growing number of socially conscious customers will opt for products and services from organizations that have thought through their corporate purpose and clearly communicate why they are doing what they do so well. Meaning and purpose always transcend the coercion of legal requirements. Merely complying with the letter or even the spirit of the law hardly motivates any employee, executive, or customer. Legislation alone cannot make corporations responsible, open, and healthy.

Radical transparency linked to radical accountability

It is an *attitude* that somehow brings a sense of responsibility into the realm of the corporate and political world. The legendary investor Warren Buffett reportedly looks for managers who are "hard working, smart, and honest." Recent corporate scandals strongly indicate that the first two of these qualities without the third can be disastrous.[25] It is in the interest of corporations to earn trust and to be perceived as trustworthy, which confirms that only an integrity-based strategy—including accountability, responsibility, and openness, supported by fair governance boundaries—will succeed in the long term.

Leaders of great companies assume they can *trust* people and can rely on *relationships*, not just *rules* and *structures*. They are more likely to treat employees as self-determining and self-managing professionals who coordinate and integrate their activities by self-organizing and generating new ideas.[26] Such a paradigm definitely differs from the traditional mainstream approach of "feudal" corporate governance. Whereas traditional governance subtly instills fear through more control, this new approach attempts to instill trustworthy behavior by opening up the organization with a zero-secrecy policy. Such organizations trust people to do the right thing by consistently adhering to the evolutionary purpose[27] of the organization.

True enough, many of us hold deeply ingrained assumptions about people, work, and governance that are based on fear—assumptions that call for an ideology of feudalism or hierarchy and control. One consequence is the high value that companies have come to place on independence in traditional corporate governance structures. Globally, the trend is to have more independent (non-executive) directors on boards, though there is

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25 J. M. Wellum, "Long-term stewardship and our capital markets," *Management Decision* 45, no. 9 (2007): 1387–96.

26 See R. Kanter, "How great companies think differently," *Harvard Business Review* (November 2011); C. Handy, *The Second Curve. Thoughts on Reinventing Society* (London: Random House, 2015); and R. Charan, D. Carey, and M. Useem, Boards that Lead: When to Take Charge, When to Partner, and When to Stay Out of the Way (Cambridge, MA: Harvard Business School Press, 2014).

27 An evolutionary purpose indicates that organizations, just like people, have a calling and an evolutionary energy to move toward that calling. See F. Laloux, *Reinventing Organizations. A guide to Creating Organizations Inspired by the Next Stage of Human Consciousness* (Brussels: Nelson Parker, 2014): 200. Laloux believes that an evolutionary purpose relates to the "deepest creative potential to bring something new to life, to contribute something energetically, valuably to the world. . ."

no definite proof that independence always ameliorates financial performance. Through radical transparency, the element of control is less of a focal point, but it becomes embedded in the organizational culture.

A culture of truthfulness and candor is characterized by virtues of humility, service to others, and respect for people—exactly the opposite of sheer hubris, which is at the root of the downfall of many executive leaders who fall into that trap. It is the board's responsibility to reward a culture of candor, hence the importance of independent directors, who are usually better placed than others to provide disinterested and objective truth telling. Nonetheless, insiders or family members may add enormous value within such a culture of candor. Boards seek a more subtle and harmonious balance between outsiders, who can bring additional knowledge and wisdom, and insiders, whose intimate knowledge of the organization and the current "incarnation" of its values and culture are highly valuable to the success of the organization. A diverse and balanced board, with both insiders and outsiders, should exemplify a conscious attitude of independence, beyond mere compliance, in the best interest of the organization.

In an organization of radical transparency, there is no culture of fear. In such an open organization, teams that have bad or inferior results do not need the protection of anonymity or opacity. On the contrary, teams that go through a difficult phase are trusted to own up to the reality of the situation and search for solutions.[28] This "owning up" is not just the responsibility of the board or top executives[29] but also of everyone in the organization, all of whom become more accountable and responsible for the performance of the teams. And compared to current corporations, they all share more proportionally the downside as well as the upside of their efforts.

The practice of sharing almost all information puts everyone in the same position as the CEO of a traditional company. It forces people to grow up and face unpleasant realities. As a matter of fact, under this new approach, organizations are not perceived as a nexus of contracts but rather as an intricate web of fluid relationships and commitments that people engage in to get their work done. Internal collaboration may become more predominant than competition to achieve organizational goals. In such a situation professionals fill in a number of granular roles and do not necessarily have a "job."[30] Governance meetings where radical transparency is promoted are more about questioning the roles and collaboration of the teams than about control and hierarchies. The goal is not to aim for perfect and definite answers but rather to find a workable solution and apply it swiftly and efficiently throughout the organization. It is about total responsibility and radical accountability on the part of all members of the teams and the organization.

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[28] Laloux, 2014.

[29] R. Charan, *Owning Up: The 14 Questions Every Board Member Needs to Ask* (San Francisco: Jossey-Bass, 2009).

[30] L. Gratton, *The Shift: The Future of Work is Already Here* (London: William Collins, 2011); and L. Gratton, *The Key: How Corporations Succeeded by Solving the World's Toughest Problems* (New York: McGraw Hill, 2014).

With *radical transparency* comes *radical accountability*. Companies that sincerely care about gaining the trust of their stakeholders, starting with customers, have to not only tolerate but also *embrace* scrutiny. It is not enough just to redesign some of the business practices, the executives and board also have to invite their customers to trust them by showing what goes on inside the company. Some companies, such as Patagonia, go so far as to place videos about their actual operations on their websites. Another example, The online Zappos company, is toying with a radical change in management structures, embracing radical transparency, though admittedly about 20 percent of the old workforce, especially managers made redundant, are leaving the company. Online retail company Everlane, founded in 2010 by a then 25-year old venture capitalist, has embraced radical transparency as its main strategy.[31] It even displays its cost and price structure online; such a level of transparency is still very rare in business.

Understandably, most companies and their boards and executives fiercely resist such dramatic change in behavior. Nonetheless, the rewards of being perceived as trustworthy can become the foundation of great collaborative teamwork and wonderful customer relationships. By letting everyone see us as we truly are, we make our transparent business practices more accountable—in a quite radical way.

From self-preservation to purpose

The core of our conjecture states that trust breeds trust[32] while fear breeds fear, referring to the old spiritual truth that *we reap what we sow*. Attempts to reduce fear and regret through pushing for more transparency as a way to control an organization are not likely to bear the desired fruits. Quite a number of contemporary organizations, where fear and control and hierarchy are the main drivers, motivate their executives through extrinsic incentives as expressed in ever-increasing remuneration packages—and penalties if the objectives are not met.

Another approach is to trust[33] people and executives through a *radical form of transparency* that focuses on intrinsic motivators found in a *meaningful* and clearly communicated *purpose* of the organization, backed up with self-managing teams. When organizations move from an external form of transparency to inform shareholders to a more internal form of transparency, management's drive for self-preservation turns into a quest for purposeful meaning of the businesses.

[31] Everlane's website, www.everlande.com, indicates how it applies radical transparency.

[32] It is interesting that neuroscience research reveals that if people were given certain hormones or neuropeptides, such as those that decrease the sense of fear or increase the feeling of trust, people's social behavior could change. See T. Singer, "Empathy and the interoceptive cortex," in Caring Economics, T. Singer and M. Ricard, eds. (New York: Picador, 2015); and D. W. Pfaff, *The Altruistic Brain: How We are Naturally Good* (Oxford: Oxford University Press, 2015).

[33] Laloux (2014) quotes Alexander Newman's argument that it was affective rather than cognitive trust in the leader that transmitted the effects of ethical leader behavior to the follower members of the organization. But cognitive trust serves as an antecedent to the development of affective trust.

Paradoxically, by *focusing on purpose rather than profits*, a company often finds that profits tend to roll in more plentifully than they did when the focus was on maximizing profitability or shareholder value. Patagonia's motto is simple and powerful: purpose comes before profits. And the results are extraordinary. Another revealing example is Medtronic's search for meaning. Its success is not measured by earnings per share but by how many people can be helped. The role of an *authentic "servant leader"* is to bring people together for a meaningful purpose that empowers people to lead.[34] Profit is necessary—as is fresh air. And investors deserve a fair return, but the objective is purpose rather than profit; we breathe to live, but we don't live to breathe.

Radical transparency could be the mechanism that glues together collaborative efforts. Even a big corporation like Ford was able to turn itself around after the global financial crisis by having managers and employees be succinct and honest in their business plan reports, thus overcoming the custom of leaders managing the information flow for self-preservation. The mindset shifted, and the managers and employees made decisions faster and coordinated actions more effectively.[35]

When people in an organization truly live for its purpose, there is hardly any competition. It exists in a "blue ocean"[36] and creates a sphere of abundance in contrast to the traditional assumption of scarcity that breeds fear. Such an organization shifts *from self-preservation to purpose*, a shift that transforms many key organizational practices, including how boards are run. The focus is not the self-preserving rat race of boosting market share and constantly increasing profitability at any price. However, as long as today's organizations remain primarily concerned with self-preservation and the bottom line, exploring the calling and purpose of the organization and its employees likely sounds like an empty slogan.

More subtle control mechanisms based on trust instead of fear could be more effective in a number of organizations and industries.[37] The social media transformation is shifting the focus from old-style leadership as commander and controller toward the leader as influencer, shaper of eco-communities and ecosystems instead of ego-systems, architect of decisions, boundary spanner, and builder of alliances. Empathy, reflection, and an appealing narrative will become more central. A paradigm switch from mere *predicting and controlling* to *sensing and responding* may be needed to ingrain some radical form of transparency into managing an organization.[38] It will require both the board and the CEO to buy into and support this adapted paradigm, which emphasizes collaborative relationships more than hierarchical command-and-control structures.

[34] B. George, P. Simms, A. McLean, and D. Mayer, "Discovering your authentic leadership," *Harvard Business Review* (February 2007): 129–38; and B. George, "Compassionate leadership," in *Caring Economics*, T. Singer and M. Ricard, eds. (New York: Picador, 2015).

[35] R. Charan, *The Attacker's Advantage. Turning Uncertainty into Breakthrough Opportunities* (Cambridge, MA: HBS Press, 2015).

[36] Blue ocean strategy is the creation of an uncontested market space. See W. C. Kim and R. Mauborgne, *Blue Ocean Strategy: How to Create Uncontested Market Space and Make Competition Irrelevant* (Boston: Harvard Business Review Press, 2005).

[37] Obviously, skewed payoffs—indicating fierce competition among organizations, as in certain industries such as smartphone businesses—sometimes cannot be avoided. See P. Rosenzweig, *Left Brain, Right Stuff: How Leaders Make Winning Decisions* (London: Profile Books, 2014).

[38] Laloux, 2014.

In many organizations the leadership and employees apparently feel enormous vulnerability at the prospect of radically opening up; yet paradoxically the results of doing so would be an uncovering of potential strength and enhanced resilience and trust(worthiness). Companies such as Southwest Airlines or Whole Food in the United States, or Novo Nordisk and Unilever in Europe, are vocal advocates of this more balanced stakeholders' perspective.

However, the next evolutionary step would be an organization that transcends mere "stakeholder management" and control of the environmental context and moves toward unleashing vast new energies within the organization by pursuing its own calling or unique evolutionary purpose, where employees, top executives, and board members are all stewards or partners of the organization and working to achieve the full organizational potential. Patagonia, for instance, is exploring new ecosystems as an unfolding "sharing and caring economy," explicitly including a social and environmental purpose. Are we not all at our most productive and joyful when we are energized by a broader, more appealing purpose that nourishes our inner energy, when we are excited about a cause beyond mere profits, where we can make a real difference?

Concluding remarks: An inspiring board that monitors but also leads

Fear is often a poor guide for business decisions, and regret usually comes too late. If we are aware that it is not the wind but the sails that determine the course, we will be able to avoid regret and to overcome fear. A transparent company fosters a culture of openness and inclusion and therefore is able to adapt to unexpected shifts in market conditions.

Allowing information to flow through all the veins of the organization and changing the way we look at an organization will result in very different energy dynamics. And if we are willing to reflect on this new organizational experience, we will be able to learn from it, making us more productive and confident in the process. Embracing a much vaster perspective of positive, constructive, and courageous dynamics, rooted in total transparency based on trust and not on fear, will most likely create a virtuous circle. Let us not forget that the common denominator of those who "do something" is conviction borne of a higher purpose. Following the calling of a meaningful purpose stokes the courage necessary to act transparently, building trust in the process.

Both Aristotle and Confucius suggested, at about the same time, that the overall good of the group (organization or state) takes moral precedence over the individual aspirations of persons in power. Visionary and compassionate *transformative leaders* and their boards function like alchemists who bring to the physical realm purposeful dreams and hopes that become attainable in a sensible business proposition. *Radical transparency* and a revisited corporate governance could provide its framework.

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