

How to Fix Corporate Governance

Excessive pay, corrupt analysts, auditing games: It all adds up to capitalism's biggest crisis since the trustbuster era

A disenchanted investor vows to vote in favor of every shareholder resolution he can find. An angry employee says she feels betrayed by bosses who have grown rich on stock options while putting the squeeze on health benefits and salaries. A dealmaker, trying to close a sale, hears yet another buyer grouse: "Who's to say this guy isn't lying about the numbers like everyone else?"

Faith in Corporate America hasn't been so strained since the early 1900s, when the public's furor over the monopoly powers of big business led to years of trustbusting by Theodore Roosevelt. The latest wave of skepticism may have started with Enron Corp.'s ugly demise, but with each revelation of corporate excess or wrongdoing, the goodwill built up by business during the boom of the past decade has eroded a little more, giving way to widespread suspicion and mistrust. An unrelenting barrage of headlines that tell of Securities & Exchange Commission investigations, indictments, guilty pleas, government settlements, financial restatements, and fines has only lent greater credence to the belief that the system is inherently unfair.

Some corporate chieftains claim that the backlash is overblown, a form of "corporate McCarthyism," in the words of Joseph P. Nacchio, head of Qwest Communications ([Q](#)), which is one of dozens of companies under investigation by the SEC for questionable accounting. But increasingly, the public perception is that too many corporate executives have committed egregious breaches of trust by cooking the books, shading the truth, and enriching themselves with huge stock-option profits while shareholders suffered breathtaking losses. Meanwhile, despite a decade or more of boardroom reforms, many directors seem to have become either passive or conflicted players in this morality play, unwilling to question or follow up on even the most routine issues. If the governance of the modern corporation isn't completely broken, it is going through a severe crisis of confidence.

The sight of Enron employees tearfully testifying before Congress was a watershed moment in American capitalism. They painted a picture of betrayal by company leaders that left them holding huge losses in their pension plans. Enron added to the sense that no matter how serious their failure or how imperiled the corporation, those in charge always seem to walk away vastly enriched, while employees and shareholders are left to suffer the consequences of the top managers' ineptitude or malfeasance.

In many ways, Enron and its dealings with Arthur Andersen are an anomaly, a perfect storm where greed, lax oversight, and outright fraud combined to unravel two of the nation's largest companies. But a certain moral laxity has come to pervade even the bluest of the blue chips. When IBM ([IBM](#)) used \$290 million from the sale of a business three days before the end of its fourth quarter last year to help it beat Wall Street's profit forecast, it did what was perfectly legal--and yet entirely misleading. That one-time undisclosed gain, used to lower operating costs, had nothing to do with the company's underlying operating performance. Such distortions have become commonplace, as companies strive to hit a target even at the cost of clarity and fairness.

The inevitable result is growing outrage among corporate stakeholders. "I feel thoroughly disillusioned and disgusted," complains Eugene J. Becker, a small investor living near Baltimore. "These people cannot police themselves. Greed is their driver. It's time for stockholders to start showing their disillusionment in tangible ways." This year, for the first time, Becker is casting "no" votes against management at the eight public companies in which he is a shareholder.

Unchecked, that rising bitterness and distrust could prove costly to business and to society. At risk is the very integrity of capitalism. If investors continue to lose faith in corporations, they could choke off access to capital, the fuel that has powered America's record of innovation and economic leadership. The loss of trust threatens our ability to create new jobs and reignite the economy. It also leaves a taint on the majority

of executives and corporations who act with integrity. Directors who fail to direct and CEOs who fail at moral leadership are arguably the most serious challenge facing Corporate America today.

More than a half-century ago, Columbia University professors Adolf A. Berle and Gardiner C. Means made clear the divergence between the owners of the corporation and the professional managers hired to run it. They warned that widely dispersed ownership "released management from the overriding requirement that it serve stockholders." A great irony of the boom era is that after years of lavish stock-option rewards meant to remedy the problem, this divergence is more extreme than ever. The senior executives of public corporations today are often among the largest individual owners of those enterprises, and board members are far more likely to have major equity stakes as well.

In theory, this ownership was supposed to align the interests of management and directors with those of shareholders. The law of unintended consequences, however, took hold. Whether through actual stock ownership or option grants, many executives and directors realized that their personal wealth was so closely tied to the price of the company stock that maintaining the share price became the highest corporate value. Investors rode the boom along with management, leading to the "irrational exuberance" of the late 1990s.

But there was a dark side to runaway stock prices. As the market overheated, it became less and less tolerant of even the slightest whiff of bad news--rumors of which could wipe out hundreds of millions of dollars of market value at a stroke. "Through the 1980s and 1990s, we constructed an architecture that emphasized reporting good news, to the point where CEOs and CFOs could not be frank with the investment community," says Anita M. McGahan, a Boston University business professor. "Many of these companies needed a course correction. But the stakes in admitting problems were very high, both because the market overvalued their stock and because of executive pay."

The tyranny of the daily stock price has led to borderline accounting and in some cases, outright fraud. And why not, when every upward tick of the stock means massive gains for option-rich executives? "Excessive CEO pay is the mad-cow disease of American boardrooms," says J. Richard Finlay, chairman of Canada's Center for Corporate & Public Governance. "It moves from company to company, rendering directors incapable of applying common sense."

A study by Finlay shows that many boards devote far more time and energy to compensation than to assuring the integrity of the company's financial reporting systems. At Oracle Corp. ([ORCL](#)), where CEO Laurence J. Ellison's exercise of stock options just before the company issued an earnings warning led to a record \$706.1 million payout last year, the full board met on only five occasions and acted by written consent three times. The compensation committee, by contrast, acted 24 times in formal session or by written consent. "Too many boards are composed of current and former CEOs who have a vested interest in maintaining a system that is beneficial to them," says Finlay. "If you look at the disconnect between audit and compensation committees, you begin to understand how misplaced the priorities of many boards are."

Enron's implosion is the most visible manifestation of a system in crisis. Self-interested executives gorged with stock-option wealth, conflicted outside advisers, and a shockingly uninvolved board: Rarely has a total breakdown in corporate governance been so clearly documented--and oddly enough, by other directors, in a report filed by William C. Powers Jr., an Enron board member. He and his colleagues found an almost total collapse in board oversight. The Powers report concluded that the board's controls were inadequate, that its committees carried out reviews "only in a cursory way," and that the board failed to appreciate "the significance of some of the specific information that came before it." That is as complete a definition of "asleep at the wheel" as you'll ever find.

With many directors lulled into complacency by climbing stock prices and their own increasing wealth, all too often the last vestige of internal control was lost. "There was this convergence of self-interest," says Edward E. Lawler III, director of the Center for Effective Organizations at the University of Southern California. "They were all doing well, and nobody wanted to rock the boat. With the escalation in board compensation through stock options, directors were the last people to the feeding trough. Once they got tied in, there was really no restraining force."

It's not just the corporation that is at fault. Many of the corporation's outside professionals fell prey to greed and self-interest as well, from Wall Street analysts and investment bankers to auditors and lawyers and even regulators and lawmakers. These players, who are supposed to provide the crucial checks and balances in a system that favors unfettered capitalism, have in many cases been compromised.

Many analysts urged investors to buy shares in companies solely because their investment banker colleagues could reap big fees for handling underwriting and merger business. Far too many auditors responsible for certifying the accuracy of a company's accounts looked the other way so their firms could rake in millions from audit fees and millions more from higher-margin consulting work. Some outside lawyers invented justifications for less-than-pristine practices to win a bigger cut of the legal fees. Far too often, CEOs found they could buy all the influence they wanted or needed. Enron managed to help write energy policy in the Bush Administration, while the Business Roundtable and Silicon Valley combined to derail efforts to change the accounting treatment for stock options.

Ending the crisis in Corporate America will take more than a single initiative or two. The breakdown has been so systemic and far-reaching that it will require major reforms in a number of critical areas. Here's where to start:

Executive Pay

As the market cratered, executives went right on raking in the dough--as nearly 200 companies swapped or repriced their stock options

As a matter of basic fairness, Plato posited that no one in a community should earn more than five times the wages of the ordinary worker. Management guru Peter F. Drucker has long warned that the growing pay gap between CEOs and workers could threaten the very credibility of leadership. He argued in the mid-1980s that no leader should earn more than 20 times the company's lowest-paid employee. His reasoning: If the CEO took too large a share of the rewards, it would make a mockery of the contributions of all the other employees in a successful organization.

After massive increases in compensation, Drucker's suggested standard looks quaint. CEOs of large corporations last year made 411 times as much as the average factory worker. In the past decade, as rank-and-file wages increased 36%, CEO pay climbed 340%, to \$11 million. "It's just way off the charts," says Jennifer Ladd, a shareholder who is fighting for lower executive pay at companies in her portfolio. "A certain amount of wealth is ridiculous after a while."

Oddly enough, CEOs came to command such vast wealth through the abuse of a financial instrument once viewed as a symbol of enlightened governance: the humble stock option. Throughout the 1990s, governance experts applauded the use of options, maintaining that they would give executives a big payday only when shareholders profited. And for a while, as the bull market ran its course, that's the way it worked. But as the market cratered during the past two years, a funny thing happened: Shareholders lost their shirts, but executives went right on raking in the dough.

In recent months, especially, shareholder anger has boiled over, as company proxies disclosed the many ways compensation committees subverted pay for performance. There is, of course, a fundamental difference between investors who have their own money at risk in the market and option holders, who do not. But companies have gone even further to shield top executives from losses in a falling market. Some awarded huge option grants despite poor performance, while others made performance goals easier to reach. Nearly 200 companies swapped or repriced options--all to enrich members of a corporate elite who already were among the world's wealthiest people.

When CEOs can clear \$1 billion during their tenures, executive pay is clearly too high. Worse still, the system is not providing an incentive for outstanding performance. It should be a basic tenet of corporate governance never to reprice or swap a stock option that is under water. After all, no company would hand out free shares to stockholders to make them whole in a falling market.

To really fix the problem, Congress needs to require companies to expense options. If every option represented a direct hit to the bottom line, boards would be less inclined to dole them out by the millions. Determining the value of an option for accounting purposes is no slam-dunk. It may be that companies should mark-to-market all or a portion of the actual gains or losses in vested stock options every year. At the very least, Congress should provide preferential tax treatment to encourage boards to replace their plain-vanilla option grants, which reward CEOs if the stock rises, with indexed options, which provide a payday only when the stock appreciation outstrips that of peer companies.

The Board

A ban on stock sales by directors for the duration of their terms would encourage them to blow the whistle on management when necessary

When Enron collapsed, many pointed an accusing finger at the board, and rightly so. Rarely has there been a management team so intent on deception or a group of directors so sound asleep. But accountability is a two-way street. It's not enough that the board keep a watchful eye on management. Just as important, the shareholders must keep an eye on the board.

That's difficult to do. Shareholders aren't invited to board meetings, individual board members rarely speak out, and when they do it's usually to trumpet the company line. The fact is investors know practically nothing of what goes on behind the closed doors of the boardroom. They must instead rely on directors to represent their interests vigorously. To make sure that happens, changes are badly needed.

In recent weeks, Congress, the White House, federal regulators, and the stock exchanges have all proposed reforms, including some that would require CEOs to vouch for the accuracy of company disclosures and disgorge personal profits from corporate wrongdoing. But the reforms would not guarantee the thing in greatest demand and shortest supply: accountability of all directors. "They're not going far enough," says Peter C. Clapman, chief counsel for TIAA-CREF, the world's largest pension system. "They're underestimating the total needs of a better corporate governance system."

To ensure accountability, shareholder resolutions that pass by a majority of the shares voted for three consecutive years should be binding. Today when a resolution passes, it is frequently ignored. At Bristol-Myers Squibb Co. ([BMJ](#)), for example, a proposal to hold annual elections for directors has won a majority of votes cast for five straight years. But the company has never acted on it, claiming that it failed to get a majority of all the shares outstanding. Making resolutions binding would make companies profoundly answerable to shareholders.

In addition, the stock exchanges, which set many of the governance rules companies must follow, should come up with meaningful regulations and enforce them. At a minimum, the exchanges should limit every board to no more than two insiders, require every board to appoint a lead director who can convene the board without the CEO, assign only independent outsiders to the audit, compensation, and nominating committees, and restrict directors from serving on more than three boards. Companies such as Disney ([DIS](#)) have begun making such changes.

Other reforms could help to make boards more inclined to act ahead of a crisis. A ban on stock sales by directors for the duration of their terms would encourage them to blow the whistle on management when necessary without fear of the short-term price declines that may follow. Mandatory term limits--requiring directors to resign after 10 years or at age 70, whichever comes first--would prevent board members from becoming entrenched.

Even more important, the exchanges should require every board to conduct an extensive annual self-evaluation, involving both a review of board policies and an anonymous appraisal of individual directors. Some boards--including Kmart ([KM](#)), Campbell Soup ([CPB](#)), and Occidental Petroleum ([OXY](#))--already do a version of this, but they need to go further. The findings need to be made public, and every three years the board member with the lowest ratings should be required to resign. Tough medicine, but a bruised ego is a small price to pay for better governance.

Accounting

"When the SEC and the Justice Dept. get their act together and start sending some CFOs and CEOs to jail, you'll see a real wake-up call"

The past few months have pointed up so many weak spots in corporate accounting that it's hard to prioritize what needs fixing the most. Clearly, auditors are not always skeptical enough. Obviously, board audit committees need a kick in the pants. Everyone agrees that rule-making needs to become a lot faster and a lot more effective.

But the deepest problem uncovered by the spate of recent accounting scandals is how easy it has been for all the players involved to pass the buck. The board fingers management, management blames the auditor,

the auditor blames the rules. Why isn't it clear who's responsible for what and what the penalties are for doing a bad job?

There are steps that would help restore investor confidence. First, there should be limits put on consulting work done by a company's auditing firm. The audit panel should review all nonaudit engagements to ensure that they don't jeopardize the audit. Auditors should rotate every few years to ensure a "fresh look" by a new firm. There should be more forensic auditing to dig behind the journal entries.

Finally, the proxy statement should clearly delineate which responsibilities fall to the board and which to management. At Enron, the audit committee was charged with reviewing related party transactions. In fact, the committee carried out only cursory reviews. But shareholders had no way of knowing it was even part of their duties. By contrast, Cendant Corp. (CD), in the wake of an accounting fraud in a predecessor company, takes extra care to spell out board responsibilities. For example, it makes clear that the board has reviewed and approved the nonaudit work provided by auditors. But Cendant is the exception.

An expanded auditor statement in the annual report would also help. Instead of just asserting that the financials meet generally accepted accounting principles, the auditors' statement should illuminate just where in the wide range of acceptable practices a particular company falls. As an up-close reviewer of the numbers, the auditor is in a unique position to judge how dependent the financial statements are on assumptions that could prove faulty. They already share this information with the audit committee. Including it in the auditors' statement would give investors access to the same insight.

Finally, a price must be exacted for failure to do the right thing. "We had Sunbeam, Waste Management (WMI), and Cendant--and I don't think anybody has gone to jail yet, and I don't know why," says Philip B. Livingston, president of Financial Executives International, a professional group of finance managers. "When the SEC and the Justice Dept. get their act together and start sending some CFOs and CEOs to jail, you'll see a real wake-up call."

Analysts

Most stock-rating terms are part of an elaborate web of euphemisms. "Neutral," for example, means "dump this loser and run for your life"

If investors have learned anything from this crisis, it's that Wall Street's analysts are often loath to put a bad spin on a stock. Historically, "sell" ratings have constituted fewer than 1% of analysts' recommendations, according to Thomson Financial/First Call. It's not that analysts have had "an ethical bypass at birth," as was said of Gordon Gekko in the movie Wall Street. It's more a case of an inherently conflicted system, that is now the focus of a Justice Department investigation.

Analysts are often rewarded for their ability to attract and maintain investment banking business. They're often under pressure from the companies they cover, big institutional investors, and their own employers to maintain positive ratings. These are conflicts that may never be resolved. But there are some steps that could alleviate the pressures that prevent analysts from telling the truth.

First, education is paramount. "Investors need to realize that the free research they're getting is often just a marketing tool," says Kent Womack, a professor at Dartmouth College's Amos Tuck School of Business. Better disclosure also could help. It should be mandatory that reports prominently disclose a firm's specific investment banking relationship with the company it's covering.

And an overhaul of the language of ratings would be helpful as well. In normal English, most ratings sound like variations on "we think this is a decent stock that you should own." In ratings land, terms such as "accumulate" and "hold" are part of an elaborate web of euphemisms in which "neutral" means "dump this loser, and run for your life." And it would make sense if all analysts used the same terms.

To help restore analysts' integrity, their compensation should not be dependent on investment banking fees earned from the companies they cover. At the least, that conflict should be disclosed. Two prominent securities-industry trade groups have recommended that analysts be paid on stock-picking and earnings-estimate prowess, a practice some firms are adopting. Some groups have already barred analysts from owning stocks that they cover.

The SEC may soon approve some of these changes. Still, even the best regulation can't make analysts completely unbiased. A healthy skepticism and a willingness to look beyond retail analysis when choosing

stocks may be the best bet of all. Says James Grant, publisher of *Grant's Interest Rate Observer*: "These days, the newsstands are thick with publications that are more inclined to search rather than cheer." Otherwise, to quote Gekko, "you're walking around blind without a cane, pal."

Regulators

More transparency in decision-making could help restore credibility at an agency like the SEC

Business abuses have raised fresh concerns about the power and influence of Corporate America over elected officials and policymakers in Washington. From Enron's cozy ties to energy policy mandarins to the ease with which the accounting industry defeated a proposal to sever their consulting operations from audit in 2000, there's plenty of evidence that regulators often are outgunned or co-opted by special interests. It's not surprising, then, that a mid-February Harris Poll found that 87% of American adults thought big companies wielded too much clout in the nation's capital.

Since politicians depend on money from private interests to fund their campaigns, there's not much that can be done to reduce radically the influence industry holds over regulators. But some small steps could make a difference. For starters: more transparency in regulatory decision-making. At the SEC, for example, some key decisions are deliberately relegated to staff, which can meet in private, unlike the commissioners. More of the agency's business should be out in the open.

SEC Chairman Harvey L. Pitt's "two strikes and you're out" proposal for corporate bigwigs is also on the right track. He wants the power to ban corporate miscreants from serving as officers and directors. But the proposal's effectiveness hinges on the fine print. If it applies only to those convicted of financial crimes, it could be meaningless, since the SEC settles most cases.

Without adequate funding, though, the financial cops won't be able to police their beat. The SEC's workload has soared even as staffing has remained stagnant. Congress should approve a hefty increase in the agency's budget, including Pitt's request for pay parity to retain top lawyers and accountants. Likewise, lawmakers should require accounting firms to pony up annually to fund the Financial Accounting Standards Board instead of forcing the rulemakers to go hat-in-hand to the firms they joust with.

Leadership

In the future, a CEO must set the company's moral tone--by being forthright, for starters, and by taking responsibility for any shortcomings

As the 1990s unfolded, Enron came to represent the triumph of New Economy thinking over Old Economy principles. It was fast, adaptive, innovative, and profitable--a corporate culture perfectly suited to what it did: creating and exploiting new markets. Everyone envied and emulated Enron.

While Enron's culture emphasized risk-taking and entrepreneurial thinking, it also valued personal ambition over teamwork, youth over wisdom, and earnings growth at any cost. What's more, the very ideas Enron embraced were corrupted in their execution. Risk-taking without oversight resulted in failures. Youth without supervision resulted in chaos. And an almost unrelenting emphasis on earnings, without a system of checks and balances, resulted in ethical lapses that ultimately led to the company's downfall. While Enron is the extreme case, many other companies show the same symptoms.

If the challenge for executives in the 1990s was to transform corporate behemoths into nimble competitors, the challenge in coming years will be to create corporate cultures that encourage and reward integrity as much as creativity and entrepreneurship. To do that, executives need to start at the top, becoming not only exemplary managers but also the moral compass for the company. CEOs must set the tone by publicly embracing the organization's values. How? They need to be forthright in taking responsibility for shortcomings, whether an earnings shortfall, product failure, or a flawed strategy and show zero tolerance for those who fail to do the same.

The best insurance against crossing the ethical divide is a roomful of skeptics. CEOs must actively encourage dissent among senior managers by creating decision-making processes, reporting relationships, and incentives that encourage opposing viewpoints. At too many companies, the performance review system encourages a "yes-man culture" that subverts the organization's checks and balances. By advocating dissent, top executives can create a climate where wrongdoing will not go unchallenged.

None of these proposals can guarantee that another Enron, Cendant ([CD](#)), or Sunbeam will never surface. No one can legislate or mandate ethical behavior. But leadership must create an environment where honesty and fairness is paramount. If integrity is to be the foundation for competitiveness, it has to begin at the top.

The Corporate Cleanup Goes Global But not all reforms will follow the U.S. model

For decades, U.S. executives and powerful fund managers have lectured the Europeans and Japanese about the need to run their corporations according to the transparent U.S. model. Now come the Enron and Arthur Andersen scandals, together with less sordid disclosures about questionable accounting practices at dot-coms, telecoms, and even blue chips such as General Electric ([GE](#)) and IBM ([IBM](#)). Shareholder deception, supine boards, and Special Purpose Entities seem to have rendered the U.S. corporate governance model a Swiss cheese of loopholes.

With the benchmark looking so rotten, will reform around the world stop dead in its tracks? Don't count on it. If anything, the trend to adopt U.S.-style accountability standards is stronger--one result of globalization and the stampede to U.S. markets by investors looking for decent returns. "People are not suddenly saying the U.S. system is all bad and we should be like the Japanese," says Marco Becht, a German economist and executive director of the European Corporate Governance Institute in Brussels. "Enron is helpful in making people realize that even more improvements are needed."

But rather than a convergence to the U.S. model, Becht and others see multiple modes of corporate governance developing around the world. "Just as you don't expect all countries to adopt the U.S. Constitution, you are going to have different corporate governance systems," says Becht. Already, British reforms look quite different from American ones. British boards of directors, for example, cannot use "poison pill" defenses to block hostile takeovers. And that is just one element of a formal code of governance adopted by the British in early 2000. Curiously, the U.S. is one of the few industrialized countries without such a rule book.

Just about everywhere, the battle cry is for more transparency in accounting and greater checks and balances between management and boards of directors. And U.S. scandals are not the only driver of change. Both Europe and Asia have their own crop of homegrown disasters. In Europe, the clubby, incestuous world of Switzerland Inc. was rocked by the collapse of Swissair in October, 2001, while mighty financial institutions such as UBS and Zurich Financial Services have been reeling from a series of mishaps that critics relate directly to the unchecked power of their executives and their indifference to shareholder rights. Scandinavian corporate practices have been under the microscope ever since it was disclosed that Swiss-Swedish engineering giant ABB secretly granted former Chairman and CEO Percy Barnevik an \$89 million golden handshake. And in Germany, a series of corporate collapses--most recently the implosion of the Kirch media empire--is finally shaking up outdated German practices.

Indeed, the changes afoot in Germany promise to transform the face of Rhineland-style capitalism, with its tradition of once-a-year earnings reports and interlocking board memberships. Under proposals submitted in February by a government committee led by Gerhard Cromme, former CEO of ThyssenKrupp, listed companies would adopt a wide range of reforms, including abolition of separate share classes, publication of management salaries, and disclosure of inside trading by board members. While most of the Cromme Commission's provisions are voluntary, commission member Peer M. Schatz, CFO of Qiagen, a Dutch biotech company listed on Frankfurt's Neuer Markt, says all German companies will be affected. "The market will ultimately have much more leverage than any legal body," says Schatz. "To be in noncompliance when you said you would comply leads to the worst punishment possible, namely loss of credibility."

In Japan--long notorious for corporate abuse of shareholders, cozy ties between banks and companies, and opaque accounting--things are also moving, albeit slowly. The Justice Ministry is pushing legislation that would amend the commercial code by allowing appointment of independent members of boards of directors--a real innovation, since most Japanese corporations have boards composed almost solely of senior executives. The new code also allows companies to let shareholders vote online, an innovation Sony Corp. ([SNE](#)), Hitachi Ltd. ([HIT](#)), and 50 others say they'll adopt during this year's annual meeting season. Still, a recent survey by communications group Dentsu Inc. of 1,000 international investors who trade

Japanese equities found that corporate transparency is perceived to be far worse in Japan than in Europe and the U.S.

Next door in South Korea, reform has been spurred by the July, 1999, collapse of Daewoo Group, whose founder and chairman, Kim Woo Choong, now in hiding to avoid prosecution on fraud charges, had allegedly engaged in accounting so creative that it falsely inflated the value of the conglomerate by \$30 billion. That shock led to a recent overhaul of Korean commercial codes, which now require, among other things, that large listed companies fill at least half of their board seats with outside directors. The codes also allow any individual or group with a combined holding of just 0.01% of outstanding shares to sue management over any perceived irregularities.

Other emerging markets are making important strides. Take Russia, once one of the world's murkiest corporate swamps. At energy giant Gazprom, Russia's largest company with sales of \$20 billion in 2001, a new team led by CEO Alexei Miller is undertaking a series of reforms, including establishment of a board-level audit committee. With its accountant, PricewaterhouseCoopers, being sued for lax auditing, Gazprom is holding an unusual tender to choose an auditor by competitive bid. "Corporate governance at Gazprom is definitely improving--it isn't just window dressing," says Stephen O'Sullivan, head of research at Moscow brokerage United Financial Group.

Of course, the new strictures, in Russia and elsewhere, will not stop those determined to deceive and defraud, any more than they did in the U.S. The Cromme Commission's rules, says Schatz, "won't prevent outright criminal activity. If you rob a bank, you don't ask which rules you're not complying with." But to inspire better behavior, you first need actual rules to enforce. Those rules are falling into place