

## Boards Need to Regain High Ground and Preserve Relevance

By Fred G. Steingraber and Karen Kane

Financial regulation and shareholder activism are a direct response to the board's overly defensive posture and perceived dismissal of the shareholder's role in corporate governance. Congress, taxpayers, activist shareholders—and now a blockbuster book written by Wall Street insiders—blame the financial crisis on a systemic collapse of corporate democracy caused by the utter failure of corporate boards to do their jobs. In the last three years, directors have presided over corporate governance failures that cost shareholders trillions of dollars.

But will boards own up to their true responsibility and take on the considerable work required to bring true oversight to management? Recent regulatory action has endorsed shareholder legitimacy for holding boards accountable. With the annual meeting season in full swing, corporate boards need to assert their independence and autonomy in carrying out their role of governance while providing true oversight of corporations. Interestingly, the loudest critics of corporate boards do not advocate their elimination. Rather, they want boards to provide greater oversight by asserting their independence and doing the job for which they have been hired.

It will take substantive changes for boards to regain the trust needed to re-establish their governance authority. A board must thoughtfully reorganize itself, examine the competencies of its members as well as board processes and committee roles. Boards need to transform themselves into strong, highly functioning work groups whose members trust and challenge one another. Directors also need to recognize the role shareholders play: they are the owners of the company and board-shareholder

engagement is an important element in keeping them invested. Most importantly, boards need to demonstrate leadership with a transparent, results-orientation in the conduct of their work.

No other entity can provide the oversight that an independent, engaged and committed board can deliver. We all have an enormous stake in reforming boards to carry out the responsibility for providing true oversight of management in a complex global business environment. Directors need to rethink and reconfigure their committee structure and committee work for greater effectiveness—which will likely involve a combination of some new responsibilities in existing committees, the creation of new committees as well as new skills and qualifications for directors.

In the future, boards must also include greater committee work on leadership development and succession planning, operations, growth, risk management and shareholder communication if they hope to provide meaningful and credible oversight for the companies they represent.

As in all blueprints for change, the devil is in the details. The following ideas represent a fundamental shift in the breadth and focus of board work required, which will bring about other needed changes. As boards get back to the proper oversight of management and focus on leadership development, corporate strategy, corporate performance and risk management, the enterprise itself will be strengthened.

The following is an outline of the responsibilities, roles and skills which need to be addressed in new or existing committees more effectively:

**Leadership development/succession planning:** Boards need to spend far more time in this area,



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*The Director's Chair* is a regular column featuring a viewpoint from inside the boardroom.

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including overseeing the human resource alignment with the business strategy. The issue of leadership development and succession is without a doubt the area of highest risk if not pursued in a proactive mode by the board of directors.

**Operations** to include the establishment of performance targets by implementing best practices in productivity, quality and service. In addition, boards should audit the application of technology, shared services, and outsourcing to achieve performance improvement. Such audits provide a vital forward-looking area of key indicators impacting risk and future financial performance.

**Corporate growth and resources** to include reviewing organic growth targets and trends. This should include products and services, markets and channels, geography and relevant resource requirements to achieve and sustain growth. This committee should oversee the due diligence related to acquisitions as well as post-merger audits. They would also be responsible for understanding and overseeing the targeted and actual growth in revenues from new products in the last three to five years.

**A risk management committee** should be configured to oversee issues which can affect the business, including macroeconomic conditions, regulatory trends, demographic changes, technology, competition, environment, consumer behavior, energy, leadership depth and breadth, financial resources and balancing change and continuity. In addition, this committee should periodically review a strength, weakness, opportunity and threat analysis (SWOT).

**Shareholder communications** requires a more proactive approach to transparency across multiple audiences—including investors, brokers, and owner research groups—as well as through traditional outlets such as proxies, annual reports, and on investor website portals.

**Compensation committees** should adopt a clear statement of compensation philosophy, which provides a transparent understanding of the factors that drive compensation decisions. Incentive compensa-

tion awards for executives should be tied to the long-term business performance and not share price. While goals may include both short- and long-term targets, longer-term performance and goals should be weighted more heavily.

Perhaps of greatest importance is the need to move to a principles-based system of compensation determination and reporting. Examples of key principles could include accountability, alignment, fairness, transparency, and objectivity. Accountability should demonstrate that incentive pay is tied to business performance targets

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**Accountability should demonstrate that incentive pay is tied to business performance and metrics based on audited financial results.**

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and metrics based on audited financial results and clawbacks for earnings restatements or fraud. The principle of alignment should address CEO incentive compensation in relation to shareholder rewards and incentives for other top-

level executives and tying it to longer-term business performance with incentive compensation to include a deferred component. Executives should be required to hold a targeted level of share investment in relationship to their compensation. There should be no tax gross-ups on executive compensation and perquisites. Objectivity should be demonstrated through verification of the independence of all compensation committee members and compensation consultants. Finally, transparency should be demonstrated by communicating clearly both internally and externally the company's compensation principles, the application thereof and, if not, why not, and what has been done instead.

Lastly, boards need to carefully consider some of the new skills and qualifications required of directors to carry out the responsibilities outlined above. Boards will need to **recruit** beyond sitting CEOs to academicians, human resource executives, research leaders, and experts in competitive assessment and shareholder communications.

In this new world, directors will need to engage with a broader group of stakeholders, convincing them of the board's execution of their duty of loyalty and duty of care in overseeing the enterprise. **D**