CORPORATE EXECUTIVE BOARD®

WHAT THE BEST COMPANIES DO

CORPORATE INTEGRITY PRACTICE

Open-Door Policy, Closed-Lip Reality

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❱ Nearly half of executive teams lack information they need to manage effectively because employees withhold vital input out of fear the information will reflect poorly on them.

Unfiltered, honest feedback becomes increasingly scarce as it moves from the bottom to the top of the organization. A recent survey of more than 300,000 employees reveals that companies that break down two key barriers to honest feedback can deliver peer-beating shareholder returns by a substantial margin.

The Emperor's New Clothes

Imagine that the CEO of your firm recently launched a bold new strategy aimed at taking advantage of a mega-trend impacting customers: environmentally friendly widgets. You're the CFO, and you're tasked with communicating the new strategy to your largest shareholders to explain how it will drive better corporate performance. You want these meetings to go well. You believe in the strategy, and you believe it's your job to communicate this new direction in a compelling way to investors. You go on a road trip to Boston and New York to meet with your five largest shareholders. While the first three meetings go great, the last two portfolio managers you meet with are not convinced. They don't express any overt hostility, but you sense that they believe environmentally friendly widgets are a fad and are probably skeptical of the long-term viability of your strategy. When you get back to the office, you bump into your CEO in the elevator, and she asks how the meetings went. What do you tell her? Do you mention the skepticism?

There is no right or wrong answer. However, many individuals will instinctively emphasize the positive (e.g., "The meetings went very well; there is some genuine excitement about the direction we are taking."). There are a number of reasons for this: 1) It confirms your preexisting desires (you wanted the meetings to go well and believe in the strategy), 2) it reflects well on your own performance (it's your job to communicate in a compelling way), 3) it is not incorrect (generally speaking, the meetings went very well), and 4) perhaps you don't believe your CEO is interested in hearing contrary feedback.

You can imagine scenarios like this playing out across the organization in conversations with customers, employees, and suppliers. The problem this creates is that the "weak signal" (skepticism over a key assumption underpinning the firm's strategy) becomes increasingly filtered out as information travels from the bottom of the organization to the top. Like the emperor in the children's fable who parades in front of his subjects wearing no clothes, the CEO never receives any contrary feedback until it is too late.

❱ Contact Us

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Multiply Your Competitive Advantage

If you are not among those folks who (consciously or unconsciously) tend to put a positive spin on results you are accountable for, then you might find the prevalence of this behavior surprising. A recent poll we conducted suggests the following:

- Nearly half of executive teams fail to receive negative news that is material to firm performance in a timely manner because employees are afraid of being tainted by the bad news.
- Only 19% of executive teams are always promptly informed of bad news that is material to firm performance.

Alternatively, you might be saying to yourself, "this is not news to me." The belief that CEOs and senior leaders are insulated from the facts on the ground is widespread. This is the reason we get out of our offices and meet with employees, customers, and investors to get a direct line of sight into the business. That is true. But imagine you worked at a company where you didn't need to. How much more effective would your company be if honest feedback flowed more freely?

Our research suggests that a significant advantage accrues to companies that know where and how to break down barriers to honest feedback. In particular, these companies appear to outperform their peers in terms of long-term total shareholder return (TSR) by a significant margin.

There Is Nothing to Fear but Fear Itself

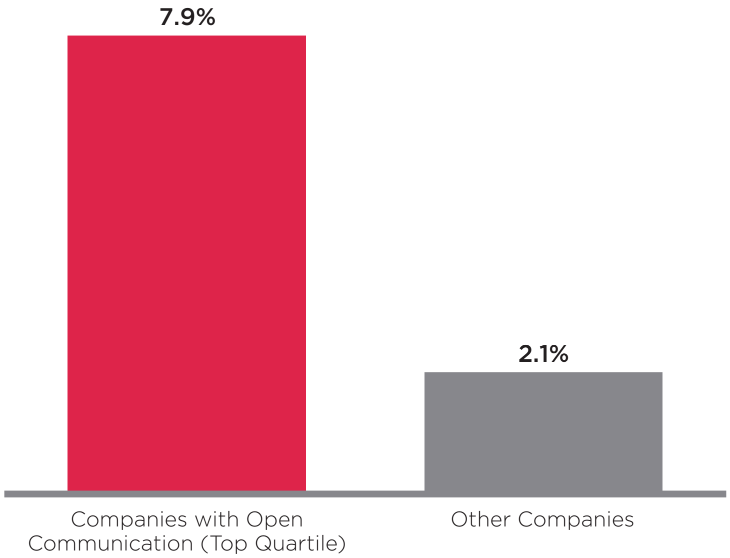
For years, our program for compliance executives has conducted surveys of hundreds of thousands of employees on behalf of our clients to help them understand the extent to which they have an ethical culture and to identify hotspots that require attention. As a by-product of that work, we stumbled across a surprising relationship: companies where employees provide honest feedback substantially outperformed their peers in terms of 10-year TSR from 1998–2008 (Figure 1). Two factors stood out in particular:

- **Openness of Communication—**Employee perceptions of the extent to which managers encourage two-way dialogue matters. We found that companies rated by their employees in the top quartile in terms of openness of communication have delivered TSR (10-year TSR 1998–2008) of 7.9% compared with 2.1% at other companies. (They also had materially lower levels of observed fraud and misconduct.)
- **Fear of Retaliation (and Willingness to Speak Up)—**Among the 12 key indicators we track in our cultural diagnostic, the one that is most strongly correlated with 10-year TSR is employee comfort of speaking up. The most important driver of this comfort is a lack of fear of retaliation. As with openness of communication, we found that companies that excel on this dimension also had materially lower levels of observed fraud and misconduct.

Fear is a particularly powerful inhibitor. We recently surveyed more than 100 of our clients and asked them to estimate the amount of harm that would have to be present to share honest (negative) feedback at risk to their careers:

- Fifty-nine percent estimated that more than $1 million worth of harm to the company would have to be at stake for employees to share honest (negative) feedback.
- Twenty-nine percent estimated that more than $10 million would have to be at stake.

Figure 1: Ten-Year Total Shareholder Returns



Not only are these barriers to honest feedback significant, they have also increased across the past two years at most organizations. Our data from 300,000 employees suggest that perceptions of communication openness fell dramatically during the recession in 2008 and remained depressed in 2009. At precisely the time when employees sought more clarity and direction from their leaders to deal with a volatile environment, their perception of open communication fell substantially.

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