8th Annual Global CEO Survey

Bold Ambitions, Careful Choices*

PricewaterhouseCoopers

Our 8th Annual Global CEO Survey focuses on governance, risk management, and compliance (GRC)—areas of critical concern to business leaders in every industry. At a time of economic uncertainty, the importance of GRC transcends geographic borders. For this year's report, more than 1,300 global CEOs were asked to state their perceptions of GRC and to assess their progress, their successes, and their failures. What emerges from these interviews is a model of effective GRC that points the way to higher performance. The report also features global economic indicators and an assessment of global economic conditions, as well as one-on-one interviews with four global business leaders who provide in-depth, personal perspectives on how they and their organisations are meeting the challenges of GRC.

In this, our 8th Annual Global CEO Survey, PricewaterhouseCoopers takes a detailed look at governance, risk management, and compliance (GRC)—a subject that is becoming increasingly important to CEOs around the world. More than simply a response to burgeoning laws and regulations, GRC is becoming a value-adding principle that is being embraced by an ever-growing number of leading organisations throughout the global business community.

In itself, GRC is not new. As individual issues, governance, risk management, and compliance have always been fundamental concerns of business and its leaders. What is new is an emerging perception of GRC as an integrated set of concepts that, when applied holistically within an organisation, can add significant value and provide competitive advantage.

We surveyed more than 1,300 CEOs to probe their attitudes about GRC, to gauge their progress, and to determine their perceptions of GRC benefits. We discovered that while the majority of CEOs understand the importance of GRC and its potential to deliver positive results, most are struggling with implementing its basic elements. In this survey, we attempt to chronicle that struggle and to provide benchmarks for other organisations that also are wrestling with the complexities involved in moving up the GRC learning curve.

The title of this year's report—Bold Ambitions, Careful Choices—reflects the cautious optimism that pervades the CEOs' responses. It is evident in their aggressive investments for future success and in their perceptions of threats to business growth prospects. Not surprisingly, it also comes through loud and clear in their approach to GRC.

No survey, regardless of scope, can provide all of the answers to the challenging issues discussed in this report. What we do hope to provide is insight into the state of GRC at a large number of leading global organisations. Our analysis examines GRC best practices and pitfalls in a way that posits a model of GRC excellence. I trust that this year's Global CEO Survey accomplishes these objectives.

Samuel A DiPiazza Jr
Chief Executive Officer
PricewaterhouseCoopers International Limited

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Highlights

- Very few CEOs (7 percent) view GRC as related solely to laws and regulations, and a majority (54 percent) consider GRC to be an integrated set of concepts and practices. Yet, only 25 percent state that they are managing GRC effectively. Pages 17, 32
- While a majority of CEOs are very confident that their organisations can respond to GRC matters related to domestic laws and regulations (68 percent) and to internal policies and procedures in domestic business units (57 percent), only 26 percent are very confident that their organisations can respond to similar matters related to foreign laws and regulations and only 24 percent to matters related to internal policies and procedures in foreign business units. Pages 17-18
- The CEOs indicate that, in varying stages of development, eight significant elements of effective GRC are in place at their organisations. However, when asked about full development of these elements, responses ranged from a high of only 53 percent to a low of 22 percent. Page 19
- In high numbers, the CEOs credit GRC with having a major, positive effect on legal liabilities (64 percent) and on reputation and brand (56 percent). However, they perceive other benefits less clearly. Page 23
- While many CEOs say that they adequately address stakeholders' concerns that are based on clear-cut legal requirements, fewer feel the same level of comfort with other constituents, whose expectations are more ambiguous. Page 24
- Fifty-eight percent of the CEOs indicate that GRC expenditures are primarily an investment; 38 percent view them primarily as a cost. Only 17 percent of all CEOs state that they can very accurately measure GRC costs. Pages 25, 27
- The 25 percent of CEOs who state that they are managing GRC effectively have an advantage over their peers in perceiving GRC benefits and in responding to stakeholders' GRC concerns. Advantages are also evident when business units feel ownership of GRC issues and when the organisation and collection of GRC information are fully automated. Pages 32-43
- The CEOs are optimistic about the future. Over 90 percent express confidence in their companies' prospects for revenue growth over the next 12 months. Page 7
- In response to low-cost competition, nearly 40 percent of the CEOs are engaging in offshoring or planning to do so. While these CEOs see the benefits of offshoring, they also perceive the risks. Pages 9-13

Survey Participants and Methods

For the eighth edition of PricewaterhouseCoopers' Global CEO Survey, 1,324 interviews with CEOs were conducted throughout the world in the last quarter of 2004. The majority of interviews were conducted on the telephone, with regional exceptions in Japan, where a postal survey was administered, and in China, Kenya, and Nigeria, where face-to-face interviews took place. The entire research effort was coordinated by the PricewaterhouseCoopers International Survey Unit, located in Belfast, Northern Ireland, in close cooperation with a team of project managers and members of a global advisory board of PricewaterhouseCoopers partners.

By region, 392 interviews were conducted in Europe, 297 in the Asia-Pacific region, 257 in South America, 224 in the United States (plus, in North America, 80 in Canada and 39 in Mexico), and 35 in Africa. By industry, financial services companies represent 18 percent of the interviews; technology and media companies represent 10 percent; and companies in the products sector (consumer and industrial products manufacturers, distributors, and retailers) represent 72 percent.

Twenty-seven percent of the respondents' companies earn revenues in excess of $1 billion; 13 percent earn $500 million to $1 billion; 51 percent earn less than $500 million; and 9 percent offered no revenue information. Regionally, the highest concentration of companies earning more than $1 billion is in Europe (37 percent), followed by Asia-Pacific (32 percent), and the US (30 percent).

The vast majority of survey participants report revenue growth over the past three years, with the largest number of CEOs (34 percent) being in the 5 percent to 10 percent range. Sixteen percent indicate revenue growth of more than 20 percent; 21 percent report 11 percent to 20 percent growth; and 23 percent are in the 0 percent to 4 percent range. Only 6 percent of respondents report negative growth.

Regarding earnings over the same period, the largest number of respondents (26 percent) report growth in excess of 20 percent. Twenty-two percent indicate growth of 11 percent to 20 percent; 23 percent report 5 percent to 10 percent growth; and 24 percent are in the 0 percent to 4 percent range. Only 6 percent of respondents report negative earnings growth.

Forty-one percent of respondents serve on boards of directors other than their own. Of these, 10 percent serve on more than five boards, 7 percent on five, 11 percent on four, 15 percent on three, and 28 percent on one. The largest number of CEOs (29 percent) serve on two other boards.

NOTE: Not all exhibits add up to 100 percent due to rounding of percentages and to the exclusion of "neither/nor," "refused," and "don't know" responses.

1 A New Optimism: Opportunities, Challenges, Strategies

Ask five experts to assess the global economy, and they are likely to provide as many different answers. Whether related to trade imbalances and currency fluctuations or to skyrocketing energy costs and increasing regulations, uncertainties abound. Yet the CEOs in this survey are optimistic about their prospects for growth and are investing today to secure future success. Is their optimism unbridled? No. It is an optimism grounded in reality and tempered by caution.

In remarks addressed to the American Enterprise Institute on December 5, 1996, US Federal Reserve Board chairman Alan Greenspan used the words “irrational exuberance” to describe an attitude within the world’s investment community that could result in “escalated asset values, which then become subject to unexpected and prolonged contractions…” First regarded as a warning concerning the excesses inherent in the “bubble” economy of the late ’90s, the term has since entered the common lexicon and has come to characterise an unrestrained but thoroughly baseless optimism of the kind that deluded both investors and executives, preventing them from recognising the potential for failure found in flawed business models and faulty strategies.

Today, a new kind of optimism is emerging, one that is tempered by a keen awareness of risk and governance and of the need to manage them effectively. For this survey, we interviewed CEOs from around the world about their level of confidence in their ability to achieve revenue growth over the next 12 months. We also asked them about potential threats to their businesses and about how they were responding to both the challenges and opportunities offered by current global economic conditions. What emerged from these efforts is evidence of an increased understanding among the CEOs that their goals and objectives—their bold ambitions—cannot be realised in a vacuum that excludes the realities of a rapidly changing global business environment.

In short, they are exhibiting an exuberance that is quite different from that of the past—a “rational exuberance” that acknowledges the great potential that lies before them but does so within a context that provides the main subject of this report: governance, risk management, and compliance.

EXHIBIT 1 PROSPECTS FOR REVENUE GROWTH

How would you assess your level of confidence in prospects for the revenue growth of your company over the next 12 months?

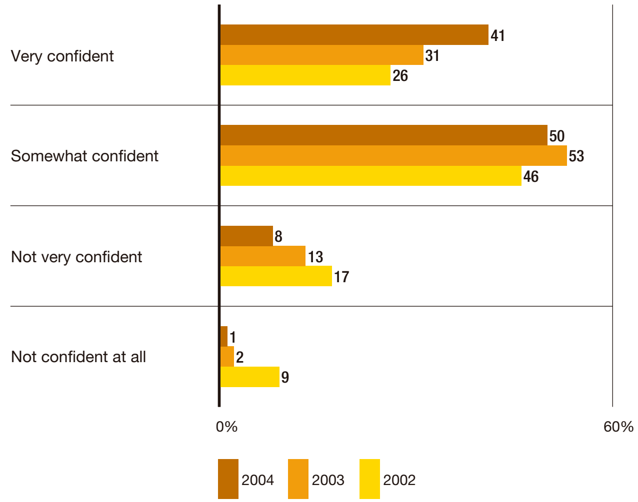
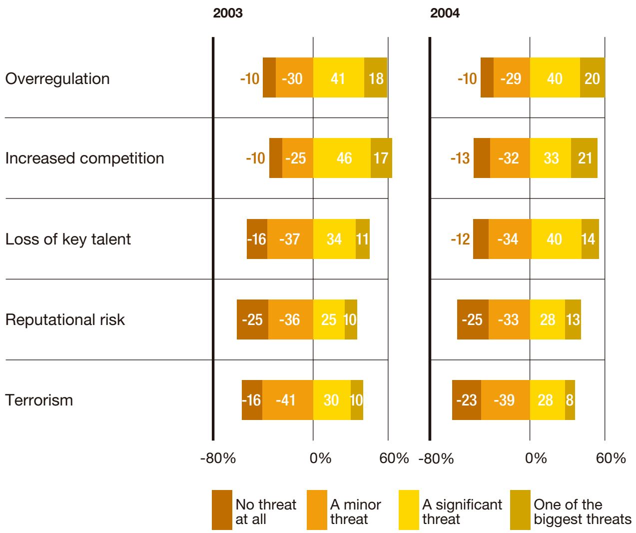


EXHIBIT 2 THREATS TO BUSINESS GROWTH—YEAR-TO-YEAR COMPARISON

What are the potential threats to business growth prospects?



Assessing the Global Outlook

As economies throughout the world have emerged from the period of slow growth and recession that has been plaguing companies since the collapse of the so-called New Economy of the ’90s, there is no question that confidence among CEOs is on the rise and has been since at least 2002. As **Exhibit 1** indicates, 41 percent of this year’s respondents report a high level of confidence in their companies’ prospects for revenue growth over the next 12 months. This figure is up from 31 percent in 2003 and only 26 percent in 2002. And when “very confident” and “somewhat confident” data are combined, results indicate a steady increase from 72 percent in 2002 to 84 percent in 2003, to an astonishing 91 percent in 2004. Not surprisingly, there is a parallel but obverse slope to the data reporting on lack of confidence. Whereas in 2002, 26 percent of CEOs surveyed were not very confident or not confident at all in their companies’ prospects for revenue growth, that figure declined to 15 percent in 2003 and dropped even further to 9 percent in 2004.

That rising level of confidence among CEOs is not based on a lack of awareness concerning threats to business growth prospects. Rather, confidence prevails in spite of such threats. While confidence among this year’s respondents has risen, their perceptions of significant threats mirror those reported in the 2003 survey **(Exhibit 2).** Apparently, the CEOs have accepted higher levels of risk as a given and have incorporated that assumption into their business lives.

As it did last year, overregulation tops the list of potential threats to business growth, increasing one percentage point to 60 percent. Interestingly, despite the demands placed on US public companies by the Sarbanes-Oxley Act of 2002, US CEOs (54 percent) rank behind European CEOs (61 percent) and South American CEOs (71 percent) in identifying overregulation as a significant threat or one of the biggest threats.

As in 2003, increased/low-cost competition is perceived as a significant threat. While 63 percent of 2003 respondents identified increased competition as a significant threat or one of the biggest threats, 54 percent did so in 2004. In 2003, 45 percent of CEOs felt that loss of key talent was a significant threat or one of the biggest threats. This increased to 54 percent in 2004. As the immediacy of September 11 continues to recede, so, too, does terrorism in the minds of CEOs. Terrorism, as a significant threat or one of the biggest threats, dropped four percentage points in 2004 to 36 percent.

Other threats that loom large in the minds of CEOs are oil prices, market volatility, the rising cost of social welfare, and changes in political direction **(Exhibit 3).** Consistent with uncertainty caused by fluctuations in the cost of energy, 55 percent of CEOs designated oil prices as a significant threat or one of the biggest threats. However, an equal number indicated market volatility. Possibly reflecting concerns over an aging population and, in some economies, rising unemployment rates, 46 percent chose the rising cost of social welfare. Forty-one percent selected changes in political direction. At 29 percent and 25 percent respectively, intellectual property piracy and inflation are less-pressing concerns. However, at nearly 30 percent, it is clear that, as a concern, intellectual property piracy is no longer limited only to a handful of industries.

EXHIBIT 3 THREATS TO BUSINESS GROWTH

What are the potential threats to business growth prospects?

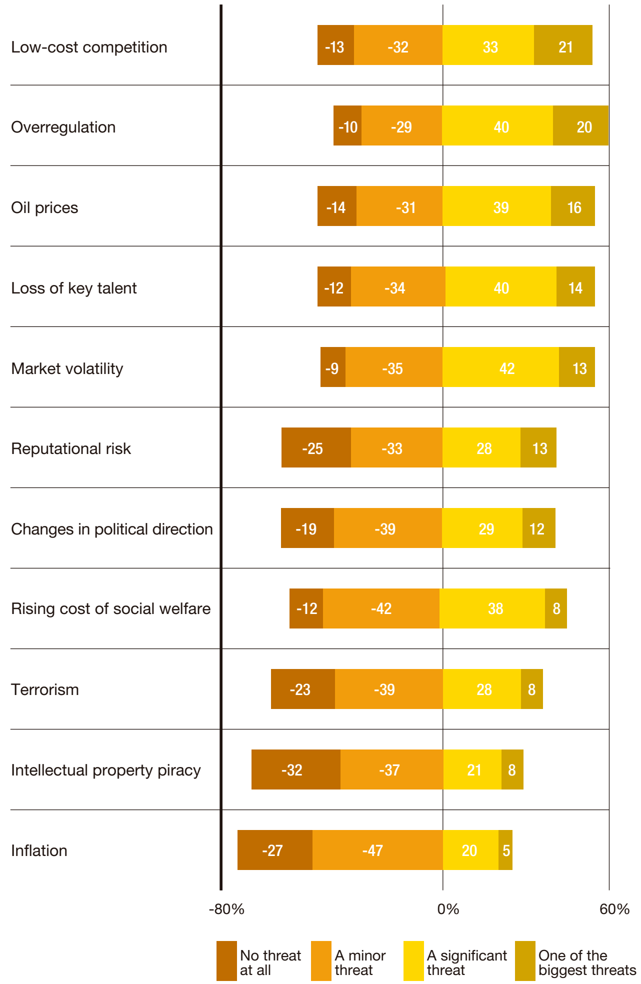


EXHIBIT 4 OPPORTUNITIES AND CHALLENGES

What methods are used to deal with the opportunities and challenges presented by current global economic conditions?

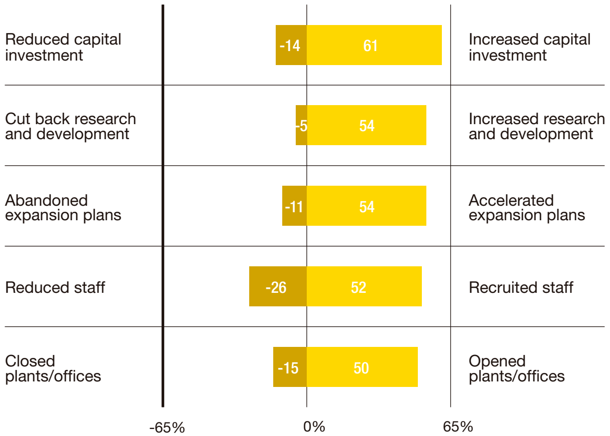
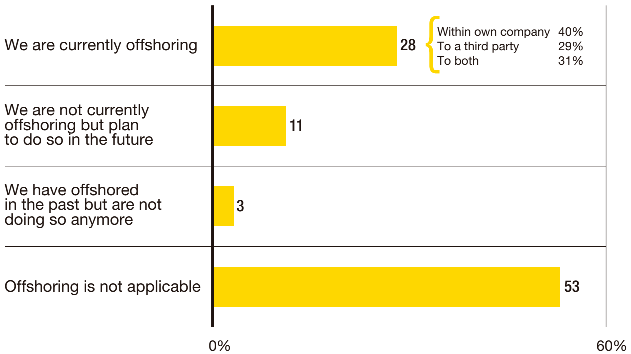


EXHIBIT 5 OFFSHORING PRACTICES AND PLANS

Which of the following best describes your company's position on off-shoring? Do you currently offshore within your own company or to a third party?



Despite the number of risks they perceive, the CEOs responding in this survey are dealing with current global economic conditions by aggressively pursuing investment opportunities. For example, as **Exhibit 4** indicates, 61 percent have increased capital investment; 54 percent have increased research and development; 54 percent have accelerated expansion plans; 52 percent have recruited staff; and 50 percent have opened new plants and/or offices.

And, in response to the risk posed by increased/low-cost competition, 371 CEOs—just over one-quarter of the total sample—are engaging in offshoring. We next look at this controversial practice through the eyes of CEOs who have embraced it.

Offshoring: A New Business Reality

Offshoring—the transferring of business processes and functions to overseas locations where costs are lower—has become an established practice among 28 percent of the CEOs questioned **(Exhibit 5),** and another 11 percent, not currently offshoring, plan to do so in the future. Of the 28 percent actively engaging in offshoring, 40 percent do so within their own companies; 29 percent utilise third parties; and 31 percent do both. While 28 percent and, potentially, 39 percent are significant numbers, equally significant is the fact that 53 percent of the CEOs say that offshoring is not applicable to their companies.

As **Exhibit 6** confirms, offshoring is a global phenomenon. While 21 percent of US companies are engaging in offshoring, 25 percent are doing so in Europe, 35 percent in South America, and 31 percent in Asia. However, as shown in **Exhibit 7,** US companies and South American companies (27 percent and 36 percent, respectively) are more likely to offshore to third parties than are European and Asian companies (24 percent and 23 percent, respectively).

EXHIBIT 6 OFFSHORING PRACTICES AND PLANS—BY REGION

Which of the following best describes your company's position on offshoring?

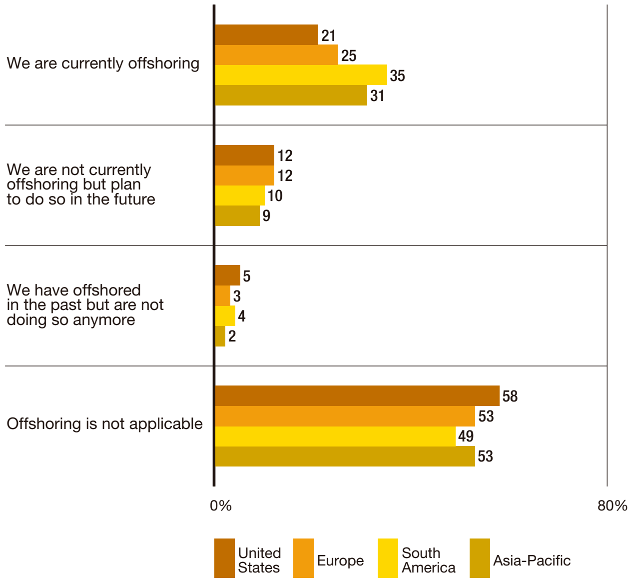


EXHIBIT 7 OFFSHORING DESTINATIONS—BY REGION

Do you currently offshore within your own company or to a third party?

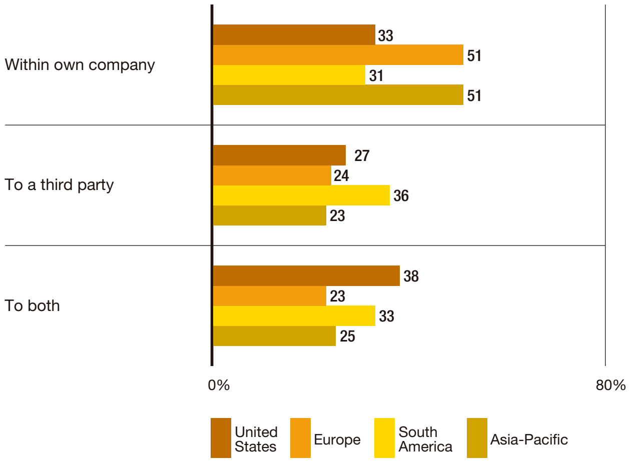
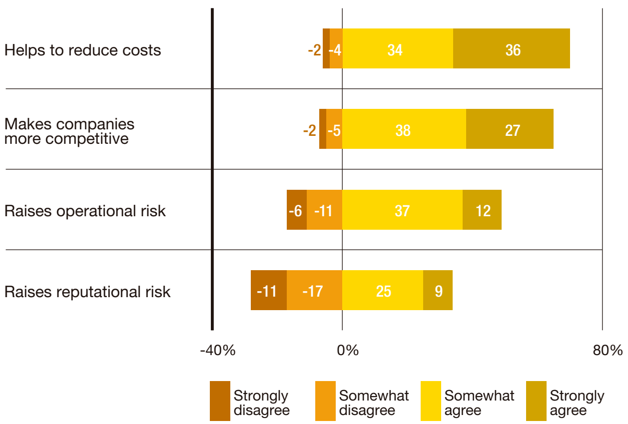


EXHIBIT 8 VALUE OF OFFSHORING

What are your perceptions of offshoring?



Offshoring is generally viewed as a cost-cutting measure, and, not surprisingly, the results of our survey bear out this notion. When asked to choose among several commonly held perceptions of offshoring (Exhibit 8), 36 percent strongly agree that offshoring helps to reduce costs, a higher response than that given to any other statement. Closely related to cost reduction, increasing competitiveness comes in a strong second, at 27 percent. However, there is also agreement among the CEOs that offshoring generates risks as well as benefits, but the data suggest that many of the CEOs have these risks under control. Only 12 percent strongly agree that offshoring raises operational risk, and only 9 percent strongly agree that offshoring raises reputational risk.

Looking at these data by region **(Exhibit 9)** yields a number of interesting observations. First, there is clearly a broad consensus across the regions that offshoring helps to reduce costs. Second, the US and European CEOs appear to be most cognisant of the risks associated with offshoring, with 16 percent of US and European CEOs strongly agreeing that offshoring raises operational risk. Last, the CEOs who see the greatest benefit in offshoring—those in the US and Europe—also perceive the greatest risk.

EXHIBIT 9 VALUE OF OFFSHORING—BY REGION

What are your perceptions of offshoring?

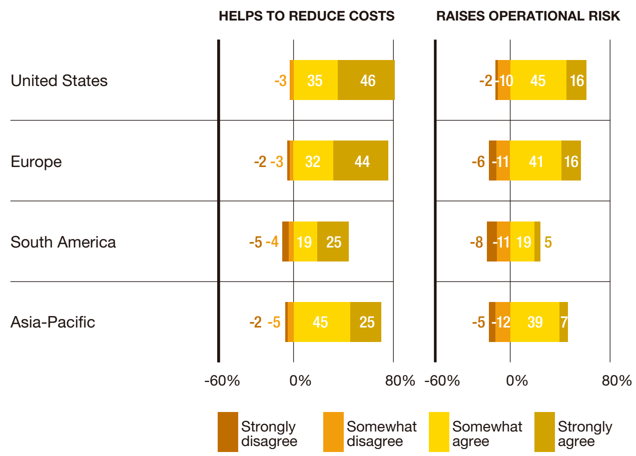
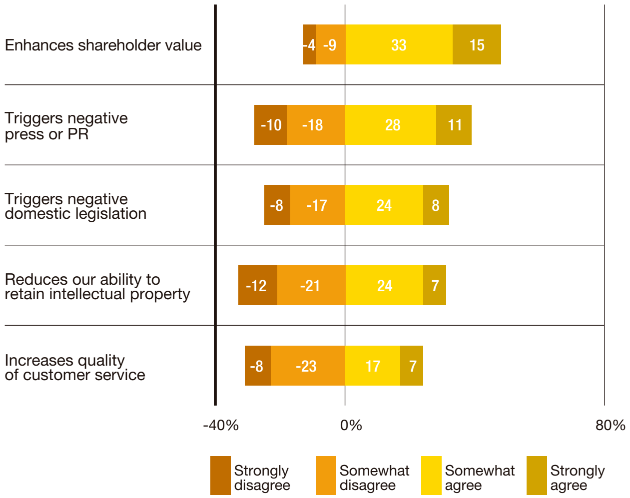


EXHIBIT 10 VALUE OF OFFSHORING

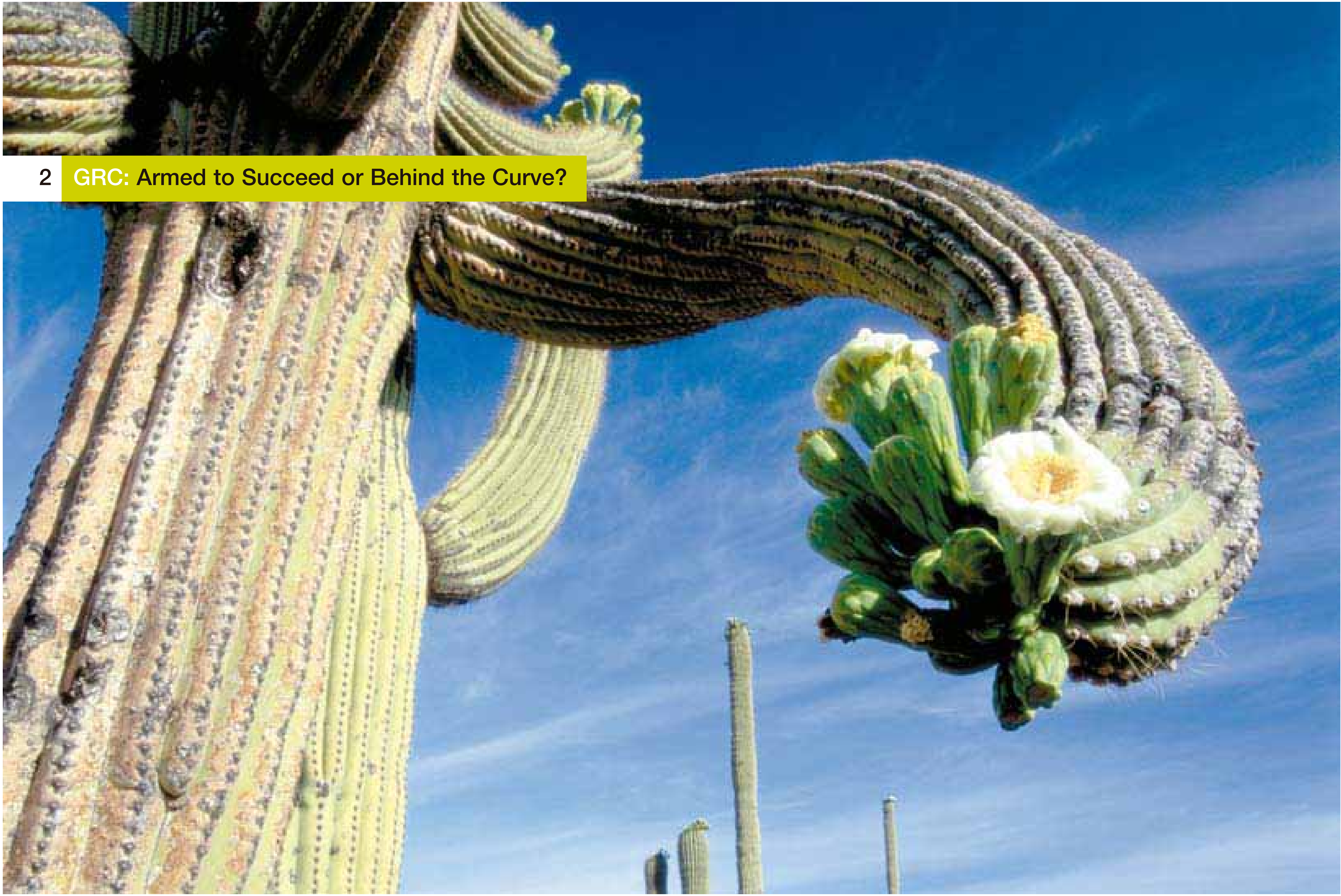
What are your perceptions of offshoring?



Even in a survey of this scope, it is difficult to reach any certain conclusions about offshoring. However, the data broadly suggest that with the exception of reducing costs and increasing competitiveness, the CEOs feel a noticeable degree of uncertainty about the effects of offshoring, both positive and negative, on other aspects of their businesses. As **Exhibit 10** indicates, only 15 percent strongly agree that offshoring enhances shareholder value; 11 percent, that it triggers negative press or PR; 8 percent, that it triggers negative domestic legislation; 7 percent, that it reduces their ability to retain intellectual property; and 7 percent, that it increases quality of customer service. The attitude of the CEOs that seems to be emerging from these data is that while offshoring reduces costs and increases competitiveness, other benefits and risks associated with this activity are less than clear. The CEOs acknowledge the promise of offshoring, but in the absence of such clarity, they are proceeding with caution.

The cautious optimism, or rational exuberance, exhibited by the CEOs in this year's survey is indicative of the increasing complexity and uncertainties that characterise the business environment in which they work. While this is evident in their responses to questions concerning threats to business growth prospects and emerging practices such as offshoring, it also defines their approach to governance, risk management, and compliance—the subject of the next section and the main focus of this report.

The cautious optimism, or rational exuberance, exhibited by the CEOs in this year's survey is indicative of the increasing complexity and uncertainties that characterise the business environment in which they work.



In today's global business environment, governance, risk management, and compliance form a triad that no CEO can afford to ignore. Costly? Yes. Onerous at times? Undoubtedly. But among the respondents are CEOs who are beginning to see GRC in a new light as **an integrated set of concepts that can provide significant benefits for their organisations.** Do such benefits come easily? Decidedly not. On one hand, the CEOs acknowledge that achieving effective GRC is a battle. On the other hand, they affirm that it is a battle worth waging.

Taken separately, governance, risk management, and compliance (GRC) are not new concepts. In one form or another, dealing with transparency and accountability, mitigating risk, and complying with regulations have always been issues with which companies have had to cope. However, when these concepts are viewed as being integrated and expanded to include compliance with all requirements that help the organisation to meet its strategic objectives, our research indicates that GRC has the potential to become a value-adding principle that is integral to a company's competitiveness and, ultimately, its success.

In a narrow sense, the words *governance, risk management,* and *compliance* often connote burdensome legal mandates—necessary tasks that drain resources and entail costs far in excess of any benefits they deliver. This perception has only been strengthened of late by the attention given to the controversy surrounding new laws and regulations. Yet, as our survey has found, 43 percent of the CEOs feel strongly that effective GRC is a value driver and a source of competitive advantage (Exhibit 11).

What, then, is the current thinking among CEOs about governance, risk management, and compliance? How are companies doing in developing eight basic elements of effective GRC that we examine? What benefits are they achieving? What effect is GRC having on a wide range of stakeholders? Do CEOs believe they are deriving value from this investment, or do they view it merely as a cost? And is that expenditure being measured accurately?

This is what we set out to discover by querying survey respondents about their attitudes, understanding, expectations, and progress regarding GRC in their organisations.

EXHIBIT 11 PERSPECTIVES ON GRC

How is GRC viewed within your company?

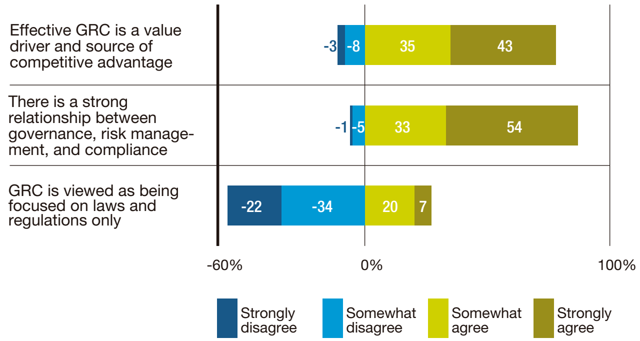
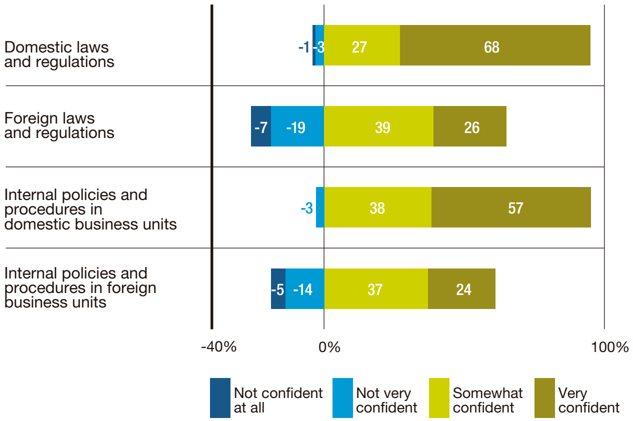


EXHIBIT 12 RESPONDING TO GRC MATTERS

How confident are you that your organisation can respond to the following GRC matters?



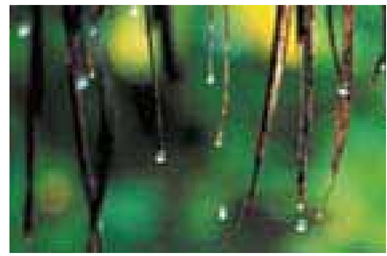
Defining GRC

For the purposes of this survey, GRC is defined as "the organisation's practices and the various roles that the board and senior management, line management, and the rest of the organisation play in relation to oversight, strategy, risk management, and strategy execution regarding compliance with laws and regulations and internal policies and procedures."

In responding to questions, the CEOs interviewed for this survey demonstrated a good understanding of both the breadth of GRC and of the interrelationships among its elements. In terms of breadth, only 7 percent strongly agree that GRC is related solely to laws and regulations. And 54 percent strongly agree that GRC is an integrated set of concepts and practices, as shown in Exhibit 11. However, the CEOs' responses also indicate that effective GRC, while understood, is not easily achieved.

One key measure of GRC effectiveness is the degree to which the CEOs can respond to GRC matters such as laws and regulations and organisational policies and procedures. A majority of the CEOs are confident that they can respond to GRC matters such as laws and regulations relevant to their domestic operations, but when it comes to foreign laws and regulations, their comfort level drops significantly.

As Exhibit 12 points out, the majority of CEOs are very confident that their organisations can respond to GRC matters related to domestic laws and regulations (68 percent) and to internal policies and procedures in domestic business units (57 percent). However, while 68 percent and 57 percent are high numbers, laws and regulations do not provide for less than full compliance. It is reasonable to ask why those numbers are not at or nearer 100 percent.



If the CEOs are less than fully equipped to respond to domestic laws, regulations, policies, and procedures, they are even less capable of dealing with those that relate to their foreign operations. Only 26 percent are very confident that their organisations can respond to similar matters related to foreign laws and regulations and only 24 percent to matters related to internal policies and procedures in foreign business units. As Exhibit 13 indicates, this disparity exists among CEOs in all regions but is greatest among US CEOs.

With regard to the difference between the domestic and foreign results, several explanations are possible. The first is somewhat intangible and relates in part to human nature. Like people in all walks of life, the CEOs are more comfortable in their "home" environments, which, of course, they know best. The disparity might also be attributable to constraining factors outside their borders, such as less mature infrastructures and fewer resources. Another possible explanation, at least for the external factors, is that the CEOs simply lack the same depth of understanding concerning foreign laws and regulations that they have of laws and regulations in the domestic environment.

While some or all of these explanations might apply, the fact is that the numbers of survey respondents who state that they can very effectively respond to these GRC matters are lower than they should be and indicate a degree of risk that should be unacceptable to most CEOs.

The CEOs' perceptions of GRC and their assessments of how well they are responding to domestic and foreign GRC matters indicates that, as a group, they are operating at varying levels of GRC effectiveness. But what constitutes such effectiveness? What elements need to be developed to ensure that effective GRC is taking place?

EXHIBIT 13 RESPONDING TO GRC MATTERS—BY REGION

How confident are you that your organisation can respond to the following GRC matters?

Percentage reporting "very confident"

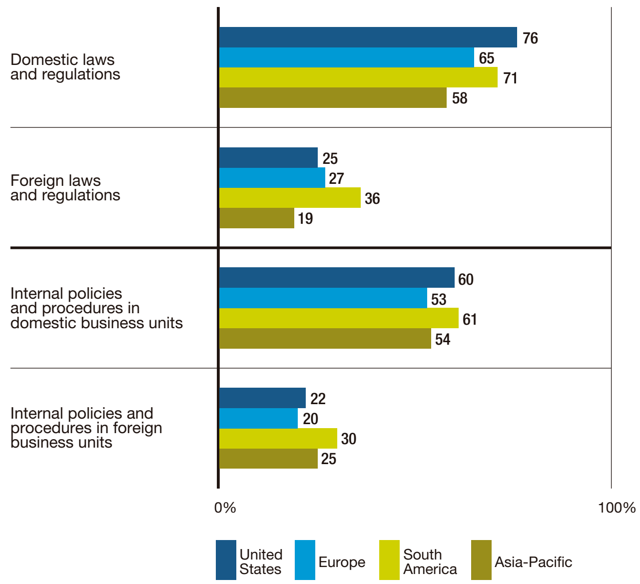
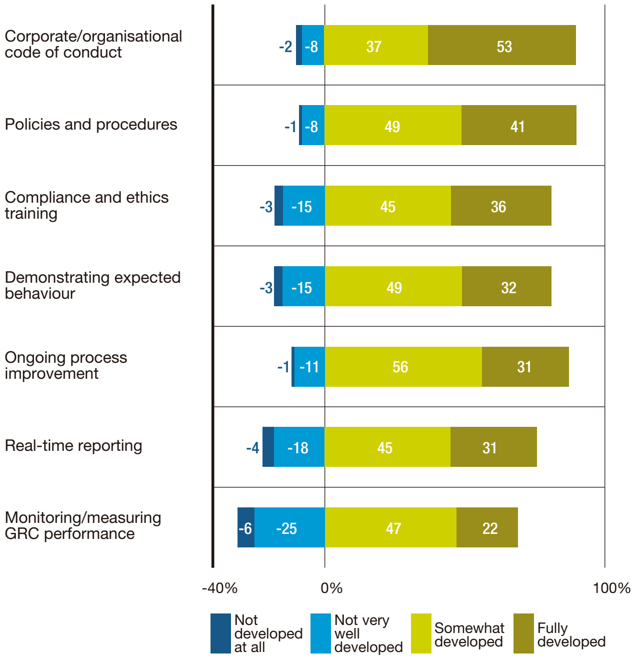


EXHIBIT 14 ELEMENTS OF GRC

To what extent is each of the following aspects of GRC developed within your company?



Eight Elements of Effective GRC

The systematic study of GRC is still an emerging field. Debate on which elements compose effective GRC is in its early stages. This survey focuses on eight elements that are basic to GRC effectiveness. By no means definitive, the following list nevertheless provides a useful starting point.

- Corporate/organisational codes of conduct
- Policies and procedures
- Compliance and ethics training
- Demonstrating expected behaviour
- Ongoing process improvement
- Real-time reporting
- Monitoring/measuring GRC performance
- Accurate, timely, complete, and consistent information

The CEOs indicate that, in varying stages of development, these eight elements of effective GRC are in place at their organisations. However, when asked about full development of these elements, responses ranged from a high of only 53 percent to a low of 22 percent. These are not impressively high numbers for such basic elements.

As Exhibit 14 illustrates, 53 percent feel that corporate/organisational codes of conduct are fully developed in their companies, and 41 percent claim to have fully developed policies and procedures in place. These and even lower numbers in other areas related to the development of GRC suggest that more work needs to be done. For example, only 36 percent report that compliance and ethics training is fully developed within their organisations; only 32 percent are fully developed with regard to demonstrating expected behaviour; and only 31 percent are fully developed concerning real-time reporting and ongoing process improvement. And while only 22 percent claim to be fully developed regarding monitoring and measuring GRC performance, 31 percent are not very well developed or not developed at all.

The low numbers with regard to monitoring and measuring might be attributable in part to the fact that only a small percentage of CEOs have fully automated the organisation and collection of GRC information within their companies. As Exhibit 15 indicates, only 11 percent of the CEOs report that their approach to the organisation and collection of GRC information is fully automated; 67 percent take a somewhat automated approach; and 19 percent organise and collect their GRC data manually.

Effective monitoring and measuring of GRC performance depend on processes that generate reliable information. Yet, the survey data indicate that many of the CEOs are less than very confident that the information they receive on GRC matters is timely, accurate, and complete. Only 38 percent are very confident that the information they receive is accurate; 31 percent, that it is timely; and 27 percent, that it is complete (Exhibit 16). The CEOs are even less sure that the information they are receiving about GRC is consistent. Only 25 percent are very confident that such information is being supplied in a consistent manner across their organisations. Nearly the same number of CEOs (22 percent) are not very confident or not at all confident that they are receiving consistent information, and the majority (51 percent) are only somewhat confident. These data raise a significant point concerning the critical importance of information integrity. On one hand, inaccurate information impedes the CEO's ability to communicate accurately to internal and external constituents. On the other hand, reliable information increases confidence and improves decision making.

EXHIBIT 15 LEVEL OF GRC AUTOMATION

Which of the following best describes the organisation and collection of GRC information?

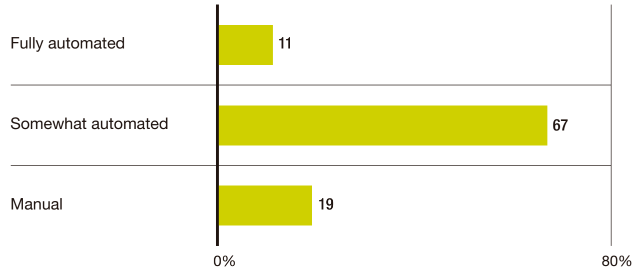


EXHIBIT 16 INFORMATION ON GRC

How confident are you that the information you receive on GRC matters is…

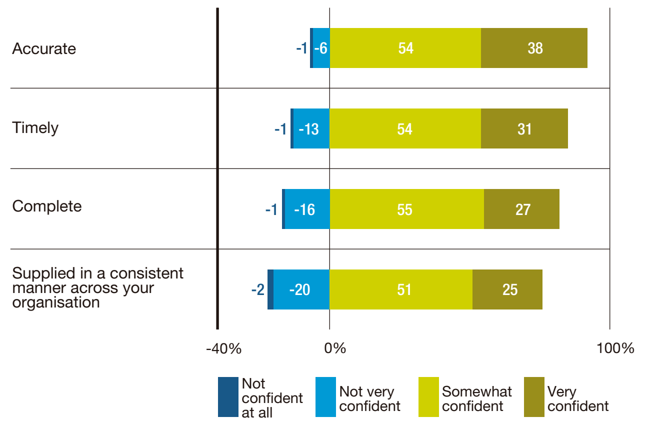


EXHIBIT 17 BOARD'S APPROACH TO GRC

What is the board's approach to GRC?

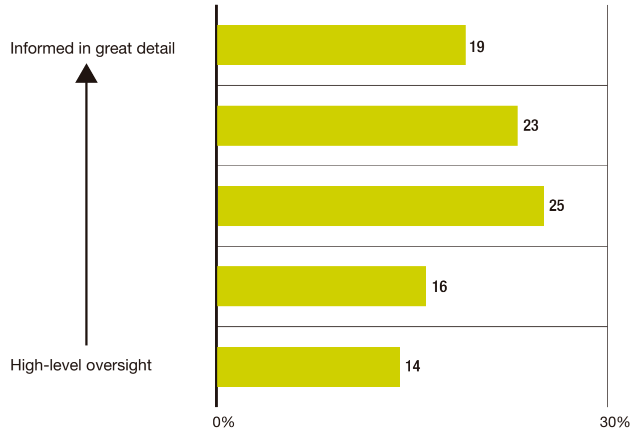
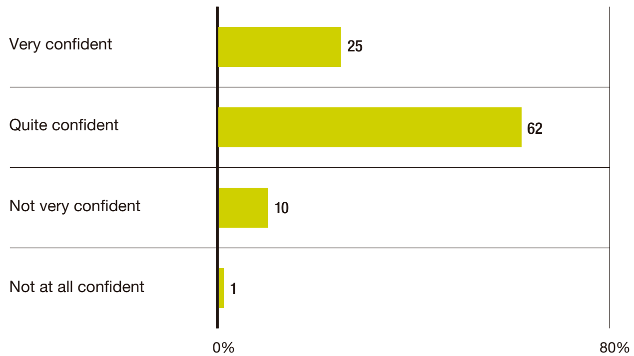


EXHIBIT 18 BOARD CONFIDENCE

As members of other boards, how confident are you that GRC data passed back to you are accurate?

Base: CEOs who serve on other boards (543)



In addition to the reliability of GRC information available to the CEOs, the survey also examined the CEOs' perceptions of how much detail about GRC matters board members are receiving, both at their own companies and at other companies where they serve as board members.

As shown in Exhibit 17, on a scale that ranges from "high-level oversight" to "informed in great detail," less than half the CEOs (42 percent) feel that their boards are informed in detail about GRC matters and 30 percent state that their boards approach GRC matters with a high level of oversight. Twenty-five percent report that their boards occupy a middle ground between the two extremes.

Of the 41 percent of the CEOs that serve on other boards, only 25 percent are very confident that the GRC information they receive is accurate (Exhibit 18). This relatively low number may be attributable to higher levels of trust in and understanding of the processes in place at their own organisations and to the fact that, in general, CEOs, when compared with independent directors, have access to more information about their own organisations.

On one hand, inaccurate information impedes the CEO's ability to communicate accurately to internal and external constituents. On the other hand, reliable information increases confidence and improves decision making.

In light of the Sarbanes-Oxley Act, which was designed in part to improve corporate governance, it is interesting to note that 41 percent of US CEOs claim that their boards approach GRC information merely with a high level of oversight, a number greater than European boards (30 percent), South American boards (29 percent), and Asian boards (20 percent) (Exhibit 19). These data at least suggest that in some organisations, the Act is not being implemented as intended and that the spirit, if not the letter, of the law is not being fully embraced.

EXHIBIT 19 BOARD'S APPROACH TO GRC—BY REGION

What is the board's approach to GRC?

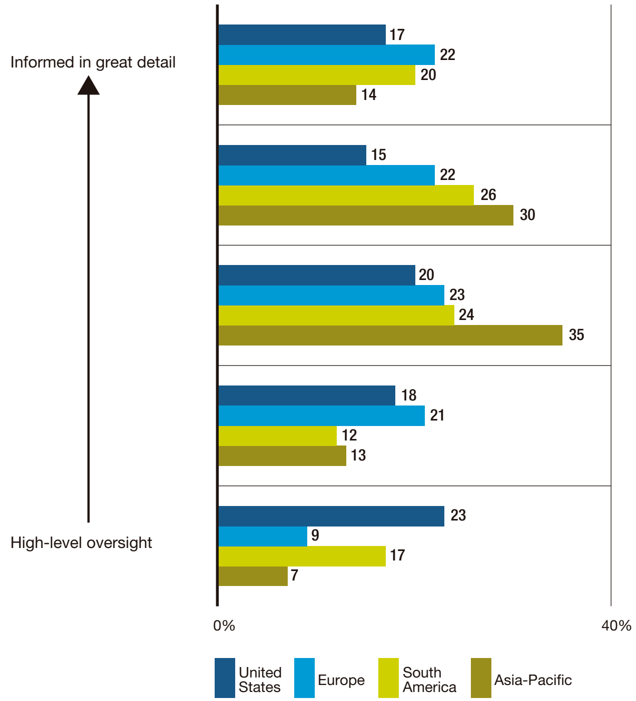
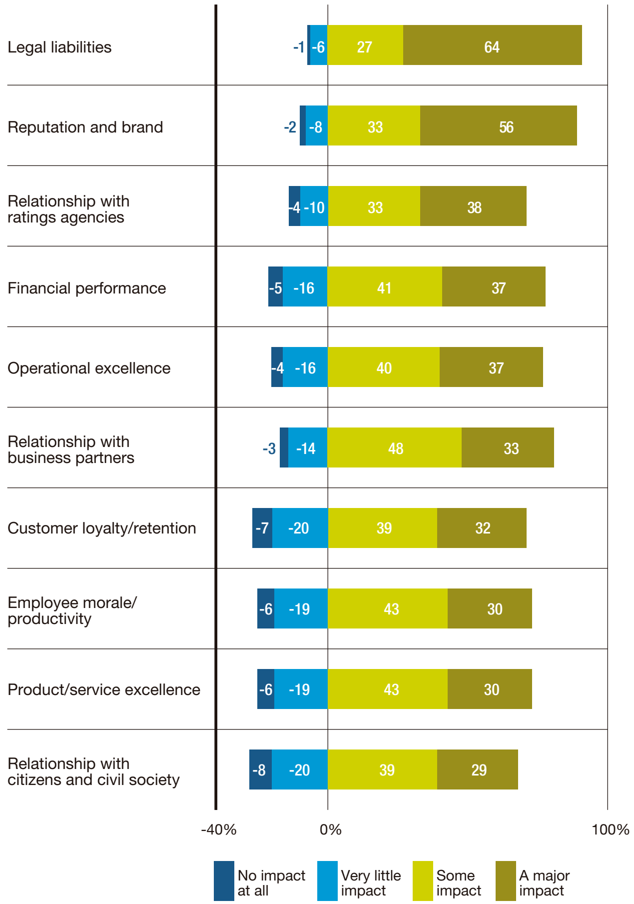


EXHIBIT 20 IMPACT OF GRC

What is the impact of effective GRC on the following areas?



The Benefits of GRC

Despite the fact that most of the CEOs are struggling with implementing eight elements of effective GRC, a generally positive view is reflected in their perceptions about a number of potential benefits that GRC can deliver. In high numbers, the CEOs credit GRC with having a major, positive impact on legal liabilities (64 percent) and on reputation and brand (56 percent) (Exhibit 20).

At the same time, however, only about one-third of the CEOs feel that GRC has a major impact on their relationships with ratings agencies (38 percent), financial performance (37 percent), operational excellence (37 percent), relationships with business partners (33 percent), customer loyalty/retention (32 percent), employee morale/productivity (30 percent), product/service excellence (30 percent), and relationships with citizens and civil society (29 percent).

Why the apparent disparity between these numbers and the higher percentages for the top two benefits reported above? While these numbers are low relative to the top two benefits, they are actually quite high when taken by themselves and are consistent with the survey's finding that the vast majority of CEOs view GRC as concerning more than just laws and regulations.

Addressing Stakeholders' Concerns

To practice effective GRC and experience its benefits, CEOs must be able to respond to the GRC concerns of their companies' various stakeholders. While many CEOs say that they adequately address stakeholders' concerns that are based on clear-cut legal requirements (e.g., those of auditors, regulators, and shareholders), fewer feel the same level of comfort with other constituents, whose expectations are more ambiguous.

When asked about the GRC concerns of various stakeholders (Exhibit 21), the CEOs state that they can very effectively address the concerns of auditors (59 percent), shareholders (46 percent), and regulators (45 percent). However, far fewer have confidence that they can very effectively address the concerns of employees (32 percent), customers (30 percent), and business partners (28 percent). The disparity here is explained in the same way as the apparent disparity in the results for benefits discussed earlier.

It should be noted that while the CEOs are doing better addressing stakeholders' concerns based on legal requirements, they are very effectively addressing only 46 percent of shareholders' concerns and 45 percent of regulators' concerns. This leaves them exposed to considerable risk. While 100 percent effectiveness is not a practical objective, the numbers reported here probably indicate more risk than most CEOs should be willing to take. The important point is that CEOs must know their exposure to risk, determine their levels of risk tolerance, and work towards achieving them.

EXHIBIT 21 STAKEHOLDERS' CONCERNS

How effectively do you feel that you address the following stakeholders' concerns regarding GRC?

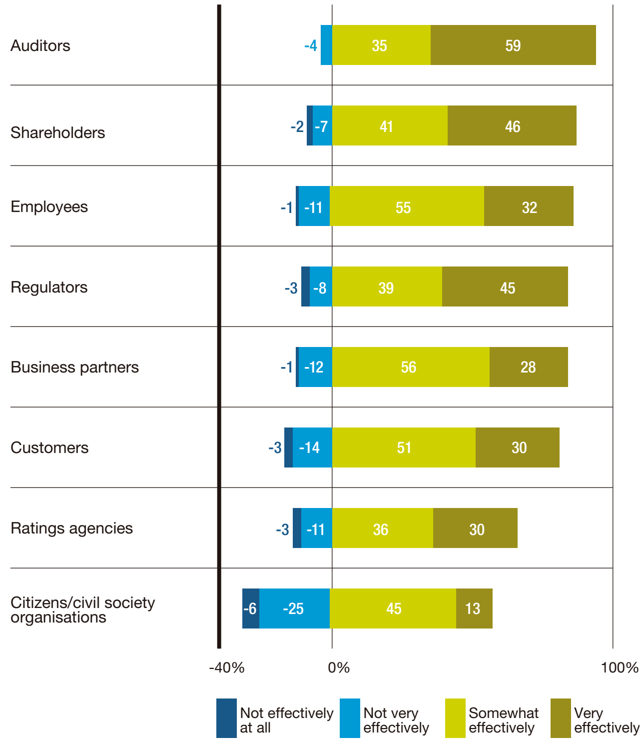


EXHIBIT 22 GRC RETURN ON INVESTMENT

What do you consider your return on this investment to be?

Base: All respondents who view GRC as an investment (775)

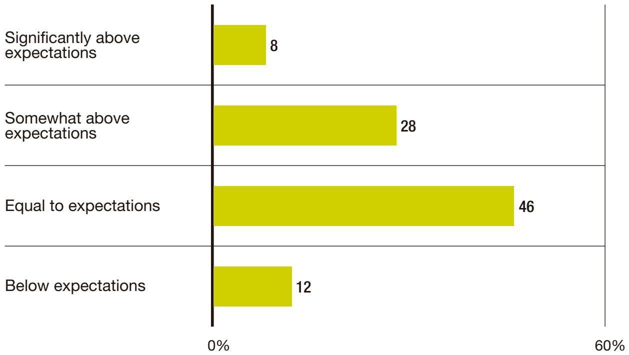
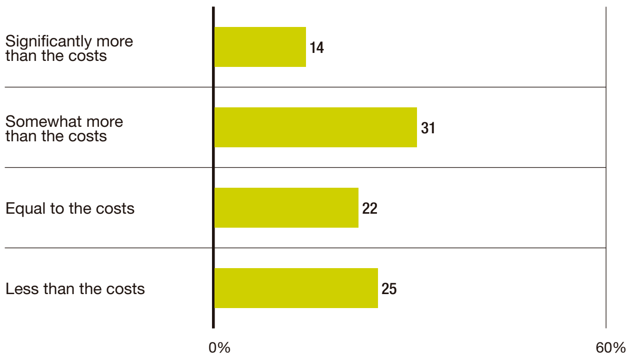


EXHIBIT 23 GRC: BENEFITS VERSUS COSTS

What do you consider the benefits of GRC are compared with the costs?

Base: All respondents who view GRC as a cost (498)



Two Views: GRC as a Cost or GRC as an Investment

Implementing elements of effective GRC and ensuring that stakeholders' concerns are adequately addressed require resources. However, whether the expenditures for these resources are viewed as an investment or as a cost provides some insight into the CEOs' perception of GRC's potential to provide benefits. In this regard, the data are not decisive but lean in a definite direction.

While 58 percent of the CEOs indicate that GRC expenditures are primarily an investment, 38 percent view them primarily as a cost. Among the "investment" group, 46 percent feel that their return on that investment is equal to expectations; 28 percent believe it is somewhat above expectations; and 8 percent claim the return on their GRC investment is significantly above expectations (Exhibit 22). Among those who consider GRC expenditures to be costs, 31 percent hold that the benefits somewhat outweigh the costs; 22 percent feel that the costs equal the benefits; and 14 percent believe the benefits significantly outweigh the costs (Exhibit 23).

Implementing elements of effective GRC and ensuring that stakeholders' concerns are adequately addressed require resources.

While these data are good indicators of the CEOs' attitudes about GRC, perceptions of actual benefits achieved more reliably distinguish the "investment" group from the "cost" group. When compared with the "cost" group, the CEOs who view GRC as an investment are far more likely to see some significant benefits (Exhibit 24). Among them are financial performance (46 percent versus 26 percent), operational excellence (48 percent versus 21 percent), employee morale and productivity (39 percent versus 18 percent), customer loyalty/retention (42 percent versus 19 percent), relationships with citizens and civil society (36 percent versus 20 percent), and relationships with ratings agencies (44 percent versus 29 percent).

What explains these differences in perception? Respondents who view GRC as an investment are also more likely to view it as an integrated set of concepts (58 percent versus 47 percent), as a value driver and source of competitive advantage (53 percent versus 27 percent), and as an aid in enabling them to take risks to create value (36 percent versus 16 percent) (Exhibit 25).

In other words, because they see it as an investment rather than as a cost, these CEOs take a broader, more holistic view of GRC. Unlike their peers who approach GRC as a series of isolated expenditures, they view it as a long-term investment and take an integrated approach in order to ensure that they achieve a positive return. The result of this integrated approach and longer-term view is a higher level of perceived benefits.

EXHIBIT 24 IMPACT OF GRC—INVESTMENT VERSUS COST

What is the impact of effective GRC in the following areas?

Percentage reporting "a major impact"

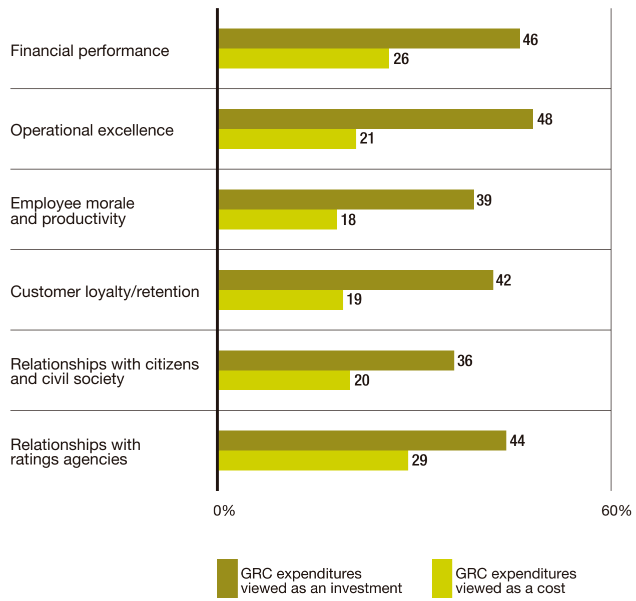


EXHIBIT 25 PERCEPTIONS OF GRC—INVESTMENT VERSUS COST

How is GRC viewed within your company?

Percentage reporting "strongly agree"

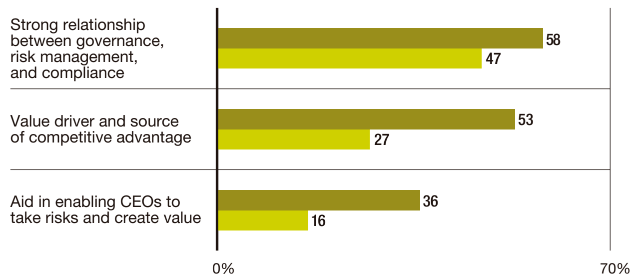


EXHIBIT 26 MEASURING GRC EXPENDITURES

How accurately do you feel you can measure your company's total expenditure in addressing GRC goals?

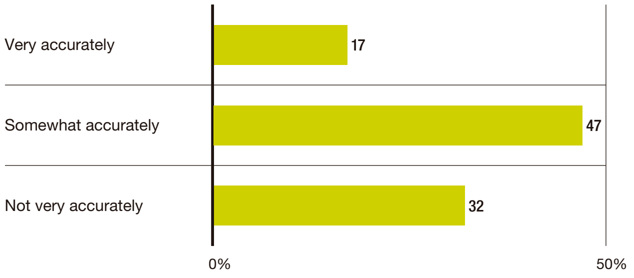
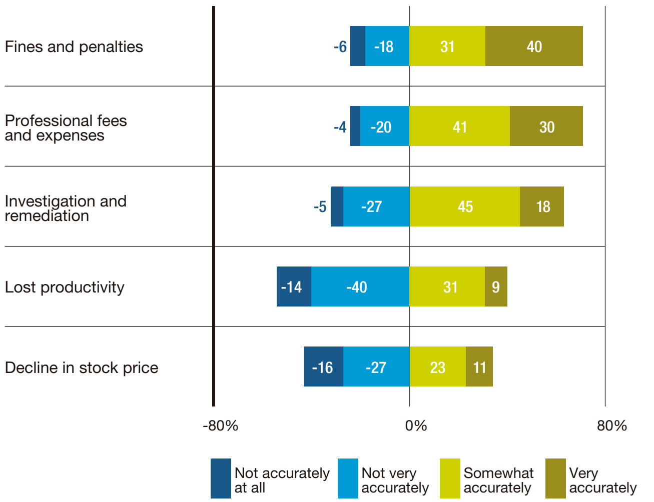


EXHIBIT 27 COST OF GRC FAILURES

How accurately do you feel you can measure the cost of GRC failures in the following areas?



Measuring GRC Costs

Regardless of how the CEOs view GRC expenditures, it is important that they be able to measure them accurately. However, the data suggest that for most, these costs are not being measured with maximum effectiveness. This is an important point, since issues relating to the cost of GRC have been in the press recently and have been discussed in conjunction with new legislative proposals.

When asked how accurately they could measure their companies' total expenditure on GRC, only about one in five (17 percent) responded that they could do so very accurately (Exhibit 26). While nearly half (47 percent) of the CEOs felt that they could somewhat accurately measure GRC costs, 32 percent believe their measurements are not very accurate at all.

One significant GRC cost is the cost of failure. While one would think that CEOs should be able to measure the costs of GRC failures accurately, this is not the case. Only 40 percent of CEOs claim they can measure the costs of fines and penalties very accurately, and only 30 percent make the same claim about professional fees and expenses (Exhibit 27). When queried about their ability to measure other types of costs, the CEOs responded with even less confidence. Only 18 percent of respondents claim they can very accurately measure the costs of investigation and remediation. The percentages are even lower for decline in stock price (11 percent) and lost productivity (9 percent). The implications of these findings are clear: most of the CEOs do not have a good understanding of the costs associated with GRC failure.

Among the relatively small group (17 percent) of respondents who claim that they can very accurately measure their companies' total GRC expenditures, the results are somewhat better. However, this group should be far more able than their peers to measure the individual costs of GRC failure. But, as Exhibit 28 indicates, even this group falls far short of 100 percent in all categories: fines and penalties (50 percent), professional fees and expenses (46 percent), investigation and remediation (33 percent), decline in stock price (20 percent), and lost productivity (19 percent).

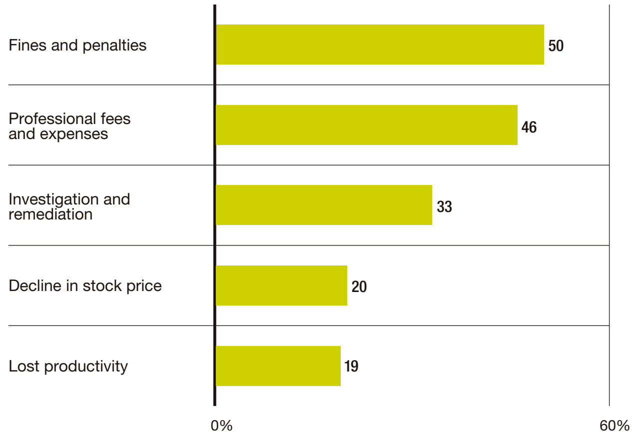
What explains these low percentages even among those who claim to be able to measure their GRC expenditures accurately? It may be the case that most of the CEOs have simply chosen not to track GRC costs or wish to track them but do not have the appropriate resources (e.g., people, processes, technology, capital) to do so. As a result, organisations may be incurring far more cost related to GRC and GRC failures—cash cost as well as opportunity cost—than the CEOs realise.

EXHIBIT 28 COST OF GRC FAILURES

How accurately do you feel you can measure the cost of GRC failures in the following areas?

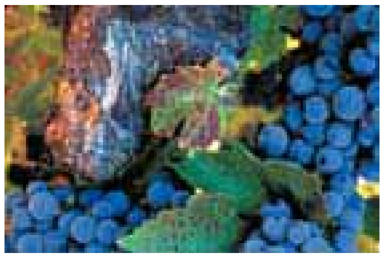
Percentage reporting "very accurately"

Base: All respondents who say they can "very accurately" measure their companies' GRC expenditures



Most of the CEOs seem to understand the importance of GRC but are struggling in varying degrees with its implementation. That is, they are having difficulty fully realising the benefits, meeting the GRC needs of stakeholders, and measuring GRC costs.

In summary, most of the CEOs seem to understand the importance of GRC but are struggling in varying degrees with its implementation. That is, they are having difficulty fully realising the benefits, meeting the GRC needs of stakeholders, and measuring GRC costs. But are there subsets of CEOs who are doing a better job with GRC than their peers? And are these CEOs reaping greater benefits? Those questions, and their answers, are the subject of the next section of this report.




3 Achieving Higher Levels of Performance

Clearly, when it comes to effective GRC, some CEOs are doing better than others. What sets them apart? What gives them a distinct advantage over their peers? Emerging from the survey data are a group of CEOs who are taking GRC to a higher level. Both in implementing effective GRC and in reaping its benefits, they are pointing the way towards GRC excellence.

The CEOs participating in this survey grasp the importance of GRC and perceive many of its benefits. But they are also struggling with the difficulties of implementing GRC, and only 25 percent are certain that they are managing GRC very effectively **(Exhibit 29).** But are there CEOs who are ahead of their peers in fully developing the eight elements of effective GRC examined earlier? Are they realising more benefits? Are they better able to address stakeholders' concerns?

This section of the report considers several subsets of CEOs in which distinct GRC advantages emerge. They are CEOs who state that their organisations are managing GRC very effectively (referred to hereinafter as *GRC-effective* organisations) and CEOs who strongly agree that their organisations are managing GRC very effectively and that their business units feel ownership of GRC issues (hereinafter referred to as *GRC-embedded* organisations). We also look at a subset of CEOs whose companies have fully automated the collection and organisation of GRC data in their companies.

It should be noted that while these subsets of respondents are clearly doing better than their peers, the data also indicate that, even among these groups, much work remains to be done.

EXHIBIT 29 EFFECTIVE GRC MANAGEMENT

To what extent do you agree with the following statement?

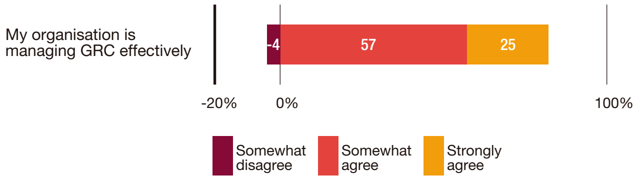
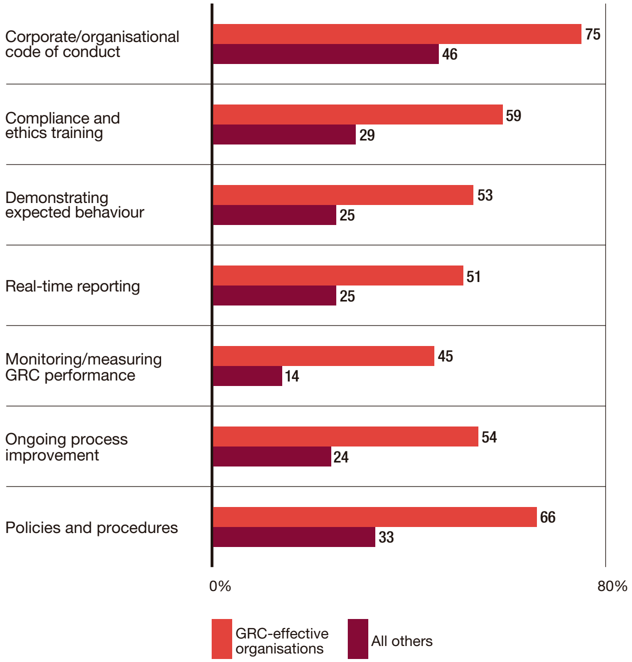


EXHIBIT 30 ELEMENTS OF GRC—GRC-EFFECTIVE ORGANISATIONS

To what extent is each of the following aspects of GRC developed within your company?

Percentage reporting “fully developed”

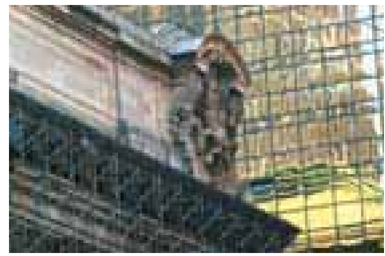


GRC-Effective Organisations

When compared with their peers, the GRC-effective organisations are much more likely to perceive GRC as an integrated set of strongly related concepts (68 percent versus 49 percent). They are also ahead of their peers in terms of fully developing eight elements of effective GRC, of perceiving GRC benefits, and of addressing stakeholders’ concerns.

ELEMENTS OF EFFECTIVE GRC

As illustrated in **Exhibit 30,** 75 percent of the GRC-effective organisations state that corporate/organisational codes of conduct are fully developed in their companies. Only 46 percent of all others make that claim. There are also significant gaps between these two groups regarding the full development of the eight elements of effective GRC we examined. It should be noted, however, that despite the dramatic differences, typically on the order of two to one, the 50 percent to 60 percent ranges in the responses of the GRC-effective group indicate that even these organisations could be doing better.



Regarding the quality of GRC information, the CEOs in GRC-effective organisations are better informed than their peers (by a factor of two and sometimes three to one) **(Exhibit 31).** And so are their boards. As noted in **Exhibit 32,** 54 percent (compared with 38 percent of all others) of the CEOs at GRC-effective organisations assert that their boards are informed in detail. And only 29 percent approach GRC with a high level of oversight, compared with 31 percent of the rest of the sample.

EXHIBIT 31 CONFIDENCE IN GRC INFORMATION—GRC-EFFECTIVE ORGANISATIONS

How confident are you about the information you receive on GRC matters?

Percentage reporting "very confident"

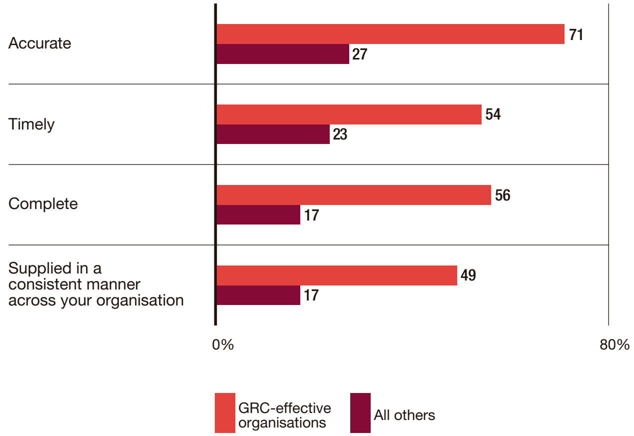
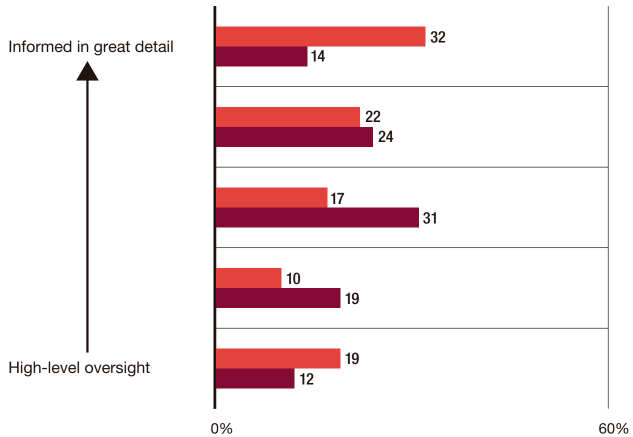
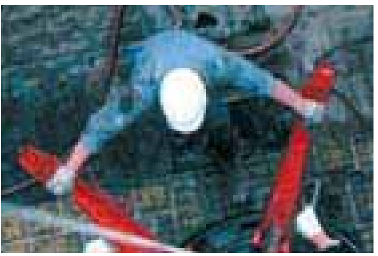


EXHIBIT 32 BOARD OVERSIGHT—GRC-EFFECTIVE ORGANISATIONS

What is the board's approach to GRC?





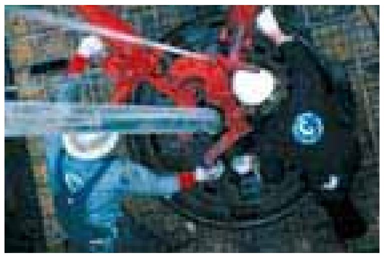
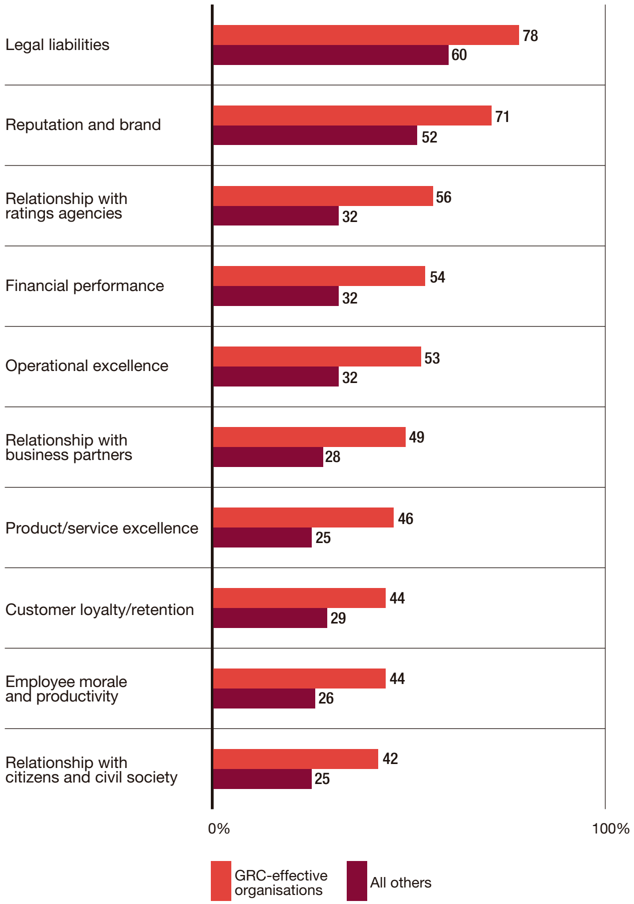


EXHIBIT 33 IMPACT OF GRC—GRC-EFFECTIVE ORGANISATIONS

What is the impact of GRC on the following areas?

Percentage reporting "a major impact"



GRC BENEFITS

In addition to greater progress in developing the elements of effective GRC, CEOs in this group also perceive higher benefits.

It is important to note that for the GRC-effective group and for all others, the same disparity exists between the top two benefits (reducing legal liabilities and enhancing reputation and brand), where absolute percentages are high, and the remaining benefits, where absolute percentages are lower. The explanation for this disparity is the same that applies to the entire sample, as discussed earlier.

When compared with all other respondents in the survey, the CEOs in GRC-effective organisations are, on average, nearly 20 percent more likely to assert that GRC delivers tangible benefits. While differences in absolute levels vary, some, particularly with regard to reducing legal liabilities (78 percent versus 60 percent) and enhancing reputation and brand (71 percent versus 52 percent), are striking and indicate that GRC-effective organisations are doing especially well in these areas **(Exhibit 33).**

Significant differences also appear with regard to financial performance (54 percent versus 32 percent), operational excellence (53 percent versus 32 percent), and product/service excellence (46 percent versus 25 percent).

ADDRESSING STAKEHOLDERS' CONCERNS

Higher levels of perceived benefits go hand in hand with higher levels of confidence that the GRC concerns of stakeholders can be addressed effectively. For example, an enhanced ability to retain customers parallels high levels of confidence in addressing customer concerns (50 percent versus 24 percent). A better handle on legal liabilities improves the ability to effectively address the concerns of auditors (81 percent versus 52 percent), regulators (65 percent versus 38 percent), and shareholders (69 percent versus 38 percent). Better relationships with business partners relate to a better ability to address their concerns (49 percent versus 20 percent), and better financial performance positively affects the ability to address the concerns of shareholders (69 percent versus 38 percent) **(Exhibit 34).**

In all, the GRC-effective group is, on average, 25 percent ahead of the peer group in all categories concerning their ability to effectively address the GRC concerns of stakeholders, with particularly significant differences regarding employees (57 percent versus 24 percent), auditors (81 percent versus 52 percent), and business partners (49 percent versus 20 percent). Yet, in absolute terms, one might expect the numbers to be even higher, suggesting that, even among respondents in this group, there is room for improvement in this area.

Clearly then, in virtually every category, from developing elements of effective GRC to achieving higher benefits, to possessing the ability to address stakeholders' concerns, the 25 percent of CEOs who strongly agree that their organisations are managing GRC effectively score higher than all others in the sample. These data suggest that there is a model for effective GRC and that these CEOs are following it. But as the survey indicates, there are variables other than GRC effectiveness that affect performance positively.

EXHIBIT 34 STAKEHOLDERS' CONCERNS—GRC-EFFECTIVE ORGANISATIONS

How effectively do you feel that you address the following stakeholders' concerns regarding GRC?

Percentage reporting "very effectively"

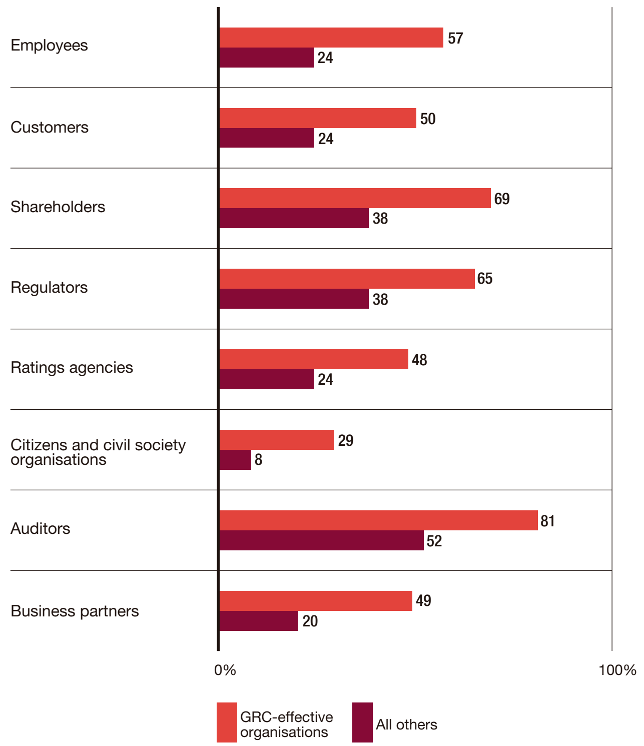
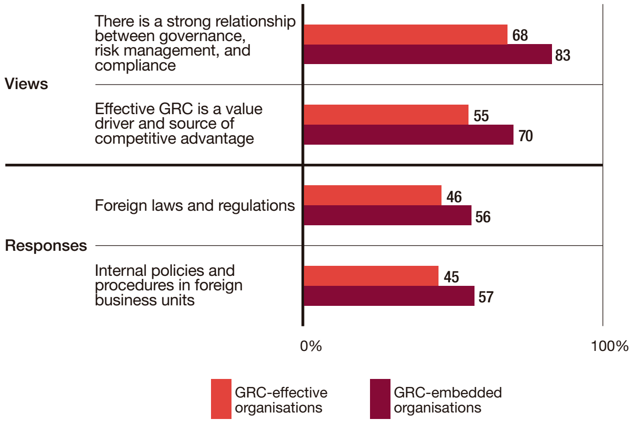


EXHIBIT 35 VIEWS AND RESPONSES—ADVANTAGES OF GRC-EMBEDDED ORGANISATIONS

How is GRC viewed within your company? How confident are you that your organisation can respond to the following GRC matters?

Percentage reporting "strongly agree"/"very confident"



Business Unit Ownership of GRC

The CEOs in GRC-effective organisations stand out in terms of their progress in fully developing eight elements of effective GRC, in their perception that GRC provides significant benefits, and in their ability to deal with stakeholders' concerns. But when this sample is narrowed to include only those GRC-effective CEOs who also strongly agree that their business units feel ownership of GRC issues, a number of significant advantages emerge.

When business units feel ownership of GRC, fundamental differences between the GRC-embedded group and the GRC-effective group are immediately apparent. For example, more members of the GRC-embedded group see a relationship among the elements of GRC (83 percent versus 68 percent) and view GRC as a value driver and source of competitive advantage (70 percent versus 55 percent). In addition, the GRC-embedded group has a better handle on foreign laws and regulations (56 percent versus 46 percent) and foreign policies and procedures (57 percent versus 45 percent) than their GRC-effective counterparts (Exhibit 35).

With higher percentages in these fundamental areas, one would expect to see similar advantages in implementing elements of effective GRC, perceiving GRC benefits, and addressing stakeholders' concerns. And this is the case.

With the exception of reliable information, the CEOs of GRC-embedded organisations enjoy a lead of approximately 10 percent in each of eight elements of effective GRC **(Exhibit 36).** While the advantage regarding information is smaller, it still averages to a five percent gain when the data on accuracy, timeliness, completeness, and consistency are combined.

EXHIBIT 36 ELEMENTS OF GRC—ADVANTAGES OF GRC-EMBEDDED ORGANISATIONS

To what extent is each of the following aspects of GRC developed within your company?

Percentage reporting “fully developed”

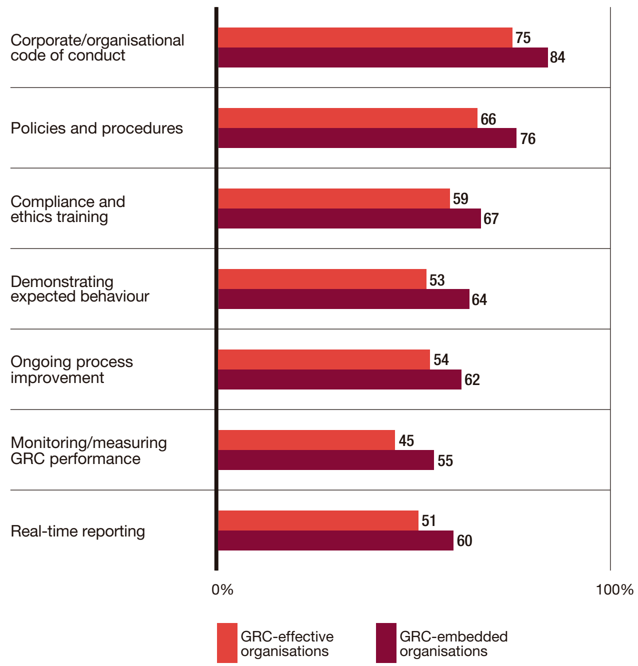
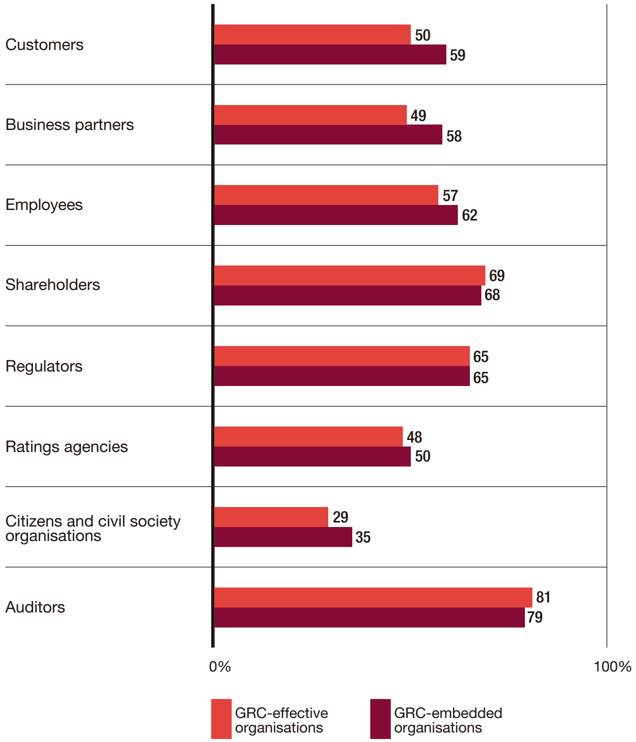


EXHIBIT 37 STAKEHOLDERS' CONCERNS—ADVANTAGES OF GRC-EMBEDDED ORGANISATIONS

How effectively do you feel that you address the following stakeholders' concerns regarding GRC?

Percentage reporting "very effectively"



In terms of benefits, the results, in certain cases, are somewhat more dramatic. The GRC-embedded group holds a 10 percent lead in financial performance, in product/service excellence, and in reputation and brand. These results are not surprising. Products and services are delivered by the business units, and reputation and brand are affected by how well the business units deal with customers. Both have an impact on financial performance. Therefore, when business units feel ownership of GRC issues, they see higher levels of benefits in these areas.

With regard to stakeholders' concerns, few appreciable differences emerge, with two notable exceptions. GRC-embedded organisations show a 9 percent gain in their ability to address the concerns of customers and business partners **(Exhibit 37).** This is understandable given the role of the business units. They are on the "front lines" of the business closest to these constituents. But what of other stakeholders? Why do no advantages stand out here when they are apparent in the data concerning the elements of GRC and the benefits?

It might be argued that time and experience are the key factors. With the elements of GRC in place, GRC-embedded organisations are beginning to reap the benefits. They are making headway with some stakeholders but not with others. Among the latter are auditors, shareholders, and regulators. The first two are easily explained. Auditors and shareholders are C-suite concerns. With regard to regulators, the matter is more complex. Any given industry is subject to a number of regulators. Some of these are corporate-level concerns; others are business unit concerns. Of course, it is also possible that, like most of the respondents, the CEOs of GRC-embedded organisations are simply grappling with the difficulties of GRC.

Impact of Automation

One final aspect of GRC remains to be examined. What, if any, is the impact of automation on GRC effectiveness?

Automation greatly enhances efficiency in all aspects of business, and GRC is no exception. Manual processes are complex and prone to error. But when manual processes are properly enabled by technology, what has been complex becomes simpler, more routine, more consistent, and more reliable. The survey indicates that the degree to which the organisation and collection of GRC data are automated has a significant positive impact on virtually every aspect of GRC effectiveness.

Exhibit 38 indicates that the CEOs in the fully automated group are significantly ahead of the semi-automated group and dramatically ahead of the manual group regarding the degree of development in their organisations of eight elements of effective GRC. While the differences between the automated and semi-automated groups average about 15 percent, the advantage the fully automated group has over the manual group averages about 26 percent, with particularly large differences in the areas of real-time reporting (32 percent), compliance and ethics training (29 percent), and policies and procedures (28 percent).

EXHIBIT 38 ELEMENTS OF GRC—BY LEVEL OF AUTOMATION

To what extent is each of the following aspects of GRC developed within your company?

Percentage reporting "fully developed"

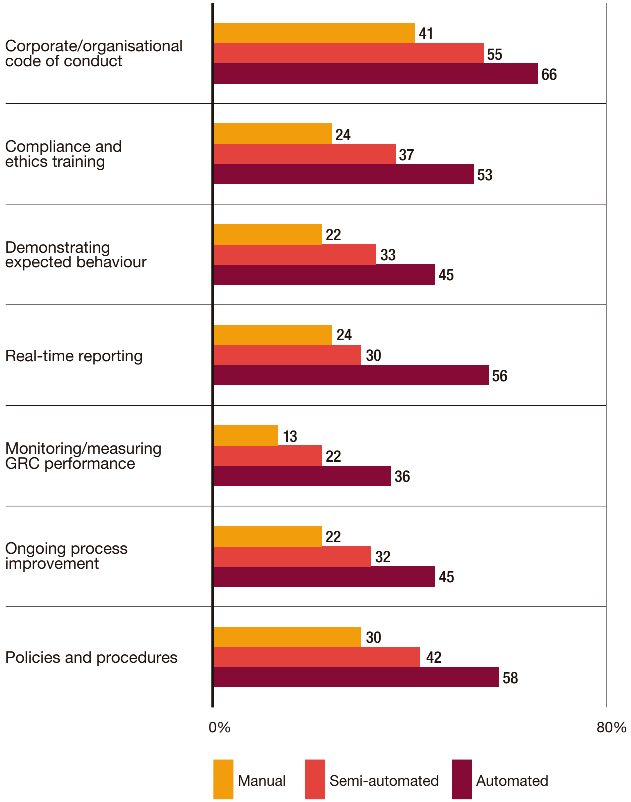
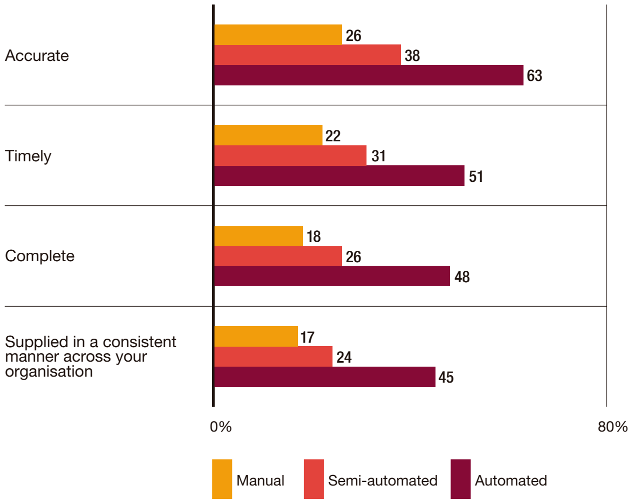


EXHIBIT 39 INFORMATION ON GRC—BY LEVEL OF AUTOMATION

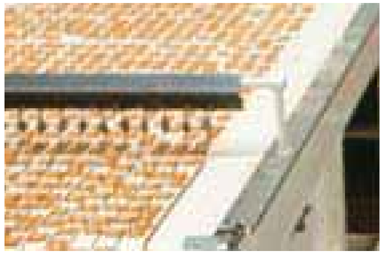
How confident are you about the information you receive on GRC?

Percentage reporting "very confident"



The differences are even more pronounced regarding the quality of GRC information. When compared with the fully automated group, the CEOs in the semi-automated and manual groups lag far behind with regard to their confidence in the accuracy (63 percent/38 percent/26 percent), timeliness (51 percent/31 percent/22 percent), completeness (48 percent/26 percent/18 percent), and consistency (45 percent/24 percent/17 percent) of their GRC information (Exhibit 39).

Also, and not surprisingly, the fully automated group's boards are better informed than those of the semi-automated or manual groups. Fifty-four percent of the fully automated group state that their boards are informed in detail, compared with 42 percent of the semi-automated group and 36 percent of the manual group.



The fully automated group also perceives the highest levels of GRC benefits, particularly GRC's ability to positively affect legal liabilities (71 percent), reputation and brand (64 percent), and financial performance (60 percent) **(Exhibit 40).** And when it comes to their ability to very effectively address the GRC concerns of stakeholders, the fully automated group reports the highest percentages for auditors (70 percent), regulators (53 percent), and shareholders (56 percent) **(Exhibit 41).**

Why the significant differences among the fully automated, semi-automated, and manual groups? Beyond the obvious advantages inherent in automation in terms of accuracy and efficiency, achieving it means far more than investing in the right technology. Fully automating any process requires discipline, rigour, and commitment—in short, the fundamentals of good management. The advantages enjoyed by this group are the result of a combination of factors. Yes, advanced technology provides an edge. But these CEOs have had to make a number of improvements—in training, processes, and procedures, for example—in order to take full advantage of what technology has to offer. In advance of most of their peers, they have recognised the value of applying technology to GRC and are making the investments required to ensure maximum benefit.

EXHIBIT 40 IMPACT OF GRC—BY LEVEL OF AUTOMATION

What is the impact of GRC on the following areas?

Percentage reporting "a major impact"

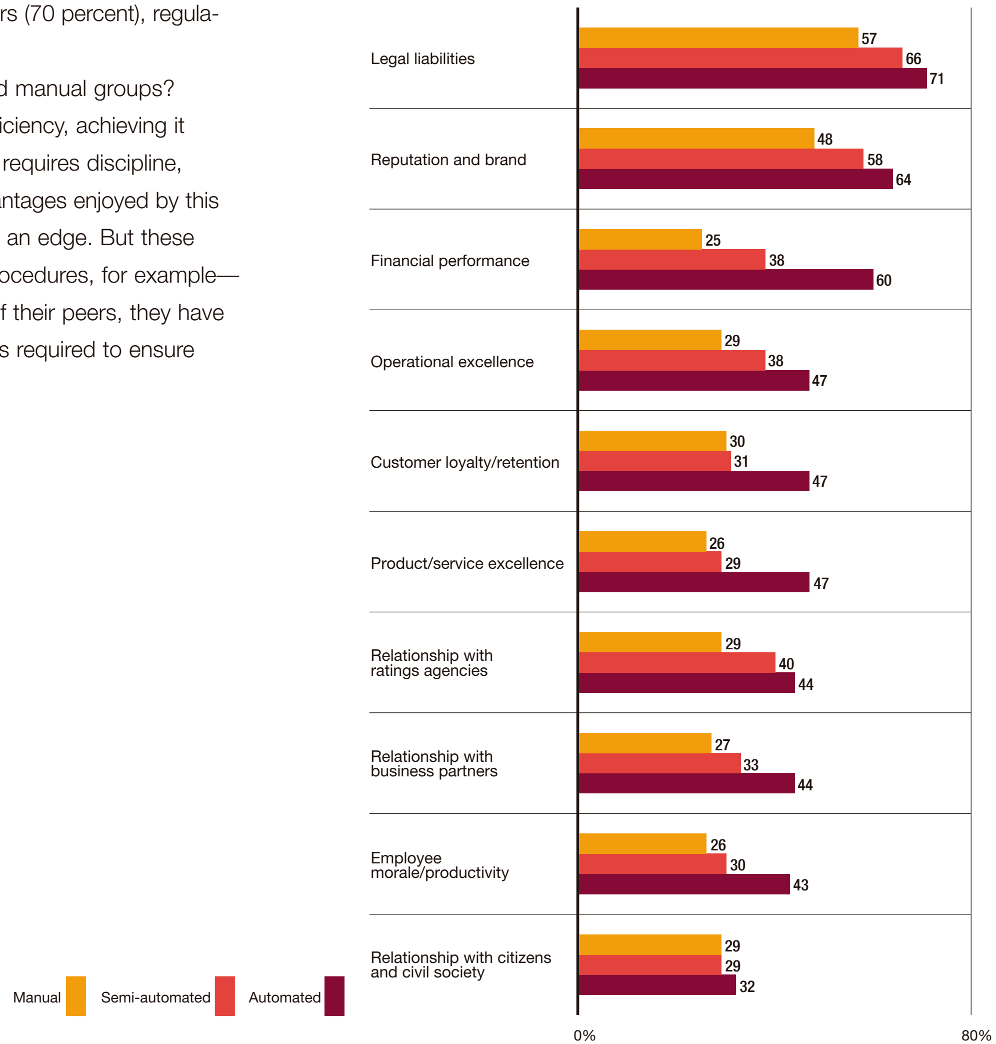
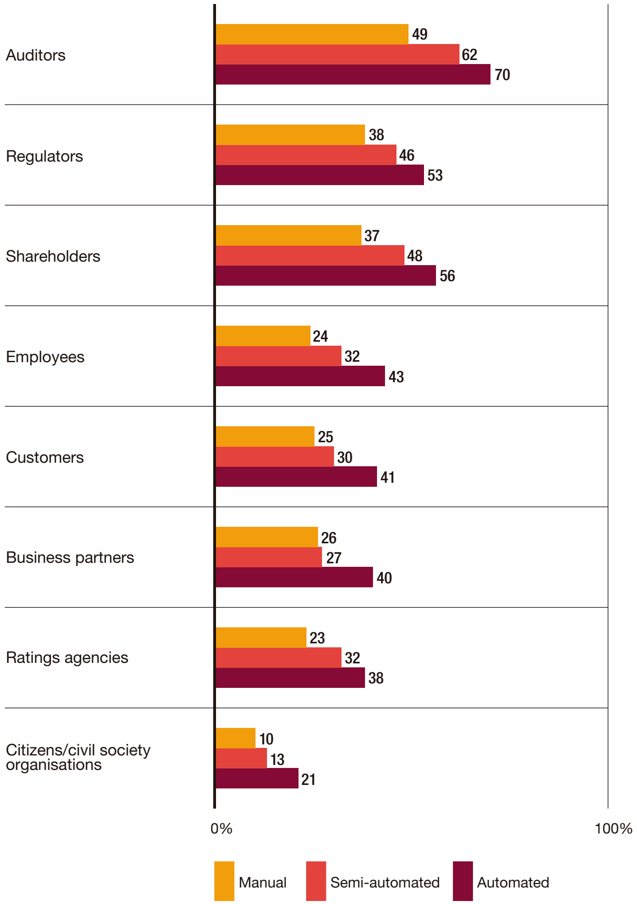


EXHIBIT 41 STAKEHOLDERS' CONCERNS—BY LEVEL OF AUTOMATION

How effectively do you feel that you address the following stakeholders' concerns regarding GRC?

Percentage reporting "very effectively"



Final Thoughts

This survey reports on what many of the world's leading CEOs have to say about GRC—an area of growing importance. The differences among them lie not primarily in degrees of awareness but in attitude, approach, and effectiveness.

A very small minority of CEOs view GRC in its narrowest sense, as a mandated and costly activity that must be performed under pain of penalty. Most, however, view GRC in a broader way as concerning much more than laws and regulations. They recognise that GRC is an integrated set of concepts, that it can add value, that it can help them manage risk more effectively, and that it can be a source of competitive advantage.

Nearly all the CEOs in the survey have a long way to go in fully developing the eight elements of effective GRC that we examined, in reaping its benefits, and in addressing stakeholders' concerns. Still, some CEOs have taken GRC to higher levels by better implementing eight elements of GRC, by ensuring broader ownership of GRC among business units, and by applying automation to the organisation and collection of GRC information.

The CEOs recognise the significance of GRC and of both the difficulties it entails and the benefits it can potentially provide, particularly at a time when these global leaders are exhibiting as much caution as optimism in their thinking and their actions. For despite changing economic and social conditions, bold ambitions among the world's business leaders persist. Realising those ambitions requires careful choices. As this survey report strongly suggests, effective GRC can provide the context within which such choices can be better assessed and executed.

Each CEO interviewed for this survey has a unique story to tell—about **challenges met, problems encountered, and victories achieved.** When data are presented in the aggregate, such stories, and the valuable insights they contain, are obscured. In the following conversations, four global business leaders who represent a diverse group of companies located on four continents offer their unique perspectives on GRC. Their remarks lend an essential human dimension to this report.




Living Our Core Values

Leif Johansson

President and CEO, Volvo Group

Since 1997, Leif Johansson has served as president and CEO of Volvo Group, one of the world's leading manufacturers of trucks, buses, construction equipment, drive systems for marine and industrial applications, and aerospace components. The group also includes Volvo Finance.

Early in his tenure, Mr. Johansson took the bold step of proposing and executing the sale of the group's prestigious automobile business, Volvo Cars, to Ford Motor Company. Mr. Johansson has also led the group's international expansion, establishing a global network of operations and a strong presence in emerging markets. The group's purchase of Renault Trucks and Mack Trucks in 2001 made it Europe's largest and the world's second-largest producer of heavy trucks. Today, Volvo Group serves more than 130 markets worldwide with its more than 76,000 employees and production in 25 countries.

In addition to being the only executive member of Volvo Group's Board of Directors, Mr. Johansson serves on the board and the audit committee of US-based Bristol-Myers Squibb. He also sits on the boards of the Confederation of Swedish Enterprise and the Association of Swedish Engineering Industries. He holds a Master of Engineering degree from Chalmers University of Technology in Göteborg, Sweden, and is a member of the Royal Swedish Academy of Engineering Sciences. Prior to joining Volvo Group, Mr. Johansson spent 17 years with Electrolux, where for the last 6 he rose to the position of president and CEO.

PwC: **How is today's stricter regulatory environment with its emphasis on more-stringent rules and tighter enforcement affecting your company?**

Mr. Johansson: The last couple of years we've spent an incredible amount of time trying to understand the new rules—most notably, Sarbanes-Oxley in the United States—and making sure we comply with them. I don't think we could actually continue to devote that enormous amount of time and resources to regulatory compliance indefinitely. But in general, I think the effort has been necessary and worth it.

PwC: **Why necessary?**

Mr. Johansson: Even though our companies were not involved in the recent scandals, we still felt some of their negative effects. Whether we like it or not, all corporations have to reestablish their credibility with investors, other stakeholders, and the broader public. There are many dimensions in the term *credibility,* but let's just look at the regulations.

I see compliance as a stamp of quality. Investors want to know that we are a compliant company. We accept that. Of course, there's been a lot of pushback on Sarbanes-Oxley. I think a lot of it is because there appears to be too much form over substance. And we've had that same issue before in areas like quality and environmental management. It's just not enough to make sure you're complying with the rules and processes. For example, someone can meet all the quality standards and obey all the rules and still produce an inferior product.

Of course, we must comply with the rules, but more important, we must always ask ourselves, What is the substance of what I'm doing? All of the best business decisions I've made have been substance oriented. There may be different ways to achieve that substance, but if the substance isn't there, the business can't be successful over time.

PwC: How do you know when you're focusing on substance?

Mr. Johansson: As you know, over the past few years, Volvo has made quite a number of very significant acquisitions. I've always said that the best way to see if we're focusing on the substance of an acquisition is to write the press release first. To boil the substance of the deal down to one page. If the parties involved can't agree on the press release, they will never agree on a 2,000-page legal contract. I've actually seen situations where people could finally agree on the legal text but couldn't agree on the press release because they couldn't get to the substance of the deal.

That same idea would apply to complex rules and regulations. You need to be able to boil the substance of their meaning down to an understandable level. That's the best way to get to compliance, to get to the substance of what the rule intends.

"Whether we like it or not, all corporations have to reestablish their credibility with investors, other stakeholders, and the broader public."

PwC: What in your view then is the substance of governance?

Mr. Johansson: To me the real substance of governance is making sure—through good management and leadership—that our stakeholders are comfortable with what we're doing.

PwC: It's interesting that you said stakeholders, not shareholders. How do you balance the sometimes conflicting interests of shareholders and other stakeholder groups?

Mr. Johansson: I think some companies find it very attractive to say that their sole purpose is to provide shareholders with returns. It's attractive because in very simple terms it clarifies what their company is doing. On the other hand, I've found after 15 years of being a public CEO that in reality business is much more complex. As an extreme, if the only reason for a company to exist is to provide short-term shareholders with the best returns over the next few quarters, then you might find the only way would be to dismantle the company.

We're running a much more complex enterprise than that at Volvo. We're much more focused on the long term, and that certainly includes providing shareholders with good returns on investments. But I feel strongly that to do that over time you must make sure that the interests and comfort level of other stakeholders, customers but also employees and society at large, are taken very seriously.

PwC: How do you go about making your shareholders and stakeholders feel comfortable with your performance?

Mr. Johansson: Among the most important things we can do in that regard is to remain accessible and transparent. On one front, we're moving toward greater transparency with a multitude of numbers. I think that's good. But you can drown your stakeholders in numbers and never explain what they really mean.

It should be the responsibility of top management to put all those numbers into context. There is a great need for narrative comments and qualitative analysis on top of all the numbers—to say publicly, "This is what's important and why." Stakeholders should expect that. Perhaps the most important thing we as executives can do both internally and externally is to make sure our companies' priorities are clear and well understood.

PwC: What are your priorities?

Mr. Johansson: At Volvo we've more than doubled the size of the company through recent acquisitions. We've taken on thousands of new employees—American, French, Chinese, Korean. We did that with a promise to derive financial benefits from those acquisitions. You could say my number one priority is to deliver on that promise. So far so good, we are performing well but can still improve. Right now and for the next couple of years we're in an execution mode.

"In governance terms, we need to set a clear expectation of what we consider an acceptable risk and to make sure that risks are quantified and understood."

PwC: What sort of risks does that involve? How are you managing them?

Mr. Johansson: I think some people have a misunderstanding about risk. They think that businesses should not take them. Actually, it's the other way around. Total risk avoidance is typically not good for a company. If you're avoiding all risks, you become too slow and not competitive enough.

There's a lot to be said for leadership and risk absorbance. That doesn't mean executives should go around taking just any risk, but they should take the ones they feel are justified after a cool analysis and assessment.

In governance terms, we need to set a clear expectation of what we consider an acceptable risk and to make sure that risks are quantified and understood. For example, we are making big investments in China. I don't think we should shy away because there are high strategic risks involved in that. We know what they are, we've quantified them, and we feel they're justified.

PwC: What happens when a company makes a mistake?

Mr. Johansson: It is often better to take the risk, execute quickly, and then find out that it is wrong than to spend too much time trying to define everything that could go wrong and lose the opportunity. Often, you just have to have the will to say, "I want to do this." Most successful leaders are driven by that kind of willpower combined with a cool, calm look at risk. They don't say, "Let's avoid risk altogether."

I had a boss once, a great leader, a man I admired very much. He always said that it is acceptable if you make a mistake. Just admit it, correct it, and don't make the same mistake again. The same holds true if you've make a bad decision. Acknowledge it and change course.

PwC: Couldn't that sort of candor still have negative consequences?

Mr. Johansson: I think that's much more likely to happen in politics, where the consequences of your mistakes can haunt you for many years. In business, if you make an honest mistake, you can generally recover. People don't tend to remind you again and again, "That was a terrible third quarter you had back in 1998."

Of course, it's always painful to tell the world that you've made a mistake. But trying to cover it up only prolongs the pain. Things just get worse and worse, and the truth will come out eventually and usually with much more severe consequences.

I find that our stakeholders and shareholders want to hear the truth. When we tell them why a decision was made or why something happened, they're much more willing to accept that mistakes can be made.

PwC: That philosophy seems very consistent with Volvo's reputation for ethics and honesty. How do you nurture a corporate culture that sustains a reputation like that over time?

Mr. Johansson: Leaders of companies must accept the responsibility to set the tone for the rest of the company by their own example. It's very seldom that the top executive isn't responsible for the company's culture, ethics, and business behaviour. We have to make sure we send the right signals.

For decades at Volvo there have been broad discussions at every level about what integrity and ethical behaviour really mean. But we don't just talk about core values; we actually live by them. Take our core value of safety, for instance. I truly believe that even if I personally ordered one of our workers to make an unsafe product, he wouldn't do it. Safety is a very deep value here.

PwC: How do you ensure that those core values are ingrained throughout Volvo, especially as you expand worldwide?

Mr. Johansson: We have something called The Volvo Way. It's a cultural, behavioural document, but it's more. It's also a basic guide for how we do business. Traditionally, we have focused on the responsibility of leaders to set the example, which is good. But lately, we're acknowledging that most of us are very often in dual positions: we may take a leadership role in the morning, but then in another context in the afternoon, we act as team members. So, how we all behave as individuals combines into culture.

If you discuss and rehearse both of these roles, you have a better understanding of the effect that a leader has on the behaviour of the rest of the team. If you do that exercise well, you end up taking your responsibility as a leader even more seriously. And that's good for the company as a whole.

PwC: Is there a limit to how far setting a good example can go in ensuring that your people behave ethically? Isn't a more rigorous form of discipline sometimes necessary?

Mr. Johansson: I don't believe that you can motivate people to good behaviour by telling them every Monday morning that you are going to fire them if they do something wrong. If that's your most frequently used tool, something is wrong with your management approach. Setting high expectations is much better. If you encourage the good things and use punishment only when absolutely necessary, you end up with a better outcome.

There's another important point to make here, though. There was a study done of businesses in Sweden that ranked Ikea and Volvo very high on credibility. People said they trusted Ikea and Volvo to be good companies to deal with. That doesn't necessarily guarantee that every individual within one of those companies will always do everything right. That's where having the right corporate culture and setting high expectations at the very top become more important.

You have to give people the confidence to make the right decisions about their own personal behaviour. I don't believe that people should take the attitude that if I always do only what my manager tells me to do, I will be doing the right thing. If what a manager says to do and what your culture expects are not the same, I would say to go with the culture, go with the higher expectations.

PwC: In addition to your top management and board positions at Volvo Group, you also serve on the board and the audit committee of Bristol-Myers Squibb. What similarities or differences do you see in governance at the two companies?

Mr. Johansson: Both Volvo and Bristol-Myers Squibb are good companies. You can look at governance in two ways: structurally and culturally. In terms of structure, the large corporations with which I've been involved, including both Volvo and Bristol-Myers Squibb, have organised their governance quite well. There's really not much more advantage that could be had from organising further in terms of leadership, management, or governance.

Then there's the cultural perspective on governance, which I just alluded to. It is how people as individuals behave within the formally organised structure. Often, we tend to overestimate the importance of structure and underestimate the cultural aspects of governance. In other words, we try to organise to make our problems go away or to create new opportunities. I think there's much that businesses could gain from broadening their focus on cultures and behaviours.

Taking the broader view provides a better perspective for understanding how a company works than overemphasising specific rules and structures. Putting governance in that broader context is how we can truly assure shareholders and stakeholders that what we're doing inside of Volvo is competitive, drives market share, creates returns for investors, and also avoids compliance or other problems. ■






Good Ethics, Good Governance

Michael B. McCallister

President and CEO, Humana Inc.

Humana Inc., headquartered in Louisville, Kentucky, is one of the largest US publicly traded health-benefits companies, with approximately 7 million covered individuals located primarily in 15 states and Puerto Rico. Humana offers coordinated health insurance coverage and related services—through traditional and Internet-based plans—to employer groups, government-sponsored plans, and individuals. Over its 44-year history, Humana has embraced change and has seized opportunities that have helped to transform its business.

As Humana's president and CEO, Michael McCallister has led the Fortune 200 company to a leadership position within the health-benefits industry. During his tenure, Humana has gained a reputation as a premier health-benefits innovator, leveraging new products, processes, and technology to guide consumers to lower cost and a superior health plan experience.

Mr. McCallister has an extensive history with Humana, having joined the company in 1974 as a finance specialist. For the three years prior to being named president and CEO in February 2000, he had senior management responsibility for health plan operations throughout the company.

PwC: We are in a particularly challenging environment for health care, with rising costs, the uninsured, and a crisis in public confidence. How do you navigate these waters?

Mr. McCallister: Every CEO can talk about the complexity of his or her business, I'm sure. We actually had this conversation internally—about what aspects of the health care business we want to be in. Most of our business is in the financial services aspect of health care. So we have the complexity of issues that relate to health care, and we also have the complexity of working inside a highly regulated industry. We are heavily involved with US federal government programmes and all the compliance issues that entails. We are also very heavily involved in Medicare. And we are a major contractor to the US Department of Defense, with TRICARE, and our subsidiaries are state regulated. So at every turn, we have to manage multiple levels of complexity relative to government bodies that are interested in how we do business.

PwC: You've been through a strategy-led transformation of Humana over the past couple of years. Can you please describe what the key drivers were for that transformation?
Mr. McCallister: We started with a fundamental principle: the costs of health care were rising at such a rate that anyone who buys it—whether a company, an individual, or an institution—simply could not continue to suffer double-digit annual increases. We began with the premise that if we as a company could, as our strategy, address the rising cost of health care, and be effective at reducing that, and outperform our competitors, there was a huge opportunity for us. It was a very big problem, so in our opinion, it represented a very big opportunity.

The second thing we looked at was what had been done already. As you look around the world, you see everything from nationalised programmes to, here in the US, what is primarily a system where the employer pays for insurance. You realise that there have been a lot of tactical things done to try to slow down the rising cost of health care, but the one thing that has never been attempted is to turn the consumer loose in this portion of the economy, armed with the same type of information that makes a consumer so powerful in other parts of the economy.

Our third point was that many of the needs of the health care system could be addressed in new and better ways by the proper application of technology—specifically, Internet-based applications—that is transforming nearly every other industry.

"We began with the premise that if we as a company could, as our strategy, address the rising cost of health care, and be effective at reducing that, and outperform our competitors, there was a huge opportunity for us. It was a very big problem, so in our opinion, it represented a very big opportunity."

PwC: It's almost a cliché that the health care industry has been slower to adopt information technology than any other. Is that because of the obvious concerns about privacy, or is there another factor?
Mr. McCallister: Well, in my opinion, looking at the provider side, companies' focus on technology was primarily on actual medical equipment, things that drive revenue, rather than on the administrative infrastructure. But they are now adopting those kinds of systems as well. On the insurance side, there are really two stories. One is a technology story, but there's also a transformation of the industry that has occurred over the past 20 years, with the traditional insurers being succeeded by HMOs. That has developed almost as a cottage industry, and differentiation was not by technology applied to administrative practices but by innovative approaches to business models. These HMOs grew up independently and individually over time. What I think we see now, both through consolidation and through some companies reaching considerable scale, is there are now opportunities to use technology to take us to another level. Not everyone has the ability or the resources, so our industry is going to go through a period of separation between those that have the capabilities and those that are laggards.

PwC: Every company has to balance stakeholders' needs. Does a for-profit institution face a particular challenge, balancing the needs of health plan members against the need to generate shareholder value?
Mr. McCallister: If every dollar in health care were being spent effectively, I would worry about that. But since I know how much waste there is in health care, I focus instead on eliminating waste. The ultimate question really is, When you are making financial decisions, are you somehow hurting people who are using your services? I would argue that we, as an industry and as a company, are miles and miles away from that day. There have been a number of studies showing that up to half of health care is not value-added, and a Rand study recently suggested that a tremendous number of people get the wrong care, either the wrong kind or too much. Maybe years from now the financial question

"When you're as closely involved with the US federal government as we are—and by extension with the governments of the 50 states—governance, risk management, and compliance are crucial to continuing to do business."

will be an issue, but I don't worry about that today because we have tremendous headroom to rationalise health care without hurting the consumer. The interesting thing is that in the rest of the economy, poor services and poor products do not survive, but in health care they do. We pay the same, in many cases, for bad service and bad care as we do for the very best. Some of this is due to the employers' buying, because the third-party payment system is insulating the consumer. In other parts of the economy, you can find the cost, you can find the quality, and you can make your own choices. That's what we're trying to do in health care. In the future, consumers will shop for health care and basically drive high quality through their decisions. As a company, we've been trying to build this into our DNA. That's why we chose the tagline for the company: Guidance when you need it most. We think there's a tremendous opportunity to add value by providing guidance to consumers as they awaken to the need to make informed decisions.

PwC: **I'd like to turn the conversation to the subject of governance, risk management, and compliance. How are these processes important to you at Humana?**
Mr. McCallister: As I said at the beginning, we're a company that, because of the business we are in, has been dealing with governance issues for a very long time. When you're as closely involved with the US federal government as we are—and by extension with the governments of the 50 states—governance, risk management, and compliance are crucial to continuing to do business. As things have heated up over the last two years, there hasn't been a major change at Humana—because it was part of our corporate culture already.

PwC: **What are the benefits of taking a thoughtful and comprehensive approach to governance, risk management, and compliance?**
Mr. McCallister: Let me talk about ethics. Given the business we're in, we have quite a lot of information about people. We know what procedures they've had, what drugs they take, what medical services they need. And we know their economic situation as well. So ethics is something we really drive hard throughout the company. We need our people to be respectful of our customers' privacy because at the end of the day, that's part of our value proposition. We have worked very hard, and built vast infrastructure in the company, to ensure that customer privacy is maintained. It's built into our processes.

PwC: **Have you faced any particular challenges in the governance and compliance arena as a company?**
Mr. McCallister: We've certainly faced challenges. Sarbanes-Oxley presented its own set of challenges, a whole new array of issues to face. But the real challenge there was to implement it within the year, just to get it up and running.

PwC: **Looking at the risk element of GRC: How do you communicate about risk management so that people in your organisation are all concerned about the same thing? How have you implemented a common framework and vocabulary among managers who assume certain risks in the course of business and report on those risks?**
Mr. McCallister: I think it starts at a very high level. You have to make sure your organisation understands your strategy in the first place. Then it cascades down through the organisation in terms of tactical implementation. You have to establish clear expectations around performance, as well as guidelines and metrics to measure your progress. When somebody gets outside of your parameters, there has to be a clear set of consequences. Risk is associated with misunderstanding. There has to be an overall structure that goes with the idea that if

you said you're going to go from A to B, then what does it take to get there? It's being clear about what your business is about, and if you're really clear, these misunderstandings don't come about. When I became CEO, we made a significant effort to get our strategy absolutely clear and then to cascade road maps, incentives, and performance measures throughout the organisation and tie those back to that strategy, so there would not be any confusion. It's something that changes as your environment changes, but you always come back to strategy.

PwC: **Acquisitions, joint ventures, and close alliances present their own GRC challenges. How do you establish comfort and confidence with respect to these things?**
Mr. McCallister: Over our 44 years, we've done a lot of acquisitions, and we've had a couple recently. We completed one in the early part of 2004, and we are working on another right now. Again, it goes back to being very clear about your strategy and being very clear with the acquiree about your expectations. Without a doubt, you need a set of guidelines, road maps, and measures to let people know they will be held accountable for results. If you combine all that with good due diligence, you can mitigate risk, and I think that the governance issues have to be very clear at the start, especially in an acquisition.

PwC: **Would you be kind enough to describe how you work with your board with regard to governance and compliance issues?**
Mr. McCallister: Our board works on the kinds of issues you would expect. We work with them on all of our policies, procedures, and the expectations we set. This is all public, all on our Internet site. We like to believe we've been operating in a good governance role for some time, so we really haven't made any changes over the short term.

If I can take it back up to a 100,000-foot view, I'm not a big believer that you can legislate or regulate integrity. And I don't think you create it through changing your board structure. People either have integrity or they don't.

PwC: **What are your specific governance priorities, looking forward?**
Mr. McCallister: As an individual company, we're in the process of bringing new board members aboard. Getting the right people on board, who are interested, is our current challenge, so we are actively recruiting.

PwC: **Do you see a value added in the new emphasis companies are putting on governance, risk management, and compliance?**
Mr. McCallister: I do, but it's in a place some people might find surprising. As I said before, it's hard to regulate and legislate integrity. So from the standpoint of whether it's really changing people's behaviour and preventing them from doing wrong, I'm really doubtful. But I do think it has the chance to give the public more confidence, that people will in fact be held accountable for their actions. To the extent it raises the bar, and gives people confidence in the system, there is value added there.



A Trace Element in Nearly Everything

Fernando Roberto Moreira Salles

CEO, Companhia Brasileira de Metalurgia e Mineração (CBMM)

Governance, risk management, and compliance takes many forms. How are these key elements of good management shaped and sustained in private companies? Companhia Brasileira de Metalurgia e Mineração (CBMM), a Brazilian mining and metallurgical enterprise with strong global markets, is a private company founded, owned, and managed by one of Brazil's most prominent families with a long history of leadership in banking, government, diplomacy, and cultural affairs. Risk management is always a key strategic concern, and CBMM is no exception to the rule, although it regards itself as taking a longer view than most public companies. Also, as a privately-held company, CBMM has a simpler governance structure and arguably greater freedom to exceed compliance standards—for example, with respect to environmental stewardship and employee welfare. CBMM's environmental programmes, going far beyond the socially expected or legally regulated minimum, offer a remarkable model.

CBMM produces a metal, niobium (Nb), in the Brazilian state of Minas Gerais and exports worldwide to customers who do everything from manufacturing strong, lightweight steel for vehicles, pipelines, and bridges to developing new types of lenses. Used as an alloy in small percentages, niobium has remarkable positive effects. Most of us who use eyeglasses and digital cameras are probably using a small amount of niobium; it is a trace element in nearly everything.

Exporting to some 40 countries, CBMM employs a workforce of 750 with sales in the past full calendar year of US$330 million.

PwC: **In order to appreciate CBMM's governance, risk management, and compliance challenges and solutions, it would be helpful to know something of the company's key products, markets, and opportunities.**

Mr. Moreira Salles: CBMM is a mining and metallurgical operation that started in the late 1950s and early '60s to commercialise products from a newly discovered ore body containing the metal niobium. At the time the ore body was discovered in the Brazilian state of Minas Gerais and a way of separating it was achieved, its uses were unclear. There was a largely theoretical view that, if added to other metals, niobium would change some properties in valuable ways by altering the crystalline structure. We knew, for example, that added to steel it could make stronger, more-resistant, and consequently lighter steels. But there was no compelling reason for research laboratories to work out the details. To try to find a commercial space for our metal, we had to sponsor or actually perform most of the research ourselves to prove that we could do this or that with our product.

PwC: Today, you are essentially the Microsoft of niobium: you have achieved enormous market share.

Mr. Moreira Salles: Depending on how you look at it, our market share is 60 to 70 percent—larger in some markets, smaller in others. Factually, we sell more niobium or niobium-derived products than the rest of our competitors pooled together. We have Ph.D. scientists on our staff and overseas commercial and research efforts in Düsseldorf, Tokyo, Pittsburgh, and, more recently, Beijing and Moscow. We were one of the earliest entrants in the mainland Chinese market; we have been there for more than 25 years. And we work closely with clients worldwide to perform the research they need and find solutions for their uses of niobium.

PwC: Now that niobium has become a constituent in many sectors of manufacturing, is it reasonably certain to remain in demand?

Mr. Moreira Salles: The future of niobium and the future of this company depend on choosing well the fields where we concentrate and commit resources to basic research. It's hard to find a substitute for niobium in, for example, pipeline steels; I don't see many technically competitive alternatives. But about a quarter of our market today is steels for the automotive industry. The automotive industry needs to build lighter cars, but it can use aluminium rather than steels containing niobium. Aluminium has its inconveniences—it needs so much energy to manufacture, and it's not as pliable for repairs and adjustments—but it also has weight advantages. Similarly, steels can be developed that would displace niobium-alloy steels. If so, we could lose market share.

"We're aware of the challenges and risks, and we're striving to open new areas, which we think will determine our future."

We're aware of the challenges and risks, and we're striving to open new areas, which we think will determine our future. For example, niobium is extraordinarily conductive, and so any device or application that needs extreme conductivity could create demand. Medical equipment for noninvasive diagnostic devices may be a growing market; we are already a participant. There could be an entirely new market for capacitors, which can be made more cheaply through the use of niobium powder, and the technology is reasonably advanced in Japan and in Europe. So several areas have great potential, but we won't get there without continuous effort to develop these technologies.

PwC: With competitors ready to chew up your strong market share, how have you addressed key market uncertainties such as commodity price fluctuations?

Mr. Moreira Salles: As you know, we are a predominantly family-owned business, although the US corporation Unocal, through one of its subsidiaries, holds a minority position, and, as well, the state of Minas Gerais has a 25 percent participation in our net operating margin. The fact that we are privately held has allowed us greater latitude to make decisions from the perspective of long-term growth and profitability. The Moreira Salles Group, which holds the majority position in CBMM, also has a major stake in a large, publicly traded financial institution, Unibanco, the third-largest bank in Brazil, and so we know what it's like to have to measure up to other people's expectations of your performance on a quarterly basis. But at CBMM we have, let's say, greater freedom to manage the company's risks and opportunities by looking much farther down the road.

Ten years ago, CBMM management thought that its best opportunity was to substitute niobium for other metals in applications where the advantages of niobium were not at the time as clear as they were in pipelines. We looked at the metals markets over the years and found them to be more volatile than other commodity markets. So we decided that we would differentiate ourselves by offering the combination of the technological qualities of our metal and price stability. We would eliminate for our customers the price fluctuations in metals, which can oscillate 30 to 40 percent over a short period. Our gamble was that long-term price reliability would permit us to enter markets we had been previously unable to enter. And the gamble paid off—but it took time, and during that time as a private company we did not have to answer analysts' questions about short-term results. At CBMM we were able to take a much longer-term perspective than most public companies could dream of.

"We do more than comply with existing environmental legislation. We try to infer what legislation could be enacted in the foreseeable future, we anticipate new requirements before they become mandatory, and, above all, we do what we know to be right without looking around us to see what everyone else may be doing."

PwC: **Although CBMM is a private company, there are compliance challenges that must be addressed—for example, increasingly stringent environmental standards. What has CBMM done in this respect?**
Mr. Moreira Salles: We believe that we are the first mining and metallurgical operation to receive ISO 14001 certification. We regard ourselves as environmental stewards and educators, and you would be directly aware of that if you were to visit us in Araxá. In 1992, we launched the Programme for Environmental Education, whose participants include students and teachers in Araxá, business-people from our own company and other companies, and members of the larger regional community. The programme explores and teaches the rational, prudent use of natural resources and the minimisation of environmental disturbance from mining and industrial operations.

In every dimension, our operations reflect that commitment. For example, we transport ore from the open-pit mine to the factory, where it is processed, by means of a 3.2-kilometre, electrically powered conveyor belt rather than by lorry. With this technology, we reduce our energy consumption, minimise noise, reduce the risk of accidents, and preserve air quality. Our use of water in the processing of raw ore into purified niobium and other niobium products is engineered to minimise environmental impacts. We recycle, we monitor, we preserve, we improve: this is fundamental to who we are as a company.

We do more than comply with existing environmental legislation. We try to infer what legislation could be enacted in the foreseeable future, we anticipate new requirements before they become mandatory, and, above all, we do what we know to be right without looking around us to see what everyone else may be doing. This makes sense from an environmental perspective, but it is also good business because if you take action early enough, generally it's much more economical than taking action later. It's better to have methods and processes and a culture already in place.

Some people might say that we go too far in the direction of environmental care. But in our view, we take niobium from nature as a gift, and we must return something of equal value. In that spirit, CBMM sponsors two unusual programmes in Araxá: a nursery for endangered animal species and a parallel nursery for agriculturally and medicinally useful plant species.

PwC: **You have such freedom as a successful private company to set your own agenda. What, in fact, is your management and governance structure?**
Mr. Moreira Salles: CBMM does not have a very typical management structure. There are essentially two shareholder groups. One is Unocal, the US-based energy company, and the other is the Moreira Salles Group. Our American partner takes no management responsibility, and this may be the first unusual aspect of our management structure. The second may be this: for many years CBMM has practised a division of responsibility at the top of the company along the following lines. One senior executive is responsible for all matters relating to policy and the company's longer-term position. That is my current role. A second senior executive, in an operating role, is responsible for ensuring that the company reaches or surpasses its strategic objectives. That role is now taken by José Alberto de Camargo, who for many years led the company. We do not have a board of outside directors. Each of our country managers reports to him, and he travels some 60 percent of his time. So there is vertical communication to and from him, but all areas of the company—for example, the commercial and technological areas—have their own channels of communication and accountability.

PwC: You are a private company competing in global markets where vast public companies typically dominate. What are the rules of the game?

Mr. Moreira Salles: The people of CBMM have working conditions and rewards that meet every test, the test of international standards but also the test of conscience. It is a fact that 100 percent of our employees own their own houses through special financing provided by the company, and the company also has its own retirement plan.

Because I am not ashamed of any feature of our operations, I am also not ashamed to tell our people what I expect of them. Do I insist on excellent conditions of employment because I'm a humane spirit? Maybe. But here is the second point: CBMM cannot be a world-class player if we do not have world-class people. We cannot hope to successfully challenge our competitors if we are anything less than world-class. How can we challenge world-class competitors unless our training programmes are equal or superior to our competitors'? How could we retain people in whose training we make serious investments if their working conditions are inferior to conditions at other companies, public or private? How could we retain valued people if we fail to provide the compensation and personal recognition they quite reasonably expect? We need people who are glad to be part of CBMM and who will do their very best to see this company move forward.

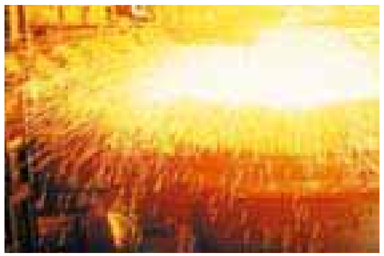
So, pragmatically, whether public or private, world-class competitors must meet the same standards. At CBMM, we have the privilege of not needing to answer every quarter to analyst and shareholder enquiries as to why we have placed our bets here and not elsewhere. But we are fully responsible to our stakeholders: to employees, to clients (who would certainly worry if CBMM were taking unwise routes), to the scientific community with which we cooperate on fundamental research, and to the communities where we operate.

Were this not a family-held company, José Alberto de Camargo and I would, conceivably, not have the responsibilities we have today; management of the company would have evolved in some other way, if you consider that he and I have worked together for nearly 40 years, and his father used to work for my grandfather.

PwC: Apart from the issue of shareholder pressure to achieve short-term results, what are the advantages and disadvantages of family-held businesses, in your experience?

Mr. Moreira Salles: We have long relationships with clients and suppliers; we have worked together for 20 years or more. Over that period, I have seen clients, for example, change their way of thinking and change virtually all their key people because a management consultant came in and told them that those people were useless. Similarly with state companies, every time a regime changes there are substantial changes in management. Family-owned companies tend to be different: at CBMM we offer clients consistency, which is not unhelpful.

This leads to the issue of institutional memory and integrity. If someone approaches us today and says, "Twenty years ago, you told us you would do this and not that," under most circumstances we will honour what was said 20 years ago. We won't wiggle out by saying that other people were involved who may or may not have made those commitments; or that we were owned at the time, but no longer, by XYZ Corporation; or anything of that kind. All those with whom we deal can rely on our institutional memory and steadiness over time. This is, in fact, one of our strongest risk management practices: we do everything possible not to put our clients and market at risk. ■






Risk and Reputation

Capt. Wei Jiafu

President and CEO, COSCO Group

Named to head China Ocean Shipping (Group) Company (COSCO) in 1998, Capt. Wei Jiafu has transformed this state-owned shipping business characterised by traditional management practices into a modern diversified logistics conglomerate. Today COSCO is a $17-billion multinational company, with headquarters in Beijing and more than 80,000 employees worldwide. Specifically, COSCO offers its mix of shipping, freight forwarding, shipbuilding, ship repairing, terminal operations, trade, financing, real estate, and information technology (IT) services in more than 160 countries. The COSCO Group also includes seven publicly traded subsidiaries, which are listed on the Singapore, Hong Kong, Shanghai, and Shenzhen stock exchanges.

Before assuming his current responsibilities, Capt. Wei held numerous leadership positions within COSCO and its subsidiaries, both domestic and overseas. During his tenure as president of COSCO Corporation (Singapore) Ltd., he successfully took that company public, marking COSCO Group's first entry into the international capital market.

With more than 10 years of experience as a seafaring captain, Capt. Wei came to his position as president and CEO with a firsthand knowledge of international shipping management and operations.

Capt. Wei has distinguished himself as a major force in international shipping and as a leader within China in both business and government. Among the positions he holds are co-chair of the China Federation of Industrial Economics and member of the Central Commission for Discipline Inspection of the Communist Party of China. He is a frequent speaker at international industry and business events and has won numerous awards for his management and leadership.

PwC: **As a state-owned enterprise transforming itself into a multinational conglomerate, how do you address the inevitable questions about shareholders' interests and corporate governance?**
Capt. Wei: This is a very important issue. Since the public stock exchanges opened in China a few years ago, corporate governance policy here also began to open up and change. Before then, most companies in China didn't understand what corporate governance meant. Now every president and CEO understands much better what it is, how it functions, and the need for transparency and discipline. Especially if a company wants to operate in the capital markets—like COSCO—you have to be attractive to investors. You must show them that you take corporate governance very seriously. You must be very transparent; allow people to see from the outside to the inside.

PwC: **What exactly is the role of corporate governance in a state-owned enterprise? What about in your publicly listed companies? How do you reconcile what must be some significant differences?**

Capt. Wei: It's all supervision, isn't it? The government of China owns the parent group, COSCO Group. That group—the state-owned enterprise [SOE]—has a single shareholder. Our governance comes from the State-owned Assets Supervision and Administration Commission. They represent and protect the state's interests in its assets—the nearly 200 SOEs.

The Commission appoints supervisors to each SOE. The supervisors for COSCO are based in our headquarters. They are present every day in our offices. They attend all our division meetings. They don't speak. They listen. No voice. Only eyes and ears. Then they report what they've seen and heard to the Commission and the State Council. By law, the Commission can appoint executives and terminate their employment, and they can reward or punish them for their performance.

We also have our own internal governance—our department for supervision and discipline. It monitors the management of both our headquarters and our subsidiaries. This is our corporate governance: no one has the right to do anything illegal—to breach the regulations imposed from outside or from within.

Our seven listed companies also have governing boards that must meet all the rules and regulations of the exchanges—regular meetings, committees, independent directors—and their balance sheets are audited by an external auditor. We want to do that. It enhances our reputation. In the end that is what we have: our reputation.

PwC: Your publicly listed companies are audited. What about COSCO headquarters, the SOE?

“All COSCO companies and employees—domestic and overseas—must be in compliance not only with local laws where they do business but also with all of the policies and regulations of COSCO.”

Capt. Wei: The State Council's National Audit Office sets the standards and can audit any of the state-owned enterprises at any time.

PwC: You serve as a member of the Central Commission for Discipline Inspection of the Communist Party of China [CPC]. What does that entail?

Capt. Wei: There are discipline inspection commissions at various levels of the CPC to make sure that party members are carrying out the party's principles and policies. This applies to all party members, including the CEO and senior management of a company. As Capt. Wei, I'm a member of the Central Commission for Discipline Inspection, which works under the Central Party Committee. But as president of COSCO, like all senior managers in state-owned enterprises, I am also subject to the Commission's review and actions. We accept a lot of supervision because governance is so very important.

PwC: Within the state-owned segment of your group, compliance is closely linked to CPC policies and regulations. What is your view of compliance as it relates to your subsidiaries, especially those outside of China?

Capt. Wei: All COSCO companies and employees—domestic and overseas—must be in compliance not only with local laws where they do business but also with all of the policies and regulations of COSCO. I don't care what nationality you are or where you live. If you work for COSCO, you must agree to follow our company rules and the local laws.

PwC: Obviously, you place a great deal of importance on discipline and compliance. How do you instill that same attitude throughout your company?

Capt. Wei: COSCO must have worldwide respect. Everyone within COSCO has personal responsibility for our reputation. If anyone does anything to damage that reputation, we will take immediate action.

We tell a story in China: the monks in the temple can change frequently, but the temple can never change. You could say I'm the chief of the monks here. I am responsible for the reputation of COSCO. You simply cannot afford to do one wrong thing or to cheat one customer. If you do, you lose your reputation.

PwC: Loss of reputation is a significant potential risk. However, your industry is fraught with all types of risks, from natural disasters and international conflicts to fluctuations in the global economy and virtually every market sector. How do you begin to approach risk management in such far-flung and inherently risky operations?

Capt. Wei: My first task as CEO of such a big group is risk management. Every day, I must be informed of the present risk situation. Where is the risk? How many risks? Which risk is greatest? I have to know which ones could damage the company most, the key risks. How many factors influence each one. Then cut, cut, cut those factors. This is my risk management skill. This is my personal view of risk.

Of course we have many risks. One oil tanker running aground like the *Exxon Valdez* could close the company down. We have legal risk, market risk. But the major risk for this company is operational risk. We have a fleet of more than 600 ships. We need high-freight-rate cargo to make money. We need the right number of ships. For example, if our fleet is not big enough, do we buy more ships or charter them? Then if the market drops the next year, what do we do?

Operational risk also involves cost, like fuel oil, which in my term of office has ranged from $9 a barrel to $57, an increase of nearly 600 percent. No one would have imagined that. So yes, risk management is a very high-level job at COSCO. All my top managers know that their job is not just to make money. It's also to manage risk.

PwC: **Despite significant risks, during your six years as president and CEO, COSCO has emerged as a shining example of how a state-owned enterprise can not only compete in the global marketplace but also become one of the most dominant forces in its industry. To what do you attribute such remarkable and rapid success?**

Capt. Wei: One word: strategy. COSCO has risen so quickly because we followed our strategy. In China, this has not always been the case. Historically, many Chinese companies have had no clear strategy. Yes, we are an advanced socialist market economy, but many executives here have tended to focus almost solely on financial management. They haven't always understood that their companies also needed strategic direction. Without it, many companies have disappeared and their laborers have been left without jobs.

PwC: **Why did COSCO take this less traditional, more strategic approach?**



Capt. Wei: When I took over as president and CEO in 1998, I did a very detailed study of the situation. I found that the business was heading down a very broad path—not just on the sea but also on land and in the air. Sea. Land. Air. Going in all three directions was too broad for us to do everything well, not to mention how much money we would have needed. I saw immediately we had to concentrate on our core.

So I invited a very senior specialist from the Chinese State Research and Development Center to head a research group to help develop a 10-year strategy for COSCO. After several months—and a great deal of careful study of the proposed strategy by me and my executive staff—we had our strategy. It's very clear. We have our core, being an ocean shipping company. Within the core, we have two key businesses: shipping and logistics. And supporting that we have five pillars: industry, trading, finance, capital markets, and IT.

PwC: **Please briefly explain what you mean by those five pillars.**

Capt. Wei: Industry means shipbuilding, ship repairing, container manufacturing, anything shipping related. Within that industry we are both the supply and the demand. Our companies need ships and containers, so we manufacture them not only for us but for other shipping companies as well.

Trading—what do we trade? Shoes? No, we trade in ships. Sell the old, buy the new. We also trade in fuel oil. COSCO is very thirsty. We need three million tons of oil a year so our fleet can carry goods worldwide. Because we demand so much, we can leverage the price and then sell fuel oil at a good price to other companies.

Shipping companies require financing. We are the second-largest shareholder in the China Merchants Bank and have sizable interests in other commercial banks, including those in Hong Kong. We also have a finance subsidiary and insurance holdings as well.

The capital markets make up our fourth pillar. COSCO has seven publicly listed subsidiaries: three overseas and four domestic.

When you have operations worldwide like we do, you must have a very strong IT infrastructure. I spent one billion renminbi (RMB) five years ago to build our IT and computer systems. Now from the computer on my desk I can see all the financial results and even all the shipping documentation for every one of our customers immediately.

PwC: **Having a strategy is one thing. Staying true to it is another. What impact has following your strategy had on your company?**

Capt. Wei: Because of our strategy, we've had two transformations. In our first transformation, we went from being a global carrier of cargo to being a global logistics provider. Before, we were in the port-to-port shipping business. To remain in business today, we must take goods from the shipper's door to the consignee's door. We move goods by truck, train, and riverboat to the seaport; load it on our ships; move it to other seaports; transfer it to our trucks or the railway; and then deliver it to the consignee's door. That was our first transformation.

In our second transformation, we went from a company operating globally to a real multinational company. As I said, we have seven publicly listed subsidiaries not only in China but also in Singapore and Hong Kong and operations around the world.

"Risk management is a very high-level job at COSCO. All my top managers know that their job is not just to make money. It's also to manage risk."

Some of our subsidiaries are considered blue-chip or benchmark stocks on their exchanges. This has been a major transformation, especially for a state-owned enterprise in China.

PwC: **How have those transformations paid off operationally and financially?**

Capt. Wei: Four figures tell the story. The first figure is shipping capacity. When I took over in 1998, COSCO had shipping capacity of 16.35 million tons. We now have a shipping capacity of 34 million tons, more than double in six years' time. We've become the world's number two shipping company, only two million tons short of being number one.

Second figure: In 1998 for the whole year, COSCO carried 115 million tons of cargo. This year we'll reach 240 million tons, more than double. Third, revenue was 32.5 billion RMB in 1998. Last year, it was 75.8 billion RMB: that's a 2.3 times increase. And figure number four is profit. When I took over, COSCO recorded a profit of 520 million RMB. Last year, it was 3.4 billion RMB. This year, 2004, up to now, we're showing three times more profit than we had last year.

PwC: **Other companies in the shipping industry have also turned sizable profits over the past few years. Why has your performance stood out among them?**

Capt. Wei: I have a model rocket sitting in my office. It says that I don't want to operate like an airplane taking off at a 30-degree angle. I want to be like a rocket, a big one, taking off vertically. I've been successful. The figures tell the story. Last year, profits were three times greater than those of the previous year. This year, we're three times ahead of last year.

It happens because of strategy and hard work. Everybody at COSCO must work hard, but Capt. Wei has to work hardest. I have heavy responsibilities to all my shareholders. For many years, I've only slept four hours a day. How can I do that? Spirit. I don't need ginseng. Work is enough.

PwC: **Where do you see COSCO heading in the future?**

Capt. Wei: Today, COSCO is already an international player as a state-owned enterprise. I also want to make another COSCO, a capital COSCO in the overseas markets. That's my goal. You can see it in my strategy. We already know how to organise a company in the capital markets. My goal for the year 2010 is to become a member of the Fortune 500.

When I was younger, I was captain of a ship. Now, I'm captain of the world's second-largest fleet. Someday, perhaps, I will be captain of the largest one. ■

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