November/December 2001 Volume 9, Number 6

Boardroom

REVIEW, ANALYSIS, AND GUIDANCE FOR CORPORATE DIRECTORS

Here Come the Rookies

BY ANN REILLY DOWD

A few weeks ago, the summer 2001 edition of the US magazine *Corporate Board Member* arrived on the Editor's desk. The lead story in this four-year-old publication was entitled *Here Come the Rookies* written by Ann Reilly Dowd. With the permission of editor Colin Leinster, we reprint with thanks an edited abstract of this article.

"You might not expect to find Priscilla Presley, former Mexican President Ernesto Zedillo, and Tom Croskey, a 23-year veteran of General Motors, as members of the same club. But they are. All have joined boards of US public corporations in the past 12 months, part of a rookie class of players in a game that has become far more challenging - and risky - than ever before.

Most new directors hail from the executive ranks, academe, or professional firms, and have made it to the boardroom on merit. If the likes of Presley and Zedillo suggest a traditional boardroom taste for celebs and politicos, get ready for a surprise. Presley [widow of Elvis], for example, is a proven businesswoman.

Today's competitive business climate and demanding shareholders have companies wringing out every last dollar's worth out of their rookies. And that's changed the way

"These days, anyone who accepts a board seat is apt to face a hail of fastballs."

many are recruited. "In the past, the good ol' boys would ask each other: 'Who do you know?'" says Michael Nieset, managing director of board services at Christian & Timbers, an executive search firm. "But that's a mindless way to go about it these days. Increasingly, companies are taking a strategic approach to hiring directors, asking themselves where they're headed and what expertise the board will need in the future. Boards use search firms to help them figure out the holes, and then plug them."

At many companies, the CEO is still the chief recruiter. But even CEOs are finding it tough to sign up folks who are both willing and qualified. Holding a boardroom seat has become extraordinarily demanding. According to NACD, a conscientious board member devotes up to 225 hours a year - more than a month of eight-hour days - to each directorship he or she holds, and more if committee work is involved. Meanwhile, mounting media scrutiny, investor activism, and shareholder litigation all but guarantee increased risk and liability. This is particularly true for outside directors who serve on audit committees. Says Nell Minow, an activist shareholder and editor of thecorporatelibrary.com, a website for directors: "People love to be on boards.

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Is Director Impotence the Antithesis of Trust?

EDITORIAL

Roger Martin has certainly opened Pandora's Box with his thought provoking statements on trust in the boardroom. (See reports on his recent interview in this and the September/October issue of this newsletter.) Until now, how many of us had really thought about the ideas that he expressed in his paper submitted to the Saucier Committee: *Board Governance and the Responsibility Virus?* Do we agree that "it is an increasingly daunting task to question a CEO on management initiatives"? If we do, how does this affect the traditional credo that the board maintains an oversight on the management of the enterprise?

Glorianne Stromberg, former OSC Commissioner, in her presentation to a symposium on ethics and corporate governance in May, 2001 hit the nail on the head when she stated: "The fundamental reluctance of directors to question management or committee initiatives has all too often undermined, and will continue to undermine, so many well-intentioned governance measures. This reluctance exists whether the board is chaired by a non-executive chair or by the CEO with a lead director. This reluctance is also likely to taint the frankness and usefulness of assessments of the board's effectiveness as a whole or of the effectiveness of individual directors."

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Guidelines Conformity May Mot Produce Good Governance

PART 2 OF AN INTERVIEW WITH ROGER MARTIN

In the first article in our September/October, 2001 issue, reporting on the interview with Dean Roger Martin of the U of T Rotman School of Management, we learned his views on information asymmetry and trust (between management and the board) being central to the governance process. Otherwise information could well be withheld from the board. But then he suggested that if you build trust and don't have expertise, you have a problem. In this article, we explore further Mr. Martin's views on the governance process.

Boardroom: Do you suggest that it is necessary to merge competence with trust?

Martin: Yes, this makes for an effective board. The foundational context is creating an environment of trust, as well as the dialogue and method of operation that engenders trust. It is like buying an option: an opportunity to bring competence to bear. This approach can actually supplement management's experience and expertise.

It is almost impossible for a CEO to be a perfect agent. Therefore, it is possible for the agent to align the interests of management badly or well. This can further be exacerbated by a complicated compensation structure in which management may feel encouraged to maximise compensation rather than produce the required shareholder returns. Therefore, compensation systems must also generate an incentive to build trust. Trust and alignment of interest together generate the option. Whether the board is able to take advantage of this depends on its competence.

Boardroom: The Saucier Report suggests that one should generate a culture of conformity in producing good governance, rather than relying purely on structural adherence to guidelines. How can one be constructive in improving the quality of governance in the smaller and medium-sized business?

Martin: This is something that I struggle a little bit with. While it may be plausible in suggesting that governance is more questionable lower down the totem pole, we do see less specific manifestations of competence. This is the main reason why we imagine we may have less effective boards. But taking the bottom two building blocks, trust and alignment of interests, I cannot see the empirical argument to suggest these will be less in smaller companies. I can also make an argument that alignment of interests should be enhanced, possibly because directors are likely to be more closely identified with the company and its problems. In such an environment, it is possible that they may possibly be better on trust and alignment of interests and, since competence doesn't matter as much, they're better off.

I'm utterly uncompelled with the notion that conformity with the TSE guidelines produces good governance. A company can conform to all the guidelines but have no trust and alignment of interests between management and the board - but still possess lots of competence around the board table. I believe it is preposterous to state, for example, that the audit committee must be more diligent and everything else will be fine. I'm a bit doctrinaire. You can conform in any social situation, shake hands and smile and say I'm glad to meet you, but not mean a word of it!

Cultural conformity doesn't ring true to me either. Conformity is not a very evocative word. The Saucier Report is saying "Structure is less important than behaviour". I say that we need to have a set of behaviours that produces a level of trust, the type of dialogue that is needed to surmount the information asymmetry and the kind of alignment of interests that overcomes any problem with the principal agent: the CEO.

Boardroom: What are your views on the certification of directors in Canada?

Martin: Certification is a tricky thing. I come out in the middle. One could argue that there are many facets where we could benefit from certification. Why not, therefore, certify directors? It has been shown that certification can be exclusionary and create a shortage of supply. There is also a generally held view, for example, that the certification program in the legal profession creates competency - more or less. In management consultancy there has been an attempt to do the same, but it has never really succeeded. People can't see the correlation between having certification and being a good consultant. Can we create a specification that is robust enough to define what are the capabilities to be a good director and then having a certification process that can test against that? That's tough sledding!

I advocate something different. Introduce a director rating system which relates to, for example, the appropriate TSE total shareholder return index. Simply track the total shareholder return for each director for all the listed companies on whose board he sits, from the day he is appointed and compare with the index over the same period to generate a rating. There would be directors who conceivably who may feel disadvantaged by going onto boards which had a terrible situation, but this should reflect in a lower stock price at entry.

The important thing is that one would be able to establish a track record for each director based on the entry stock market valuation, and what he has done to improve it. If you do something to help that company, the stock price should appreciate. You would then have a higher total shareholder return relating to your time on the board, always compared to the index as a benchmark. This is essential as it takes out of the equation overall stock market movements as against the progress of individual companies. B