1 THE MYTHS AND REALITIES OF ACTIVIST INVESTORS  by Charles Nathan
If activists are just troublemakers, why is their advice so often good?

5 MY FIRST 100 DAYS AS CHAIRMAN  by Bruce H. Stover with Patrick Dailey, Ph.D.
Welcome onboard—the company is facing a crisis. How do you lead?

11 OPTIMIZING BOARD EVALUATIONS  by Blake Stephenson, Yafit Cohn and A.J. Kess
Best practices for conducting evaluations and turning results into action.

17 AS GLOBAL BUSINESS TRANSFORMS, BOARDS MUST KEEP PACE
by Nels Olson, Tierney Remick and Andrés Tapia
How do you add needed new board talent while retaining your best veterans?

22 RETHINKING THE “DIGITAL DIRECTOR”  by Rhys Grossman and Tuck Rickards
Assuming there is a single “digital director” profile is problem number one.

27 IN REVIEW  Index to actions, regulations and surveys.

30 SPOKEN & WRITTEN  Excerpts of articles and speeches.

31 DIRECTORS’ REGISTER  Recent board elections.

32 CONVERSATIONS: JANICE ELLIG  Making board gender diversity happen.
The Myths And Realities Of Activist Investors
by Charles Nathan

They are greedy, take only a short-term view of the company and prevent long-term plans that are the source of sustainable value creation. This characterization of activist investors is frequently heard in board rooms, but is it accurate and productive? The author, who brings a lifetime of experience in corporate law and governance, suggests that it is time for directors to rethink their reaction to activists to take into account the realities of their situation.

One of the oldest adages in any conflict situation is to know your enemy. This is certainly true for board members of a company which is, or worries that it may become, the target of an activist investor. One recurring difficulty is to distinguish between the myths that surround activist investing and the reality. Far too often a board’s attitude toward and response to an activist investor is premised on the myths rather than the reality. Those reactions are at best misguided and at worst a prescription for disaster. This article debunks the myths and articulates the reality of activist investing and of dealing with activist investors.

Frequently, the terms short-term and long-term are used to refer to the period of time activists are reputed to maintain their ownership stake in a company. The implication is that because activists are mere short-term holders, they are not entitled to the same voice in a company’s governance as more virtuous and deserving long-term holders.

There are two flaws in this reasoning. First, many studies have demonstrated that, on average, activist investors maintain their position for a matter of years, not months. Second, there is no rational reason to think that long-term shareholders have special insights into or understanding of corporate decisions and strategy. Indeed, if long-term holders are index funds, their investment has nothing to do with a company’s strategy or business decisions, and the investment manager has no basis to claim any knowledge or insights.

The mythology of activist investing also conflates the putative holding period of the activist with the implementation period for programs advocated by them. Castigating a corporate strategy as short-term, rather than long-term, simply misses the point. The issue is not the duration of time required for implementation, but rather the value creation potential of the program. No rational investor, or company manager, should advocate adoption of a longer-term strategy over a shorter one, if the shorter one has a higher value creation opportunity. The confusing use of the terms short-term and long-term lead directly to the second major myth of the anti-activist literature.

Myth Two: Long-term is inherently good and short-term is inherently bad. There is nothing innately virtuous about the long-term, whether it be the duration of a portfolio position or a company strategy.

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Nor is there anything innately evil about a short-term holding period or implementation period for an alternative company strategy. Notwithstanding this obvious truism, anti-activist mythology consistently assumes short-term is bad and long-term is good.

The reality, of course, is that there are both good and bad short-term strategies, just as there are good and bad long-term ones. The relevant issue is determining which strategy will create more net present value for the company and its constituencies, not which one will take longer or shorter to implement.

While activist holdings entitle the activist to be heard, they simply do not have the power or share ownership to compel a company to take any action, good, bad or indifferent.

- **Myth Three:** Activist investors possess “unprecedented influence” and “immense financial power.” As large as some activist funds may be, they are utterly dwarfed by the size of the equity investor universe. A few activist funds may exceed $10 billion and total activist funds may approach $150 billion in the aggregate. Yet activists are hardly a blip when compared with the $60+ trillion size of the total equity markets.

  Another way to measure the relative insignificance of activist investors is to compare the size of their funds (say, $10-15 billion for the largest) to the leading asset management firms in the US, starting with BlackRock ($4,770 billion under management), Vanguard ($3,148 billion), State Street ($2,448 billion) and Fidelity ($1,974 billion).

  Activist investors simply do not have the financial resources or desire to own a large amount of the stock of any company. It is rare that an activist’s holding in a company exceeds 10 percent and many are well below five percent. While activist holdings are not insignificant and surely entitle the activist to be heard, they simply do not have the power or share ownership to compel a company to take any action, good, bad or indifferent.

- **Myth Four:** Activists take “unfair” advantage of the 10 day filing window under Section 13(d) to buy additional shares of a target company’s stock from unsuspecting shareholders who are unaware of the activist’s impending campaign. The thrust of this myth is that announcement of an activist’s accumulation of more than five percent of a company’s stock usually triggers a positive stock market reaction. Accordingly, it is “unfair” that an activist can continue buying shares for as many as 10 days if it chooses to make its required Section 13(d) filing on the last permissible day. Indeed, the Wachtell Lipton law firm filed a rule-making petition with the SEC several years ago urging the Commission to close this “loophole” in the regulatory scheme.

  The petition’s essential argument is that in today’s world of instantaneous internet transmission of information, there is no logistical reason not to require a 13(d) statement to be filed on the same day or, at most, the day after a purchaser crosses the five percent filing threshold. In other words, back in the information dark ages of 1968 (when Congress legislated the 10-day window), it may have been reasonable or even necessary to give purchasers of five percent of a company’s stock up to 10 days to file their initial 13(d) statement. Now, though, it seems absurd to allow this relic of a distant informational era to survive in today’s world of instantaneous communications.

  There is a fatal flaw in this argument, however. It is crystal clear from the legislative history of Section 13(d) that Congress did not legislate the 10-day window because it believed it was logistically desirable or necessary. Indeed, a companion section of the legislation, Section 14(d), permitted an acquirer to launch and complete a cash tender offer for 100 percent of a company’s shares in seven calendar days—three days less than the 10 day filing window. Thus, how could Congress at the same time have believed that a buyer of five percent of a company’s stock needed 10 days to make a relatively simple 13(d) filing?

  As the legislative record makes abundantly clear, Congress understood that the 10-day window was an appropriate balance of competing interest—that of the buyers who, absent the imposition of a statutory filing requirement, would be free to continue buying shares without any public announcement, and that of the target company and its shareholders learning
that a third party was accumulating more than five percent of the company’s shares. There is simply nothing wrong, unfair or underhanded in activists taking advantage of the balance of interests inherent in the 10-day filing window.

Myth Five: The desirability of maximizing transparency in the stock market justifies eliminating the 10-day window under Section 13(d).

A secondary argument in the Wachtell Lipton rule-making petition is that transparency in the equity markets, generally acknowledged as furthering their efficiency and fairness, compels elimination of the 10-day window. The fallacy of this proposition is that it proves too much. No market requires buyers and sellers to explain their motivations and price thinking. Buyers may have any number of reasons to pay the price they offer, but there is no market where they are obligated to disclose those reasons to their seller. Similarly, no market requires a seller to disclose its motivations to its buyer.

The Section 13(d) filing requirement is a unique anomaly that was justified by Congressional concern about bidders seeking to acquire working control of a public company without paying an appropriate control premium. In 1968, the stock market was dominated by individual holders who, because of collective action issues, could be easily dominated by a block-holder owning as little as 15 to 20 percent of a company. In that context, the Section 13(d) filing requirement was seen as a desirable protection for individual shareholders.

Unlike 1968, though, our equity markets are now dominated by institutional shareholders who are not susceptible to the collective action concerns that justified the Section 13(d) filing requirement in the first place. As a result, rational reform would eliminate Section 13(d), or at least raise the filing threshold to a percentage that in today’s markets would presage actual working control—an amount far in excess of five percent.

Myth Six: Activists use “unscrupulous” tactics. Activists are not alchemists who nefariously transmute relatively small share ownership positions into the power to compel companies to adopt wrong-headed policies rightly opposed by their boards and management. Rather, activists are ultimately dependent on the support of at least a majority of a company’s other shareholders to achieve their goals. The activist investor’s typical game plan is simple and consistent.

First, identify a company that is undervalued in the market because it is not fully realizing its potential. Second, propose a solution to management and the board that the activist believes will unlock the full value of the company. Third, if management and the board are unwilling to work with the activist, bring the activist’s proposed plan to the company’s shareholders who own the company and have the final say on company policy though their ability to vote at shareholder meetings.

There is nothing unscrupulous about giving the owners of a company a choice between competing strategies or business plans. Nor is there anything wrong if a majority of shareholders agree with the activist, rather than management. To suggest the contrary is to advocate a corporate system in which management has the final say on all matters, and shareholders have no power to vote managers out of office. This model is antithetical to the very premises of our corporate system.

The bottom line is that shareholders are the ones who get to decide. If they decide against management, it is hardly the fault of the activist.

Myth Seven: There is something wrong with our corporate governance system because shareholders can decide that an activist’s program has more merit than management’s. This argument against activist investing boils down to a classic case of blaming the messenger. Activists do not possess some magical power which allows them to bewitch shareholders. Rather, they present a case for their proposed solution to what they perceive as a company’s shortcomings. Management has an at least equal ability to present its case.

Whether management’s case is in defense of a long-held strategy, or a new attempt to “be your own activist,” the bottom line is that shareholders are the
ones who get to decide. If they decide against management, it is hardly the fault of the activist. Viewed rationally, it is the fault of management, either because its program is not as persuasive or because it fails to articulate the program successfully.

**Myth Eight: Activist investors line their pocketbooks at the expense of workers, communities and, more generally, the entire American public.** Activist investors cannot prosper unless the other shareholders prosper. To be successful, an activist investor’s program must produce sufficient value to increase the price of the company’s stock. This is not to say that every activist program will raise the price of the company’s stock, but to make money the activist has to be right more often than wrong. As a result, the value created by an activist investor is shared among all shareholders. Indeed, this is the reason why shareholders so often support activist investors’ initiatives.

Those other shareholders are, largely, institutional investors who manage a very large part of the combined wealth of the American public. The funds institutional investors manage comprise the largest part of the life savings of our nation held in countless public and private pension funds and innumerable 401K and Roth plans. Activist investors succeed only when institutional investors likewise benefit, thereby increasing the value of the holdings of the various pension plans and individually owned accounts managed by institutional investors.

**Myth Nine: Company management and their experts know better than the activist and for this reason deserve the support of a majority of shareholders.** The ultimate myth of the anti-activist mantra is that somehow, for some reason, it should not matter that a majority of shareholders often embrace activist campaigns. On the contrary, there is no principled reason to believe that boards, management and their advisers really do know better and should be freed from the distraction, stress and risks of a debate over their corporate stewardship. The paternalistic and patronizing view that management always knows best is simply an inversion of the reality of shareholders’ ownership and rights under our corporate governance system.

Defenders of management against activist investing too often dismiss the reality that boards and management are accountable to shareholders on at least an annual basis. Our corporate governance model is based on the fundamental principle that shareholders are the owners of the company with the ultimate right to decide their company’s future.

**Conclusion.** When an activist comes knocking, the company and its directors should begin by accepting the reality that the activist always has the ability to appeal over their heads to the company’s shareholders. Moreover, the evidence is clear that institutional investors, which control a majority of almost every public company’s stock, increasingly favor activist programs over those of management.

Boards which reflexively adopt a defensive posture fail to understand that they can only defeat an activist campaign by presenting an alternative that their shareholders will favor. More important, directors should understand that discussion with the activist is a far more sensible first step than manning the barricades. Activists are not infallible and usually are willing to listen. Activists are not interested in a proxy contest if they can achieve their objectives through constructive dialog.

Activists are not ogres, nor are they always wrong and misguided. They deserve to be treated as serious and well-intentioned shareholders. If they are, they will respond accordingly and will sit down with management and the board to discuss their ideas and to hear management’s. Frequently, that dialog will be constructive and productive. Needless wrangling, name-calling and negative campaigning can be avoided, and positive results can be achieved which will serve the best interests of management, the board and the shareholders.
My First 100 Days As Chairman
by Bruce H. Stover with Patrick Dailey, Ph.D.

After a brief tenure as an independent director with an oil and gas exploration and production company, Bruce Stover was named to chair the board—just as the company faced a major hit from plunging oil prices. How then does the board respond to stanch the bleeding, sell its story to the markets, and prepare for the worst?

In November, 2015, I was asked to become the non-executive chairman of a financially-challenged oil and gas exploration and production company. With my appointment, I began the journey to stabilize our board, help our interim CEO broaden our operational leadership, stabilize the business in the short run, and shape a “first mover” plan for ramping up growth when the energy markets first showed signs of a turnaround.

Some background information seems necessary. At the time of my chair appointment, I had served as an independent director with this company only since the spring of 2015. Business conditions were extremely challenging. The price of crude oil experienced a steady decline during my early tenure. This was caused by a growing oversupply in the global marketplace, combined with weakening demand.

These market forces caused a material decline in revenues for all oil and gas exploration and production companies, forcing them to reduce capital spending and operating costs, along with overhead. Many of these companies, like mine, had high debt levels incurred during the long period of industry growth over the previous ten-plus years. My company had successfully taken steps in the spring of 2015 to restructure its debt and extend liquidity, assuming commodity prices based on the “forward curve” market forecast at that time, with consideration of reasonable downside price outcomes.

Suggestions for a newly-appointed chairman.
To say the least, these were challenging times for my company and for me, as a newly appointed chairman. I encountered many known and many unknown challenges during my “first 100 days.”

I thank my board colleagues, executives, and advisors for partnering with me during my first 100 days, and also wish to share my learnings with newly appointed chairs as they begin their journey. Perhaps, I can be helpful.

Getting the soft skills right can be the difference between an adequate board and an exceptional one.

- **Optimize your board.** At the outset of my appointment as chairman, three directors had announced their retirement. Consequently, our experience and knowledge base was going to be significantly diluted. This increased reliance on our CEO. We needed to quickly evaluate adding new directors with specific skills and experiences we had lost. The search and recruitment process needed to move ahead quickly and our selection skills needed to be on target.

- In addition to the “hard skills” of director candidates and their work experience and subject matter expertise, I also focused on the “soft skills”—the intangibles—of our candidates. I suggest you scrub your board candidates for key soft skills and weigh these factors as heavily in your assessment as specific skills and job experiences. Getting the soft skills right can be the difference between an adequate board and an exceptional one.

  - **Integrity.** As a chair, I want to surround myself with directors who demonstrate a clear moral compass along with the “smartness” to do the right thing in the right manner.
  - **Authentic.** Directors who are comfortable in their own skin. These men and women are passion-
ate, positive and genuine. They may not always be extroverts, but they are comfortable and confident of what they see in the mirror. They earn the trust of others for their reliability and courageous leadership.

- Simple communicator. These candidates express their analytic insight, values, and purely personal opinions with professionalism and respect for others. They speak with clarity and candor, but are not shy about getting to the point. They tend to use simple words in short sentences with profound impact.

- Visionary. These men and women are analytically astute. They often see the future before others, then articulate a realistic path forward that others can get on board with. They do not just toss out impractical “blue sky” ideas. “What ifs” are always interesting, but “what now” gets us to the future.

- Consensus builders. Directors should be both willing and skilled on “working the room” to uncover hidden issues, forge collegial alliances and converge on a winning path forward, along with the tactical steps and guiding metrics. These are people who make it happen.

Through an executive search firm, we identified a number of candidates that fit our specifications and who were interested in learning more. However, rapidly deteriorating events beyond our control led us to defer the search until a later date, and we decided to weather the storm with our existing four directors.

As a board, we each committed to be constantly engaged and available, focused, responsive and decisive on all matters.

- Reach an early agreement on the “big three” risks the board must mitigate. The decision to move forward with a smaller board meant that we had to realistically address and mitigate several important risks.

The biggest business risk was our rapidly deteriorating financial condition, due to the continuing decline in commodity prices. First, we had to agree that we as a board had the essential skills needed to do the job effectively. We each committed to be constantly engaged and available, focused, responsive and deci-

Our second business risk was assuring that we had the right senior management team, and keeping those we deemed critical to operational effectiveness and solid financial management. This might require changes at the top and special compensation consideration for retention. One potential change we weighed and rejected was the replacement of our interim CEO with an executive having more direct industry experience. We knew we had the right person for the immediate task ahead.

Our third business risk was keeping our core operating team intact, motivated and committed to execution. We knew that we might be in for a fairly long downturn.

In addition to our work programs and capital spending, our board had to decide whether to remain committed to prior decisions on organizational structure and related overhead costs. We also had to be keenly focused and responsive to the timeliness of upcoming decisions in relation to rapidly changing circumstances. Finally, we had to stay ahead of our financial and organizational challenges rather than waiting for events to dictate actions we were not prepared for, actions which might actually destroy underlying stakeholder value.

- Have a story to proudly share. Our stakeholders were anxious to hear about the company’s response plans. How did the company plan to maximize revenues, control costs and survive? As chairman, it was clear to me that we needed to have a meaningful and realistic message for investors and for our employees. It was important for me that the company tell a compelling story describing where we were and a credible roadmap of where we planned to go.

We offered a great story that the board and management team firmly believed in. Ours was a company with a solid asset foundation that could position itself to take a leading role in the industry consolidation that inevitably follows such a downturn, when energy prices rebounded. Our company was defined by the fact that a majority of its assets were high quality with low risk growth potential.

Furthermore, we had an excellent core team of people, and had successfully developed best practices

B. Stover with P. Dailey, Ph.D.
to achieve profitable growth in the exploitation of our core assets. My 40 years of experience in the upstream oil and gas exploration and production sector told me that this company had “good bones”—a solid foundation to build upon if the financial situation could be improved.

“Investor relations spin” was not what we wanted to offer our investors, creditors, or employees. We needed to be totally transparent and express confidence in the plain truth about our assets and people. I was a strong believer in our story as were others on our board.

Never underestimate the impact of a message that is factually correct and emotionally compelling, a story that can be reliably repeated by other directors, management and employees. If our financial condition became direr and required a more aggressive response, we knew we would improve our chances of having a constructive and efficient solution with our creditors if it was founded on a solid and compelling story.

☐ Rush to get lean. We had a sound strategic plan in place, but I was very concerned about execution. I believed it was crucial to move very quickly to shape an organization we could afford. We needed a structure that could execute our short-term business plan and allow us to ride out the storm longer than our competitors, while maintaining credibility with our creditors and other stakeholders.

In my early days as an independent director, we worked with our new CEO to make sure the company was appropriately adapting to the realities of our financial challenges. This involved shutting down our corporate headquarters in a high-price market and moving it to and consolidating with our regional office in a lower-cost location. We were able to simultaneously reduce headcount and flatten the organizational structure. The relocation turned out to be a good move.

At the time of my transition to chairman and just when we thought oil prices could not get any worse, they did. The Iran nuclear deal was done, and Saudi Arabia responded by putting another million barrels a day into a global oil market that was already saturated. Oil prices dropped from a “bottom” of $35/barrel to $25/barrel over the next two months.

It was a perfect storm of bad things in the market. Our new and leaner board had to respond. We needed once again to look at reducing staffing and further cuts in operating and capital costs. Again, all this was done to put us in a position to stretch our liquidity and survive.

Assess individual skills, team skills, organizational fit and temperament of the senior management team.

☐ Get senior leadership right. The board asked the CEO to assess the individual skills, team skills, organizational fit and temperament of his senior management team in consideration of our revised business plan and financial objectives. In my early days on the board, we had taken steps to add depth to our operating structure and develop that new talent for eventual internal succession. That effort resulted in the recruitment of experienced personnel to complement our existing field operations team.

However, issues related to our need to further downsize late in the year caused us to eliminate one senior operational position until such time when we could resume a growth mode. The challenging macroenvironment forced us into a course correction. This may have been a case of “right talents, wrong time.”

The CEO, supported by the board, chose to rally around the existing core team and move on. The board also decided to stay the course with the interim CEO at the helm. He was doing an outstanding job, and his talents and experience were deemed best suited to the near-term strategic course we envisioned.

☐ Reach outside to build bench strength. Other companies in our market area were in worse shape than us and their highly-trained employees were actively looking to make a change to another company. We were fortunate to find ourselves in this position and effectively “high-graded” certain key positions in our organization. In some cases, we were able to replace an employee with someone having superior experience and capabilities.

This may have seemed counter-intuitive to our “go
lean” strategy, but we actually achieved a “win-win” of cost reduction and improved organizational and operating performance. This process was also great for building bench strength and sending the right message to our work force about our commitment to assuring a better future for the company. Our “story” was attractive to these new hires. We got better, even in tough times.

- **Optimize to preserve long-term value.** The board determined that the continued erosion of revenues and net income, in spite of material cost reductions, would weaken our liquidity. Something else had to be done—and soon.

As 2016 began, the board quickly realized that we could not rely on a commodity price recovery to address our worsening financial expectations. In
order to optimize short-term liquidity protection, while giving us the best probability of preserving the long-term value of our assets for all stakeholders, we had to continue improving our cost structure.

We made some big decisions. First, we would prepare for another material reduction in our work program and capital budget. We would focus spending only on the most important and profitable projects in our inventory, those necessary to preserve the longer-term value of our assets for all stakeholders.

Second, we would have to make another round of overhead cuts to reflect organization downsizing in line with our reduced capital spending, thus rightsizing the organization for the rough ride ahead. Finally, we re-engaged with our trusted financial and legal advisors from the spring 2015 debt restructuring to help us assess the best strategic options for the company, including major debt restructuring alternatives with our new creditors.

☐ Fulfill fiduciary duties for all stakeholders.

By the end of my first 100 days as chairman in mid-February, we had determined that, absent an utterly spectacular rebound in commodity prices, we must prepare for the possibility of a protected bankruptcy process.

Facing significant interest payments and declining net income, we decided to shore up our liquidity by drawing down the rest of our capacity under our revolving credit facility with our banks, and charged senior management and outside advisors to prepare with our creditors for a pre-agreed plan for bankruptcy.

From our view as independent directors, our company had an outstanding foundation upon which to create real long-term value for our stakeholders. The company had high-quality assets, good people and experience, outstanding operating practices and avenues for profitable growth in the future through post-recovery industry consolidation.

Our duty of loyalty and duty of care would be best achieved by making sure the company survived the downturn to thrive in the upswing. This would avoid value destruction if the company were to be sold off for parts in a court-administered auction. Engagement with our stakeholders began in earnest in late January and early February.

At the same time, and in consultation with the rest of the board, I decided that we should hold more frequent board telephone calls with the CEO and management. This would document the progress of our work, and show diligence in optimizing near-term results while preserving long-term value. The minutes of these meetings would demonstrate the board’s focus, thoughtfulness and responsiveness to an ever-changing set of circumstances. These actions did, in fact, ultimately demonstrate to the judge overseeing our bankruptcy process that the board had shown exemplary good faith in its direction of the process. We had rightly and successfully protected our motives and actions against any future legal actions that might be brought against us.

☐ Get alignment with outsider advisors. You must know these advisors well, and they must know you. It was clear that our outside legal and financial advisors believed we had the right message to give to our creditors—one that would maximize the chances of a fair and rapid process to reach agreement on a plan of restructuring.

This was critical, and our advisors would be passionate advocates of our “story” in the creditor engagement process that would follow. Instead of “nickel and diming” each other in the negotiation process, they would hopefully focus on the real value proposition—competitive advantage through an early emergence from the bankruptcy process.

☐ Protect yourself. As chairman, I was keenly aware that my leadership and the decisions of the board might be challenged, particularly if a contentious bankruptcy were to occur. Our record of taking responsible actions to show the duties of loyalty and care would be essential. My personal wealth and professional reputation were at stake.

My first 100 days as chairman ended with the bitter-sweet knowledge that we as a board had acted to preserve the long-term value of the company for most of its stakeholders, while understanding that a major debt restructuring would likely be necessary.

A pre-agreed plan of reorganization was reached with the creditors. The “story” and the plan for growth following emergence were the key. I believed in it,
our CEO and his team believed in it, and our advisors believed in it.

We had taken steps to minimize the chances of a contentious bankruptcy process by getting our secured creditors to believe in it. Much credit also goes to senior management for their efforts to maintain a constructive relationship with our first lien debt holder throughout the process. Their support and confidence in the company helped create confidence in the other tranches of secured debt holders. Even though the originally proposed plan of reorganization was contested by the unsecured creditors, a compromise was eventually reached, in part by the desire of all the stakeholders to get the company moving again in the pursuit of our compelling story.

Finally, the presiding judge in our case gave a solid endorsement to the quality of our efforts in this process when he said, “In [my] 20, going on 26 years as a lawyer and judge, I’ve seen good cases and bad cases. I haven’t seen very many debtors and their professionals that have acted more responsibly than I’ve seen in this case.” That statement, for me, was the best validation I could have hoped for as the chairman of the board. Confirmation of the company’s plan of reorganization was successfully achieved. My duty of loyalty and duty of care were fulfilled and I am greatly gratified.

How am I different now because of this experience as board chair? I took a risky job that others might have declined. I believed in the potential of the company, its management, its people and assets, along with its growth potential. My decisions, diligence and focused oversight were validated by the results.

I take pride in knowing that the company has emerged from the bankruptcy process, in a relatively short period of time, as a much stronger and healthier company that will continue to build on a solid foundation to provide excellent value for new stakeholders, and employees will enjoy a bright future as they make it all work. A phoenix will have risen from the ashes and I am gratified I did my part as board chair to make it possible.
Optimizing Board Evaluations
by Blake Stephenson, Yafit Cohn and A.J. Kess

While board evaluation has become an accepted (sometimes mandated) part of corporate governance, the process is still often mishandled. How should this best-practice evaluation be managed? What formats are most effective? How do you avoid liability dangers? How can your board turn their findings into results?

The effectiveness of a company’s board of directors is critical for ensuring that the company has a sound and long-term business strategy, executed within an environment of prudent risk management. Board effectiveness contributes to the sustainability of the corporation over the long term and is therefore of vital importance to stockholders and other stakeholders.

A periodic board evaluation has become part of the accepted governance landscape and, if conducted properly, can be a valuable tool to increase board effectiveness. In addition, board evaluations are now required by certain stock exchange rules and governance documents of many public companies. The costs of failure to properly assess a company’s governance arrangements can be considerable. These costs are greater than any potential non-compliance with stock exchange listing requirements, the company’s governance documents and/or applicable regulations in certain non-U.S. jurisdictions. Failure to assess and subsequently improve the company’s governing body may, over time, lead to a board that is unable to fulfill its fiduciary responsibilities effectively.

Board evaluations go to the heart of the directors’ competence and might therefore be a challenging process to conduct.

As the pace of change around us accelerates, it is imperative that corporations evolve as well. Consequently, over time, the balance of skills and experience on the board will inevitably need to change to make certain that the board continues to oversee the management of the company effectively and that the challenges of the day can be handled well.

A dispassionate and objective assessment of the board and its committees (and, in certain cases, individual directors) helps ensure that the board continues to function optimally in a changing business environment.

Board evaluations go to the heart of the directors’ competence and might therefore be a challenging process to conduct. To help companies and their advisors plan their first board assessment (or to build on their previous ones), this article provides insight into the common types and formats of board evaluations and outlines considerations for those designing the assessment.

The list of competencies and capabilities required for an effective board is long, and prioritizing the most significant ones is essential to a successful evaluation. Thus, this article seeks to focus companies and their advisors on several key topics that each evaluation should address. Finally, this article concludes with some tips regarding the post-evaluation discussion with the board to ensure that the necessary improvements identified through the board evaluation process are implemented.

**Designing the evaluation process.** It should come as no surprise that there is no single evaluation format that suits every board. In order to enhance the effectiveness of the evaluation, those designing the evaluation process must tailor their approach to the particulars of the company and its board.

There are several factors that should be considered in determining the optimal method for any given board. The culture and internal dynamics of the board should be significant drivers of the evaluation.

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process selected. Understanding these factors will enable the process to be designed to engender the directors’ trust and, by extension, their forthcoming participation.

Thoughtful consideration should also be given to the needs and situation of the company at that specific point in time. For instance, periods of transition, such as where there has been a change in management or the introduction of a significant number of new directors to the board, may require a different evaluation process than times marked by little change.

It is also critical to consider, at the outset, the company’s underlying objective in conducting the evaluation. For example, is the evaluation process simply meant to comply with the company’s governance guidelines and any applicable stock exchange listing requirements and/or to gauge the directors’ general satisfaction with the functioning of the board? Alternatively, are there perceived deficiencies or issues that the evaluation is meant to address? Understanding the goal(s) of the board evaluation should guide the approach the company decides to take and will enable those designing the process to select tools that are best suited to achieve the company’s objectives.

Keeping these factors in mind, those planning the board assessment will need to choose among several approaches on the board evaluation spectrum. Procedural aspects of the evaluation will require careful consideration and should be revisited from time to time, since the approach a company decides to take may change as priorities shift based on the issues facing the board.

☐ Should the evaluation be conducted orally or via written surveys? The board evaluation process typically involves soliciting the views of directors via individual director interviews, written questionnaires, or some combination of the two (such as following up written questionnaires with one-on-one interviews).

If conducted properly, and by someone who inspires the participants’ trust, oral discussions may allow directors a greater opportunity to express concerns and raise issues in a thoughtful and complete manner. Written surveys have the potential downside of being more of a “check the box” exercise and eliciting less qualitative information.

Questionnaires also create a written record of the directors’ opinions of the board’s performance, which may be discoverable in a potential subsequent litigation. On the other hand, written questionnaires can be drafted in a way that focuses directors on the critical issues to be assessed. Assuming the questionnaires provide ample opportunity for directors to express their opinions and depending on the board and its dynamics, they may be more effective in provoking the directors’ candid responses. Moreover, a written process may allow for greater reflection than a process that requires immediate responses to verbal questions.

☐ Should the evaluation be facilitated by a third-party service provider or by an insider? While the vast majority of companies handle their board evaluations internally, others hire a third-party facilitator, such as outside counsel or a governance advisory firm, to spearhead the process.

In determining which approach to take, boards should consider who would be most effective in facilitating the evaluation and the ensuing discussion with the board. Boards should ask themselves whether, given the circumstances of the company and the issues facing the board, the directors would be comfortable and forthcoming with an internal facilitator.

Additionally, boards should bear in mind that hiring a third party has the benefit of enhancing the objectivity of the process. This may make directors feel more assured that confidentiality will be honored and empower directors to voice concerns that may not have otherwise surfaced.

Hiring a third party, however, can be costly. Additionally, in some cases, the third-party consultant may want access to board and/or committee meetings in order to form its own view of the board’s performance, which may cause discomfort among directors and make them more hesitant to provide a frank assessment.

In our experience, when the board is functioning well overall, boards typically opt to conduct their evaluations internally, while they are more likely to hire a consultant when there are more significant issues to address and the board does not feel qualified to lead the evaluation. In cases where the board
hires a third-party facilitator, the facilitator should be one that is respected and trusted, experienced in conducting board evaluations, and well-versed in evolving governance practices. The board should ensure that the outside firm it engages does not apply a generic approach and should work with the firm to ensure that it has all the information necessary to implement an evaluation process that is tailored to the specific issues facing the board.

For one-on-one director interviews, ensure that the person selected for the role is a good listener, knows how to inspire candid, complete responses and, most of all, has the directors’ trust.

Where the evaluation is conducted internally, who should be tasked with leading the evaluation? Evaluations conducted internally are often carried out by the chairman of the nominating and governance committee, the independent chairman of the board or the lead independent director, the in-house legal department, or some combination of these.

Particularly where the evaluation involves written questionnaires, the corporate secretary’s office may have significant involvement in crafting the relevant questions and determining what, if anything, should be modified from the previous year’s evaluation (sometimes with the input of outside counsel). Typically, the corporate secretary then discusses the proposed questions with the nominating and governance committee, and collects feedback from the directors.

Where the evaluation process involves one-on-one director interviews, the board should give serious consideration to who would be best suited to conduct the interviews. While it is often the chairman of the nominating and governance committee or the independent chairman of the board or lead independent director (depending on the board’s structure) who conducts the interviews, the board should strive to ensure that the person selected for the role is a good listener, knows how to formulate questions to inspire candid, complete responses and, most of all, has the directors’ trust.

Should the evaluation include peer reviews of individual directors? Peer reviews of individual directors may lead to greater director accountability and help to identify underperforming directors. Peer review is not without risks, however. One concern often expressed is that peer reviews may undermine a collegial board culture. Given this significant drawback, boards deciding to assess individual directors should do so with sensitivity.

Information from board evaluations may be discoverable in litigation. Be sensitive to how material is processed and retained.

Those tasked with devising the evaluation process should consider the attendant litigation risk and how that risk might be mitigated. Information obtained through board evaluations may be discoverable in litigation. In addition to considering this fact in determining whether to conduct the evaluation orally or via written questionnaires, boards should be sensitive to how board evaluation material is then processed and retained.

It may be advisable, for example, to implement a document retention policy applicable to board evaluations (subject to any hold notices that may be issued for pending or threatened litigation) pursuant to which actual survey results are not retained once the summary report or slide deck (which does not reference individual directors) is prepared and delivered to the board. In addition, for companies employing written questionnaires, the person leading the process should consider reminding the participants that individual survey results may be discoverable in litigation and that, because their words might be used in ways that were not intended, they should be thoughtful in phrasing their responses.

Finally, boards may consider retaining an attorney or law firm to be involved in the evaluation process including the preparation of any summary report, and placing “Privileged and Confidential” legends on all board evaluation material. While these measures alone do not guarantee the protection of evaluation material from discovery in a subsequent litigation,
they do preserve the ability to advance the argument that the materials are covered by the attorney-client privilege.

**Are directors given sufficient time before each board meeting to read relevant papers and thus arrive properly briefed?**

*Key topics to be addressed in the evaluation.* Once the evaluation process has been designed, those leading the evaluation must decide what to assess, keeping in mind the objective(s) of the evaluation. An effective evaluation requires thoughtful consideration of the topics to be explored and the questions that will likely elicit robust responses regarding each topic. While there is no one-size-fits-all approach, there are several areas that should be addressed in nearly every evaluation.

- Efficient use of board time. Because a primary purpose of evaluations is to assess the effectiveness of the board, evaluations should address whether the board allocates its time appropriately. Some specific questions that may be asked in this regard are:
  - Should the board be spending more time on certain matters than it currently does? Should the board be spending less time on matters that it currently spends too much time on?
  - Are there topics that are addressed that are not necessary? Are there topics that are not addressed that should be? In other words, is the board focused on the right issues?
- Quality and quantity of information. Ensuring that the right information—and the right amount of information—is appropriately presented to directors (and that directors have sufficient time to evaluate it) is critical to enabling the board to function effectively. There are several categories of questions that may be asked on these issues:
  - Adequacy of information. Does the information provided to directors allow them to exercise their oversight responsibility on an informed basis and make well-considered decisions? Are there any changes you think should be made to the information provided?
  - Amount of information. Is there a sensory overload from board packets that are simply too long, or are lengthy materials a necessary side effect of increasing regulatory oversight and expectations? Would an executive summary be helpful? If briefing materials are too long, what risks are posed with respect to directors being unable or unlikely to spend the necessary time to review them prior to the meeting?
- Preparation time. Are directors given sufficient time before each board meeting to read relevant papers and thus arrive properly briefed?
- Frequency and length of meetings. Are the number and length of board meetings adequate, in light of the company’s situation and the issues it is facing? Are there too many or too few meetings? Are meetings too long or too short?
- Time allocation. Is ample time allocated at the board meetings to ensure full discussion of important matters?

*Ensure an appropriate balance of skills, experience, independence and knowledge on the board to adequately oversee management and address issues.*

- Board culture and dynamics. The quality of the directors’ relationships with one another can be an indicator of the board’s ability to work productively as a unit, as can be the dynamic in the boardroom. Evaluations should address such questions as:
  - How effective are the key board relationships?
  - Are individual directors given sufficient opportunity to contribute to discussions at board meetings?
  - Does the board encourage robust discussion and value the expression of diverse views and respectful disagreement?
  - Do you feel that conflicts are addressed in an appropriate manner?
  - Do directors come to board meetings prepared?
- Board composition, leadership structure and role of independent directors. Each board must ensure that there is an appropriate balance of skills,
experience, independence and knowledge on the board to enable it to adequately oversee the company’s management and address issues as they arise.

Similarly, it is imperative that the board periodically assess whether its leadership structure continues to be effective, given the company’s situation at the time, and whether there are any impediments to the ability of independent directors to perform their intended roles. Board evaluations should include questions focused on these issues, such as:

- Does the board have the right mix of skills and experience to perform its functions completely and effectively?
- Is there sufficient diversity among the directors?
- Is the leadership structure (such as the separation/combination of the chairman and CEO positions) working as intended?
- Is there a proper balance on the board between independent directors and management?
- Does the company’s governance structure allow independent directors to perform their roles effectively?
- Do the independent directors conduct enough executive sessions throughout the year? Are they effective?

Committee effectiveness. Evaluations should also address the effectiveness of the board’s committees. Some questions that may be asked include:

- Are the three core committees operating effectively and communicating the results of their work and analyses with the full board?
- Is the committee structure effective? What is working and what could be improved? Should the company have a risk committee separate from the audit committee?

Other potentially relevant topics to address. Evaluations will invariably differ with regard to the additional topics they address, but some questions that may be worth incorporating in the evaluation include:

- Does the board have an appropriate CEO succession plan in place that addresses succession in the ordinary course, as well as in the event of an unforeseen crisis, such as a sudden death or resignation? As a related matter, do management and the board engage in and encourage the continuous development and promotion of the company’s strong internal talent?
- Do you feel that the company has an appropriate control environment?
- What is the board (and committee) process for identifying and reviewing risk?
- Do you believe you have appropriate access to management and that management has appropriate access to you?
- Are you comfortable that the company’s internal controls are effective?

Board oversight. Board evaluations should determine whether the board is effective in its oversight of management. An evaluation might ask: In its oversight role, do you believe the board appropriately advises, supports, and counsels management?

Controls and compliance. A key role of the board is to create and foster an appropriate culture of controls and compliance at the company. In assessing the board’s effectiveness in this regard, director interviews and questionnaires should include such questions as:

- Do you feel that the company has an appropriate control environment?
- What is the board (and committee) process for identifying and reviewing risk?
- Are you comfortable that the company’s internal controls are effective?

Post-evaluation discussion and follow-up. Even the most thoughtful of board evaluations will not be effective unless it is followed by a guided discussion with the board regarding the results of the evaluation and the delegation of appropriate follow-up tasks to address any issues that surfaced during the evaluation.

Once responses are collected—via interviews or questionnaires—the director, corporate secretary, or outside facilitator who is spearheading the evaluation process should anonymize, aggregate, and organize the data and present it at the next board meeting.
This presentation is typically conducted orally, perhaps with the assistance of a slide deck, and should encourage open dialogue with and among the board members regarding the findings and what should be done to address any identified weaknesses. The presentation of the evaluation’s results and the related discussion should be reflected generally in the minutes of the meeting.

Where specific shortcomings have been identified, it is critical that the discussion result in a plan of action for the board to follow up on the recommendations that come out of the process. The person leading the evaluation process should make sure to assign specific responsibilities to the relevant group or individual (such as a committee of the board, a specific director or a certain member of the management team).

For example, where concerns are raised regarding the quality or quantity of financial information provided to the board, it would be most logical for the chief financial officer (or the person he or she has designated) to take responsibility for the appropriate fix. Necessary improvements regarding the items on the board’s agenda or the opportunity for individual directors to contribute to board discussions would be more appropriately delegated to the chairman of the board or lead director. Concerns related to the mix of skills on the board should be tasked to the nominating and governance committee.

The leader of the evaluation process should also provide target dates for completing each of the follow-up items assigned. Regular evaluations of the board and its committees can be important to ensuring that the board can and does oversee the management of the corporation effectively.

Board evaluations can help foster long-term value creation and enhance the sustainability of the company over the long term. Accordingly, it is in the best interest of each company and its shareholders to devise thoughtful and comprehensive assessments designed to optimize the board’s performance and to implement any necessary changes arising from these assessments.

B. Stephenson, Y. Cohn and A.J. Kess
As Global Business Transforms, Boards Must Keep Pace
by Nels Olson, Tierney Remick and Andrés Tapia

With accelerating change in how the world does business now the norm, board turnover and refreshment remain stuck in the last century. Boards realize that they must upgrade their skills to meet new demands—but also value the insight and experience of their incumbent members. How do best-practice boards balance these competing talent agendas?

In an increasingly complex, continually morphing, nonstop global business environment, no CEO, no matter how gifted, can be expected to do it all. In fact, the best CEOs have learned to rely on their boards for the competitive edge they need. That requires a modern board carefully recruited with the skills and experience required to support the CEO and the strategy.

The organizational pyramid with the CEO at the top, is as antiquated as a buggy whip. Running a company is increasingly a team sport, a joint effort between the CEO and his or her team collaborating with the board. When boards are assembled thoughtfully, directors are a not-so-secret weapon in the highly competitive world of global business. They provide valuable functional expertise and diverse perspectives that enhance board discussions and decision-making, and can also open doors and provide crucial intelligence in new markets.

We wanted to learn how the process of board succession and renewal among the largest companies was proceeding. Following the 2008 global financial crisis there was little turnover in board membership as boards battened down the hatches. Now we see this changing as veteran directors, whose expertise was needed in tough times, take the opportunity to retire. Boards in turn may have a rare opportunity to push the “reset button.”

We were also interested in how board leaders perceive and are acting on the need to modernize by adding a broader range of backgrounds and experience to the team. What skills are boards particularly eager to add, over what period of time, and what, if any, obstacles do they view as getting in the way?

Boards recognize the need to modify their composition, but change is not coming easily. There is reluctance to implement new practices that increase diversity of skills.

For some answers, we recently surveyed heads of nominating committees and board chairs of Fortune 500 companies. Among the top-line takeaways:

- **External pressures prompt change.** As boards confront new challenges (from global macro-economic trends to disruptive industry shifts to new competitors), many acknowledge that current board composition does not include the skills and experiences required to effectively compete today.

- **New director backgrounds needed.** Boards want to recruit new directors that bring greater diversity of the skills and experiences they currently do not have. At the same time, though, they want to hold on to the CEO-directors who comprise the traditional director profile and who contribute indispensable operating wisdom.

- **More strategic approach to recruiting.** Boards are taking a far more systematic, strategic approach, focusing on board succession planning and not merely one-off recruitments.

- **Roadblocks to needed change.** Although boards recognize they need to modify board composition, they face significant challenges in implementing these changes.

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these changes are not coming easily. There is reluctance to implement new practices to increase the diversity of skills and experiences that boards seek.

Overall, our survey findings paint a picture of conflicted boards.

- **What is driving change?** Proxy season 2016 was distinguished by a record number of shareholder proposals seeking proxy access and a say in the director nominating process. According to law firm Skadden, Arps, Slate, Meagher & Flom LLP, more than 240 public companies (including more than 35 percent of S&P 500 companies) now have a proxy access bylaw, up from approximately a dozen companies at the end of 2014. That is the “push” of external forces seeking to change board composition.

The “pull” for change comes from board members themselves. Korn Ferry’s survey demonstrates that directors, too, are concerned that they lack the strategically relevant skills and experience required to remain competitive.

What are the major transformational changes boards face? What skills and experience are they seeking as a result? What challenges will boards face?

Board and nominating and governance committee chair respondents were asked to identify and rank external forces that are having the greatest impact on their industry.

Perhaps not surprisingly, new technologies topped the list. Not only did 85 percent of respondents agree that “new technologies are transforming our industry,” technology was cited more often than any other factor when explaining why their industry is facing more change than other industries.

These chairs also cited regulatory and global business change among the top drivers of transformational change, ranking them second and third, respectively.

More than half of respondents agreed that “demographic changes are having a significant effect on our business,” and demographic change ranked fourth among causes of transformational change.

- **How satisfied are board leaders with current board composition?** Respondents recognize the need to add new directors with the skills they require to meet their company’s competitive needs, and have even identified those missing skills. Yet they also express satisfaction with their current board composition, and appear not to be in a hurry to move existing long-term members off the board.

Responses to specific questions illustrate that board and nominating and governance committee chairs we surveyed are of two minds when it comes to their own board’s composition. While 80 percent of them agree that “all of our directors have skills that are relevant to our strategy,” only 69 percent say “we are satisfied with the current composition of our board” and 64 percent say “we have identified new skills we need on the board in order to compete.”

Among those who believe current board composition is lacking, two-thirds explained that the source of their dissatisfaction is lack of diversity regarding directors’ skills and experience.

- **How do boards plan to shift membership?** Those we surveyed anticipate major changes in board composition in the near future. This is at least partially driven by the need to add new skills and experience in a shifting global business environment.

Eighty-two percent of respondents say “we plan to add directors in the next few years and will have the opportunity to do so.” Only 10 percent say “we do not anticipate that the composition of our board will change significantly over the next several years.”

Board leaders clearly want to hold on to the director talent they have while adding what they view as missing and essential to board effectiveness. Three-quarters say “our veteran directors are valuable contributors to our board,” and more than half add “we are eager to add directors with new, needed skills.”

There are roadblocks to adding these new directors, however. One-quarter of those we surveyed say “it’s very difficult to cycle directors whose skills are no longer relevant to the business off the board.” Nearly the same number say “a retirement age for directors should be firmly enforced.” The overwhelming majority of respondents do not favor term limits. Reasons cited include inflexibility, consistent turnover, and
the potential loss of competent, experienced board members.

Respondents see the need to add directors with new skills and experience, but which are most in demand? There is continuing demand, as there has been for some time, for financial skills and experience, most sought after by 60 percent of board leaders surveyed. This is followed by global and cybersecurity (44 percent each), regulatory (38 percent), marketing (36 percent), and others in dwindling numbers.

While respondents seek specific skills, they do not want the downtime of new directors getting up to speed before they can contribute. Some 96 percent agree “we want directors who can quickly add value, not just serve as token additions.”

Gaining the value of these new directors (particularly those who have never served on a board before) is a hurdle some boards apparently need to clear. Eighty-six percent of those surveyed agree with the statement, “We recognize that directors who are serving on a board for the first time need additional support integrating into the board.”

Moreover, nearly half of respondents agree “our board needs to work on accepting newer directors so we reap the benefits of diversity on the board.” More than a fifth went a step further, agreeing “we have to make the culture change required for new directors to participate in board discussions.”

Apparently, some boards are trying to bridge this gap and more quickly integrate new directors onto the board. Some 62 percent say they have a formal onboarding program, and a third have an informal one.

Adding new directors to the board—whether experienced or first-timers—should be viewed in the context of board succession planning, not merely one-off recruitments. That is, within a larger, more strategic framework than adding a single needed skill to the board.
The best boards view succession as an ongoing process, much the same way they view CEO succession planning. Both take into account global economic shifts, industry shifts, and strategy shifts to determine not only current needs but future needs. Just as boards create an ideal CEO profile when planning for a change in CEOs, these boards seek directors whose skills and experience closely align with strategic challenges and risks the board is most likely to face in the future.

Implementing continuous, “evergreen” board succession planning helps to ensure boards are never scrambling for director talent, regardless of the circumstances. That may include both planned and unplanned director departures, as well as the recognition that there is a gap in board skills that needs to be filled relatively quickly.

Increasingly, boards think more about strategic additions to the board team and less about individual recruitments. Boards that adopt a succession planning framework have the added advantage of being able to continually scan the corporate and governance landscape for the most capable director candidates (who sync with their strategic objectives), and to keep a close watch on them. Sometimes the best directors are not immediately available. When they are not, it is often wise to build relationships that will pay off longer term.

This raises the practical issue of board size. Boards cannot maintain their membership while adding new directors unless they plan to increase in size. This would buck the long-term trend for boards generally to pare down in size.

Part of the solution may be a rigorous director evaluation process, with the relevancy of skills in current directors regularly assessed and addressed. Directors committed to high-performing boards should also hold themselves accountable by assessing their value to the board—particularly if they have been on the board for a long time. This is understandably a sensitive topic, but individual directors should be honest with themselves, taking stock of their relevancy to the business, their ability to continue to add value to the board—and whether someone new might be more appropriate.

**Recruiting an ideal board candidate may be worthwhile even if it means temporarily enlarging the board.**

What if boards identify an ideal director candidate with needed skills and experience, but do not foresee an immediate vacancy? It may be worthwhile to recruit the candidate, even if that means temporarily enlarging the board, especially if the alternative is to risk losing the candidate to another board (perhaps even a competitor).

Recruiting new directors may sometimes be an urgent matter but, on the best boards we know of, it is part of a thoughtful, ongoing process—an emerging best practice. It entails keeping track of individual directors’ plans, such as retirement, to maintain awareness of when seats may open up. At the same time, boards should maintain a skills matrix that indicates the skills and experience currently represented on the board team as well as those that are needed.

This approach enables boards to preemptively develop a pipeline of potential directors who are particularly desirable, and maintain contact and relationships, rather than waiting for an imminent departure to ignite a more urgent search.

Adding new profiles of directors beyond traditional CEOs comes with challenges of its own. A sizable number of directors surveyed see challenges in integrating new directors. For one, an overwhelming majority of respondents recognize that first-time directors need additional support, some indicating that their board requires a change in culture to integrate new members.

From the CEO’s perspective, recruiting and integrating this new generation of directors is well worth the effort. CEOs should welcome this added diversity on their boards, best tailored to the company’s and board’s needs. Board teams that result from this sort of advance, continuous planning can prove to be the strategic arsenal of CEOs’ dreams.

While 58 percent of board leaders surveyed “are eager to add directors with new, needed skills,” many cite logistical barriers in adding new directors to the board. Nearly half of respondents agree “our board needs to work on accepting newer directors so we reap
the benefits of diversity on the board” and more than a fifth agree “we need to make the culture change required for new directors to participate in board discussions.” Board leaders clearly recognize the need to update and expand their board’s repertoire of skills, and that this modernization brings challenges.

To conclude, we offer the following suggestions to boards that want to better their odds of finding directors who both fit the bill and will be poised for success, especially if they have never before served on a board:

☐ **Widen the net.** When seeking nontraditional board candidates do not restrict your search to the “usual suspects” in the usual places. Nontraditional directors likely reside below the CEO level, in other functions, or lead smaller organizations.

☐ **Provide onboarding.** New directors, particularly those who are first-time directors, may need guidance to get up to speed quickly and contribute. Consider formal and informal (mentoring from an established director) approaches.

☐ **Prepare the board.** Consider cultural “coaching” to help board members understand why diversity is essential, and to embrace the change.

☐ **Assess board meeting protocol.** Ensure that your board meetings welcome all views and encourage everyone to participate.
The past several years have seen an explosion of interest in how all companies today are digital companies, and need digital directors in their boardrooms. This trend is real, but not enough thought has been given to definitions, job descriptions and strategic plans.

The need for boards to incorporate a digital perspective has been well established. Indeed, in 2009, Russell Reynolds Associates recruited Sheryl Sandberg, COO of Facebook, to the Disney board as a “digital director.” It was recognized at that time that the media industry was going through a significant change, and it would be valuable to bring someone with a fresh industry view onto the Disney board.

Since that time, the topic of digital directors has been front and center for boards across every industry sector. Now, as we talk to CEOs and boards today regarding transformation and leadership, the question we hear most frequently is “how do we drive an integrated approach to digital transformation and change across the organization?”

Companies are recognizing that there are multiple areas in which their boards can increase their digital quotient.

This requires not only digital savvy board members but broad board engagement in strategy, change management, and technology platforms by the entire board. Such enterprise transformation requires strong support at the top.

A recent article from McKinsey & Company notes that companies are recognizing that there are multiple areas in which their boards can increase their digital quotient. They need to close the insights gap, understand how digital can upend business models, engage more frequently and deeply on strategy and risk, and fine-tune the onboarding and fit of digital directors. These digitally savvy directors bring important perspective regarding today’s products and services as well as future business models.

Russell Reynolds Associates has done extensive research in the area of digital directors. In our latest report, “Digital Directors 2016: Diverse Perspectives in the Boardroom,” we define the digital director as any non-executive board member who meets at least one of the following criteria:

- Plays a significant operating role in a digital company (primary business function based on a web-based, social, mobile/device, cloud/SaaS or big data platform).
- Has a primary digital operating role within a traditional company.
- Has two or more non-executive board roles at digital companies.

The report analyzed the backgrounds of every board member at the global 300 companies to uncover the prevalence and background of digital directors and understand how they differ from other directors.

While digital directors still make up less than five percent of board seats across the global 300, their number has increased by six percent over the past two years. These digital directors are found across all industry sectors, including digital laggards such as healthcare and industrial. While only four percent of industrial board members are digital today, we expect this figure to change significantly as the impact and opportunities of the Internet of Things (IoT) grow over the next three years.

The United States accounted for the majority of digital director placements over the past two years (76 percent of all new appointments). Simultaneously, the general population of board leaders in the United States is becoming increasingly savvy about digital topics, blurring the distinction between digital and non-digital non-executive directors. Such change has

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been slower to come to European companies, with a slight increase of the amount of digital representation in the Asian Pacific, from three percent in 2014 to eight percent in 2016.

Certain industries are far more likely to add a digital director. Fifty-five percent of technology boards have a digital director, the highest rate for any industry. Consumer (at 49 percent) and healthcare (at 50 percent) also seem to recognize the value of adding this perspective. However, only 14 percent of financial services and four percent of industrial companies currently have a sitting digital director on their boards.

There is evidence that some boards “get” digital to the point of doubling or tripling down, while others still remain hesitant.

Notably, when grouping boards by number of digital directors, from “Highly Digital” with two or more, down to zero digital directors, the “Highly Digital” group is actually larger than the “Digital” segment (a single digital director) in the United States (now 26 percent of United States boards). This is evidence that some boards “get” digital to the point of doubling or tripling down, while others remain hesitant.

Women comprise a very high percentage of digital board members. Our analysis revealed that they account for 58 percent of the digital directors recently added to boards. As a result, while only 19 percent of global 300 directors are female, women represent 37 percent of digital directors. The United States leads the way, with 38 percent, but Europe (36 percent) and Asia/Pacific (33 percent) are close behind.

Furthermore, of the digital directors who bring transformational experience, 67 percent are women. Women are also more likely to be the sole digital voice on their boards (40 percent versus 27 percent of male digital directors).

As boards consider naming new digital directors, they typically seek at least one of the following four digital perspectives for the company:

- **Customer perspective**—an understanding of marketing, data, customer insight, products and analytics and digital engagement.
- **Vision and strategy**—insight on market dynamics, the latest digital trends and their implications for the business.
- **Leadership and culture**—the capability to ensure the business is developing a pipeline of digital talent, advise on the transformation, and recognize that digital businesses have different aspirations and paces of development than traditional businesses.
Commercial and investment acumen—the ability to contribute to board debates on appropriate investments in complex, capital-intensive technology projects.

Being good in one of these areas does not mean the digital director will be good in others. For example, directors who stand out for their consumer perspective or vision may not always be good at investment oversight.

As companies move from developing a digital strategy to actual implementation of digital platforms and technologies they are also beginning to look for a broader definition of “technology” in the boardroom.

Digital directors can bring a range of experience and competencies to the boardroom. These bring distinct tradeoffs in terms of functional experience and “disruption” versus “transformation” experience. Many bring a strategy consulting background in addition to operating credentials.

These directors fall into seven basic archetypes:

- **Digital industry specialist**—with broad cross-functional expertise. They offer broad contributions, with particular ability to ask the right strategic questions regarding digital opportunities and risks, especially for large companies.

- **E-commerce leader**—skilled at building digital operations through brands, merchandising and fulfillment, with expertise in the use of data analytics (web traffic, customer metrics) to push product innovation and revenues.

- **Chief marketing officer**—able to lead sizeable, multichannel marketing organizations, and oversee digital marketing, including the migration of traditional media budgets to digital. This director can drive a digital vision that aligns the overall company strategy with key stakeholders. He or she is capable of ensuring a compelling digitally-enabled consumer experience across all touchpoints.

- **Mobile/social specialist**—a best-in-class change agent in the ways that people interact, organize, consume and share information. Expect a tech-savvy view on where digital technology is heading and its potential impact on the business and consumers.

- **Data analytics guru**—an expert at using sophisticated analytic tools to identify insights, better serve and target customers, refine operations and create monetizable products. They align analytic capabilities for customer/client focused strategic direction to drive company growth and performance.

- **Consumer packaged goods/brand expert**—digitally savvy in the areas of channel sales, branding, PR, digital awareness, social media and mobile.

- **Expert in general consumer or services businesses**—with expertise in director-to-consumer sales, and is skilled at driving customer acquisition, retention, and conversion as well as effective use of data analytics, mobile and social. He or she can play a key role in driving and leveraging digital across all levels of the company.

Experience with operating in a traditional company environment and then transforming an old business into a new one is seen as increasingly important.

Apart from the individual’s skills and abilities, it is also important to consider the desired scope of disruption brought by a digital director. Different experiences will translate to a different fit within the boardroom. A digital director steeped in technology, for example, but without the experience of running a traditional business, will likely be a “digital disruptor.” In contrast, a director who understands the tech environment well, but has not grown up in it, will be more of a “digital thinker.”

However, one of the key considerations in appointing digital directors is the general management “weight” of the individual. There is a tradeoff between seniority and experience with complex P&Ls on the one hand, and proximity to the digital world on the other. In addition, experience with operating in a traditional company environment and then
transforming an old business into a new one is seen as increasingly important.

As businesses and business people become more digital, the distinction between an independent director and a digital director is becoming blurred. Where a digital director sits on the spectrum above depends largely on their background and experience.

All digital directors will bring an important perspective to the business, challenging the board’s decisions and strategic directions. They will also have an internal impact on leadership and the culture. They will often play a hands-on role with the executive team, ensuring that there is a pipeline of digital talent coming through and advising on digital transformation, recognizing that different businesses and their customers evolve at different paces. Additionally, these digital directors will often advise on commercial and investment decisions. Digital transformation tends to mean shifts of capital around the organization—and significant investment in technology and talent. The digital director can bring a new perspective to the scale and return of this investment.

Digital directors can also add value to the business by challenging the existing board dynamic to nurture true change. They can do so by bringing fresh thinking to the board, questioning the status quo and maintaining a sense of proportion about the potential for digital technologies.

Some chairs have told us that traditional directors are primarily reactive, performing a type of policing function. In contrast, digital directors stimulate early management thinking and action as a catalyst.
for change. They can also embrace their role outside of the board room more fully than their non-digital counterparts, as digital directors can be closer to the executive team and more comfortable in having conversations outside of the boardroom. This may be the result of the executive team being drawn to them for new insights and ideas.

**Build digital capabilities via many board members whose experience and competencies complement and overlap one another.**

We note that digital directors should be independent directors first and digital advisors second. They should be able to contribute to the wider board debate, not reserving their judgment for “digital only” issues. Here are a few considerations for avoiding a poor fit:

- Ensure digital candidates provide well-rounded contributions on all matters, rather than only in their areas of expertise. Evaluate the right balance between digital expertise and board-readiness.
- Boards too often view “digital” as a defensive play, reacting to market changes. Do not wait for a crisis in order to begin digitalization. Digital disruption is “when,” not “if,” and smart companies anticipate the potential implications for their business.
- A digital mindset should go beyond “checking the box” with a single digital director. Build digital capabilities via many board members whose experience and competencies complement and overlap one another. Ensure digital directors are constructive and collegial, helping to educate colleagues on digital topics. Consider adding more than one digital director.
- Demand for digital directors is creating an increasingly competitive director-talent pool. Look beyond the digital “academies” such as Google, Facebook and Yahoo! to find executives who have successfully implemented digital strategies in non-digital firms. Customize digital-director job specifications for your company.
- Typical director requirements such as the need to be a sitting CEO or top current board director limits the pool of proven digital talent. Target specific competencies and experiences. Consider younger candidates who are “in the trenches” on digital strategy and can offer a fresh perspective.

Disruption can be viewed as a painful threat to be dealt with, or an opportunity to reinvent and lead. In spite of market hyperbole, this is a “fork in the road” moment for large, established companies and their leadership teams. Companies in all industry sectors still have the opportunity to make bold moves in the digital arena. As GE has demonstrated, even old line industrial companies can dramatically reposition themselves as next generation digital businesses.

At present, very few if any companies have figured out this transition, and even early stage disruptors will hit their speed bumps. At the end of the day, it is all about the vision, team, company structure and culture required to deliver. Reinvention must happen at the core, not the fringe, of the business. Progressive boards, in part enabled by digital directors, will be important ingredients in enterprise transformation.
In Review

Recent Notes & Events

Board Composition

New survey highlights role of women on boards and in top management.

The Credit Suisse Research Institute has released its bi-annual CS Gender 3000 report. The report, first launched in 2014, analyzes the Credit Suisse Gender 3000 (CSG 3000), which encompasses 27,000 senior managers at over 3,000 companies. The report examines gender diversity and better performance, and looks specifically at firms with more than 50 percent female representation in senior management, microfinance institutions and venture capital firms.

- Debunking the “Queen Bee” myth. Do women promote women? The report examines the much debated notion of a “Queen Bee” syndrome which argues that women who have made it to senior positions actively seek to exclude other women from promotions into top management.

- The data in the CSG 3000 disputes this idea; the findings show that female CEOs globally are significantly more likely to surround themselves with other women in senior roles. Female CEOs are 50 percent more likely to have a female CFO and 55 percent more likely to have women running business units.

- Further, 25 to 30 percent of microfinance CEOs are women and around 50 percent of the lending officers are women. Female-led microfinance institutions are more focused on female clients (59 percent openly target women versus 43 percent for male CEOs), have a greater share of female board members (44 percent versus 23 percent), are more likely to have a female chair of the board (43 percent vs 16 percent), and have more female clients (76 percent versus 60 percent).

- While female partners in venture capital remain very few, firms founded by women have a much higher percentage of female partners than the industry average (43 percent vs. 8 percent). Additionally, female-founded VCs tend to invest more in women entrepreneurs. Women are clearly supporting and promoting women not only in the corporate sector but also in the microfinance and VC worlds.

- The analysis also demonstrates that the higher the percentage of women in top management, the greater the excess returns for shareholders. From 2013 to mid 2016, the outperformance of companies with 25 percent senior women is a compound annual growth rate of 2.8 percent, 4.7 percent for companies with 33 percent senior women, and 10.3 percent for those over 50 percent compared with a one percent annual decline for the MSCI All Country World Index over the same period.

- Challenging the “Glass Cliff.” The report also examines the evidence of a “glass cliff” for female CEOs. This is the idea that female leaders are appointed to lead companies as a last resort when all other options have been exhausted, and are thus set up to fail.

- Evidence suggests that the share price underperforms (almost 10 percent annualized) from 8 months before a female CEO is appointed, while women led companies outperform between 8 and 12 months after the appointment (14.4 percent annualized).

- However, after examining a companies’ actual financial performance, evidence of a glass cliff is mixed. The report finds no significant difference in company return on equity between female and male CEO appointments and that women are actually appointed to companies with higher cash flow returns on investments. After examining the companies’ return on assets, firms with male appointments saw a 12 percent decline versus 16 percent for female CEOs over the past 12 months before taking control.

- “Gender diversity in both board and particularly senior management positions is a tremendous benefit to companies and their shareholders,” said a Credit Suisse spokesman. “Management manages companies, while boards supervise them. To understand the full impact of gender diversity, we need to focus on management. The data show that there is a strong correlation between companies with high levels of diversity in management and their performance.”

- The state of women on boards and senior management. Boardroom diversity has increased globally from 12.7 percent at the end of 2013 to 14.7 percent at year-end 2015, a 16 percent increase in two years and a 54 percent increase since 2010. The top five countries with the highest percentage of women represented on corporate boards are Norway (46.7 percent), France (34.0 percent), Sweden (33.6 percent), Italy (30.8 percent) and Finland (30.8 percent).

- However, the findings show that there is no consistent correlation between higher diversity in the boardroom and increased participation of women in senior management. Paradoxically, the efforts made to increase gender diversity in boardrooms can limit the available female talent in senior management and hinder expanded representation for women in executive positions in the future.

- The average age of male board members is 60 in Europe and 64 in the U.S., which would signify a retirement position. Female board members are on average 55 in Europe and 60 in the U.S. indicating that women in their prime executive years are being siphoned off into board positions and away from management roles, where they may have more capacity to make structural change.

- Female participation in senior management (CEO and those reporting to the CEO) shows a global average of 13.8 percent compared to 12.9 percent in 2014. However, an exact matched-set data comparison shows representation has increased much less from 13.6 percent to 13.8 percent. Just 3.9 percent of CEOs in the CSG 3000 are female, barely unchanged from two years ago.

- Women make up 14.1 percent of CFO positions globally, though this is highly skewed toward Asia where they account for 22 percent. Shared services remains the main employer of women at senior levels accounting for 33 percent of female management positions globally and
underlines how women’s path to the top is still concentrated in that area.

Women make up 9.9 percent of business unit heads (a traditional launchpad to senior roles and boardroom positions) versus 8.5 percent in 2014, which is an 18 percent increase. However, with only one in ten women heading these business units, the current rate of progress would achieve gender parity by 2070.

Disclosure

Use care in communicating CEO pay ratios with employees.

335:1. 276:1. 247:1. 71:1. Those figures represent alternative ways to calculate the ratio of CEO to worker pay in the U.S., ratios that every public company will be required to report for its own workers in 2018. Since the SEC passed this measure one year ago as a continuation of mandates from the Dodd-Frank legislation, the CEO pay ratio has become a lightning rod for discussion around executive pay.

The pay ratio is controversial for different reasons to different constituents. In the corporate governance universe, executive compensation professionals and the shareholders who vote on executive pay have debated the ratio’s usefulness as a means to help them evaluate CEO pay. Companies are concerned about the costs involved—by some estimates, it will cost public companies a collective $1.3 billion to comply with the rule in its first year, and about half that amount every year thereafter. Meanwhile, opponents of what they describe as exorbitant CEO pay have said they would use the ratio to shame companies publicly.

HR departments are undoubtedly asking how they can best communicate their own company’s ratio and educate employees on what it means.

Determining the CEO pay ratio. What makes the pay ratios reported by various sources thus far so vastly different? The largest of these figures cited above—335:1—is according to the AFL-CIO Executive Pay Watch. This accounts for the average reported total compensation for S&P 500 CEOs vs. the average for nonsupervisory workers in the U.S.

The smallest of these figures—71:1—was calculated by PayScale, comparing median cash compensation for 168 of the highest-paid CEOs in the annual Equilar 200 study to cash pay of the median employee for those companies. This included all employee levels from individual contributor to executive level.

These differences reflect the fact that while companies will be required to provide disclosure of their CEO pay ratios beginning in 2018 public filings, there is some flexibility in the SEC rule that allows a company to select its methodology for identifying its median employee and that employee’s compensation.

The question remains how the ratio should be calculated to create the most direct comparison.

Executive vs. employee pay strategies. It is difficult to draw a direct comparison from executive to employee pay for several reasons. The AFL-CIO Executive Pay Watch included all reported CEO pay, which factors in equity such as stock and options awards, while PayScale’s employee survey exclusively tracks salary information and thus compares more directly to the cash components of CEO pay in the form of salary and annual bonus.

On paper and in practice, stock and options make up a vast majority of CEO pay. Equity accounted for 68 percent of the reported compensation for the CEOs included in the Equilar 200 study used for the PayScale comparison. In other words, on average, less than one-third of these CEOs’ pay was earned in cash. At the same time, CEO compensation reported in annual proxy statements often includes dollar values that are not paid in that year, because a significant portion of CEO pay is contingent on future performance. The ultimate value of those awards may be less or more than the reported numbers had indicated.

Non-executive employees may or may not receive company equity as part of their compensation. Even if employees do receive stock or options, they are less likely to be certain about the present value of their equity, and thus self-reported data may not fully capture the amount they ultimately realize as something tangible, even if it were accounted for in the pay ratio. As a result, survey data better reflects cash.

The highest-paid CEO on the Equilar 200 list—Dara Khosrowshahi of Expedia—received stock options valued at more than $90 million on the day the award was granted. However, he will only realize that value if he hits aggressive performance goals. On top of that, the company has said it will not award him any more equity pay until 2020. According to PayScale’s survey, the ratio of CEO pay (including equity) to the median employee would be nearly 1,000-to-1 at Expedia in 2015. In any other year, it would likely fall far closer to the 39:1 ratio shown in PayScale’s study, which represents the amount of cash Khosrowshahi took home in 2015.

Employee perception of executive pay. The alternative ways to calculate the CEO pay ratio reflect another reality: The figure will be calculated differently at every company.

So whether a particular company’s ratio is 335:1 or 71:1, HR departments will have to come up with detailed communications plans to address how the median employee was determined and why the ratio is what it is, especially if the figure may appear out of step compared to industry competitors.

To appraise employee sentiment on CEO pay, PayScale conducted a survey soliciting more than 22,000 responses on whether employees knew what their CEO’s compensation was, and if so, the degree to which they thought it was fair.

Overall, the findings showed more than half of employees were not aware of their CEO’s compensation (55 percent), and among those that did, nearly 80 percent believed it was appropriate. Meanwhile, more than half of respondents who felt that their CEO is overpaid also reported that it negatively affects their view of the company (57 percent).

Unsurprisingly, employees at higher levels in their companies have more knowledge about and more readily ap-
prove of CEO compensation than employees at lower levels. In other words, the perception of the CEO’s pay and its impact on the respondent’s opinion of the company is directly related their job level.

These responses underscore the value of transparency in setting expectations about the forthcoming ratio and its influence on employee morale. If employees are surprised by revelations in the news or from a union advocate, they are likely to be less informed than if it comes straight from the source.

Ultimately, CEOs are paid very differently than employees, and the data suggests that workers who understand the nuances are more receptive to learning more about why. HR departments and other internal communicators have the opportunity to gather information and data now so they can accurately tell their company’s story and dampen the noise from external parties that may try to tell that story for them.

Shareholders & Investors

Companies are taking a closer look at their investor base.

Broadridge Financial Solutions, Inc. and PwC’s Governance Insights Center in September released their ProxyPulse report for the 2016 proxy season, analyzing data from 4,200 U.S. public company annual shareholder meetings held between January 1 and June 30, 2016.

According to the report, companies have sought a greater understanding of their retail shareholder base, including key demographic attributes. Some of the findings from the report include:

- Thirty-eight percent of U.S. shareholders are Republican, while 31 percent of U.S. shareholders are Democrats.
- The analysis showed that, on average, institutions voted 91 percent of their shares, while retail investors voted only 28 percent, leaving 24 billion retail shares unvoted.
- “A number of companies that have come under pressure over the past few months from large institutional investors or activist investors have looked to target an untapped segment for many—retail shareholders,” said Paul DeNicola, managing director of PwC’s Governance Insights Center.
- Other highlights from the report include:
  - Of the 69 proxy access proposals that went to vote, 60 percent achieved majority support; retail shareholders cast 85 percent of their voted shares against proxy access.
  - Institutional ownership of shares in street name increased to 70 percent from 68 percent for the same period last year.
  - While average shareholder support for directors was 96 percent, 382 directors failed to obtain majority support this season.
  - For say-on-pay, approximately 11 percent of companies did not surpass the 70 percent shareholder threshold this season.
  - While average shareholder support for proxy access proposals that went to vote, 60 percent achieved majority support; retail shareholders cast 85 percent of their voted shares against proxy access.
  - Institutional ownership of shares in street name increased to 70 percent from 68 percent for the same period last year.
  - Of the 69 proxy access proposals that went to vote, 60 percent achieved majority support; retail shareholders cast 85 percent of their voted shares against proxy access.

Other highlights from the report include:

- People under the age of 40 represent 20 percent of U.S. shareholders, compared to 31 percent of the U.S. population.
- Twenty-two percent of U.S. shareholders have a graduate degree, compared to 11 percent of the U.S. population.
- Sixty percent of U.S. shareholders are active investors, compared to 30 percent of the U.S. population.

Books Received

Why Are There Snowblowers in Miami? By Steven D. Goldstein. Greenleaf. $21.95. Dysfunctions are a common part of any business enterprise. Many exist because no one ever asked “why?” The author explores why this happens and offers five principles of engagement to prevent it.

Earn Your Seat on a Corporate Board. By Jill Griffin. Jill Griffin Books. $24.95. Solid advice on preparing yourself for and pursuing a seat in the boardroom.

Retrospectives

20 years ago in The Corporate Board.

At a time of escalating change in corporate governance, the role of the board of directors in planning management succession is growing in importance. Progressive boards have already assumed a more active role in business decisions at many companies. Now, directors are actively engaged in the process of selecting senior management, sometimes two or even three layers below the CEO level.

— James J. Drury, Looking Beyond the CEO for Management Succession, November/December 1996

10 years ago in The Corporate Board.

When I was at the SEC, we often remarked on the “driverless” car syndrome. When corporate fraud occurred, very often those who served in positions of responsibility would deny that he/she was “driving” at the time of the wreck. The only way to avoid a recurrence of this is to make sure many different hands are on the wheel, and that those hands are engaged in building an ethical and responsible culture throughout the company.

— Harvey L. Pitt, Expensive Lessons on CEO Pay, November/December 2006
Regulation has a big effect on the economy and a determined president can either increase regulation and make it much more punitive or decrease regulation and make it less punitive. Most regulations...are like a boulder in a strong-flowing river. Throw in one boulder and the river finds ways around it. But throw in a thousand boulders, and the river’s flow slows considerably.

— David Henderson, Economist

My firm belief is that market transparency should be the overriding goal of all emerging market [corporate governance] codes. Code drafters should never lose this bird from their sight. The oft-advanced argument that transparency in these markets is “not enough” because there are few market “enforcers” in the shape if institutional investors is a bit spurious. You first need to build an efficient market that provides meaningful information for investors to invest.

— Stilpon Nestor, Nestor Advisors

When today’s young Americans learn the extent of the debt burden we have left them, they will legitimately question the premises of self government. When tomorrow’s older Americans finally understand how they have been misled about the nature and the reliability of our fundamental social welfare programs, it may be the last straw breaking the public confidence on which democracy itself depends.

— Mitch Daniels, Purdue University

Historically, small firms haven’t been very interesting to scholars or students at business schools. We haven’t wanted to study them, Instead, we have wanted to study (or work at) Google, Facebook, Microsoft, Goldman Sachs, Blackstone or General Electric. Those companies are highly innovative, and it’s only natural that we’re drawn to exciting and fast-changing industries.

— Nitin Nohria, Harvard Business School

It is important to remember that markets, even rational efficient ones, don’t have perfect foresight. Hindsight has a tendency to make us forget the true uncertainty before the fact. The next time markets are surprised by an outcome, stop and consider the possibility that markets didn’t get it “wrong” after all, and that they do a pretty good job of aggregating and processing information.

— Peter Hecht, AQR Capital

[An IPO] is not the end. It is a means to an end for some, but it isn’t something we’re really thinking about. For us, it is real independence. When we get to that point, it is a conversation that I would have honestly which is: “Is a public company really independent?” Because now you’re beholden to the public, right?

— Steve Huffman, reddit, inc.

Teaching is about more than simply telling a student what to do and not do. It is surely one of the most demanding as well as important vocations of all. Parent, instructor, friend, diagnostician—these are some of the things a great teacher must be.

Yet it is also a vocation that is immensely satisfying as one watches a talent grow. To me, the most important challenge a teacher must confront is keeping an open mind. One must convey knowledge and artistry without overpowering a student’s sense of self.

— Byron Janis, Pianist

Yes, some people are left behind [by technology]. But as society gets wealthier, we can help them catch up. We need to get our education system right, teach the fundamentals of computer science much earlier, and provide continuing education on how to adapt to changing technology and adopt these new tools.

Doing more with less is what drives progress and societal wealth. We all benefit by the investment of the saving into higher productivity activities, like immunotherapy, drones or even finding Pokémon (entertainment too can become more productive). These will all create new and maybe even better jobs.

— Andy Kessler, Author

I really believe that giving significant sums to charities helps quell envy because you get more satisfaction out of giving money away than spending it on yourself. You cease to be envious of others who have more—why do you need to buy an expensive watch or car when there are much more worthwhile things to do with your money?

— Peter Singer, Princeton University

Short termism—the notion that companies forgo long-run investment to boost short-term stock price—is one of the greatest threats to America’s enduring prosperity. Over the past eight years, the U.S. economy has emerged from crisis and maintained an unprecedented recovery. We are now on the cusp of a remarkable resurgence. But the country can’t unlock its true potential without encouraging businesses to build for the long run.

— Joe Biden, U.S. Vice President

I’m a big believer in keeping conversations around business as objective as possible. Let’s make a decision based on what we know rather than what I feel or what I think. Especially for women, who often do have great feelings or intuition around business, grounding that on facts and objectivity makes you a strong participant in any debate.

— Melanie Whelan, SoulCycle
Directors’ Register

Recent Board Elections

Avon Products, Inc. has elected to its board Jose Armario, former executive vice president of McDonald’s Corporation.


The Clorox Company has elected to its board Amy Banse, managing director and head of funds for Comcast Ventures.

Comerica Incorporated has elected to its board Michael G. Van de Ven, executive vice president and chief operating officer of Southwest Airlines Company.

Covanta Holding Corporation has elected to its board Danielle Pletka, senior vice president of foreign and defense policy studies at the American Enterprise Institute, and Michael W. Ranger, co-founder and senior managing director of Diamond Castle Holdings, LLC.

Dominion Resources Inc. has elected to its board Ronald W. Jibson, former chairman, president and chief executive officer of Questar Corporation.

Dr Pepper Snapple Group has elected to its board José Gutiérrez, senior executive vice president and chief of staff to the chairman and CEO of AT&T Inc.

DSW Inc. has elected to its board Joanne Zaiac, chief operating officer of DigitasLBi North America.

Duke Energy Corporation has elected to its board Tom Skains, former chairman, president and chief executive officer of Piedmont Natural Gas, and William E. Webster, Jr., former executive vice president of the Institute of Nuclear Power Operations.

Equifax, Inc. has elected to its board G. Thomas Hough, former Americas vice chair of Ernst & Young LLP.

Essendant Inc. has elected to its board Dennis J. Martin, executive chairman of Federal Signal Corp.

Harris Corporation has elected to its board James F. Albaugh, senior adviser to Perella Weinberg Partners LP.

Kennametal Inc. has elected to its board Sagar A. Patel, president of aircraft turbine systems of Woodward, Inc.

Kohl’s Corporation has elected to its board Adrienne Shapira, former chief financial officer of David Yurman Enterprises LLC.

Landauer Inc. has elected to its board Teri G. Fontenot, president and chief executive officer of Woman’s Hospital.

Lennox International Inc. has elected to its board Max H. Mitchell, president and chief executive officer of Crane Co.

MasTec, Inc. has elected to its board C. Robert Campbell, lead director of Forward Air Corporation.

Momenta Pharmaceuticals, Inc. has elected to its board Corey N. Fishman, chief executive officer of Iterum Therapeutics Limited.

The Mosaic Company has elected to its board Kelvin Westbrook, president and chief executive officer of KRW Advisors, LLC.

Pegaynsystems Inc. has elected to its board Dianne Ledingham, partner and director at Bain & Company.

Pulte Group, Inc. has elected to its board William J. Pulte, chairman and chief executive officer of Carstine Brands LLC.

Raytheon Company has elected to its board Dinesh Paliwal, chairman, president and chief executive officer of Harman International Industries, Incorporated.

Realogy Holdings Corp. has elected to its board Chris Terrill, chief executive officer of HomeAdvisor, Inc.

Reliance Steel & Aluminum Co. has elected to its board Karen W. Colonias, president and chief executive officer of Simpson Manufacturing Company Inc., and Douglas W. Stotlar, former president and chief executive officer of Con-way Inc.

Reynolds American Inc. has elected to its board John Boehner, former speaker of the U.S. House of Representatives, and Jean-Marc Levy, chief operating officer of DAY medical SA.

Visteon Corporation has elected to its board Nomi Bergman, former president of Bright House Networks.

WellCare Health Plans, Inc. has elected to its board H. James Dallas, founder of James Dallas & Associates and former senior vice president of quality and operations for Medtronic, Inc.

WESCO International, Inc. has elected to its board Matthew J. Espe, former chief executive officer and president of Armstrong World Industries, Inc.

West Pharmaceutical Services, Inc. has elected to its board Paolo Pucci, chief executive officer of ArQule Inc.

Wex Inc. has elected to its board John E. Bachman, former partner at PricewaterhouseCoopers.
A growing body of research suggests that women corporate directors are associated with stronger company results, better resilience and increased innovation. Many European countries have set either mandatory or suggested quotas for female board membership. In the U.S., SEC Chair Mary Jo White has proposed rules requiring public companies to disclose their board diversity.

How do corporations actually go about increasing their gender mix—especially when history has shaped a clubby “who knows who” approach to board recruiting? Janice Ellig has a few answers. With corporate experience including Pfizer, Citibank, and Ambac Financial Group, she has built a second career in corporate recruiting. She was named by Business Week as one of the world’s most influential headhunters, and brings unparalleled experience to both executive and board search.

The Corporate Board: Why has the topic of women on corporate boards suddenly taken off?

Janice Ellig: This has actually been an issue for a long time. I don’t really think gender has been a focus for boards themselves, but if you look at the gender division, we see more quotas and targets overseas, and now the SEC is talking about greater diversity here. So the press has put more light on it.

TCB: What is the boardroom view? Is gender makeup becoming a concern?

Ellig: When you query boards, this is not really a priority. Traditionally, when recruiting, they’ve gone to their known networks. PwC did a survey on this and found 90 percent of board vacancies were filled from the current directors’ networks. Those networks primarily consist of men, and that’s a major obstacle. Last year, Catalyst looked at board openings and found only 27 percent went to women.

TCB: What seems to be the roadblock for boards?

Ellig: Diversity requires a board focus, a commitment. The business case has been made. Studies show heterogeneous groups make better decisions, and also lead to better governance. Diversity is the way to go.

TCB: What tactical changes should boards make to bend the needle on this?

Ellig: The board search process should start with a slate of candidates who represent the marketplace, but this doesn’t always happen. In three out of four searches, women are not adequately represented on the shortlist of candidates. These candidates should not have to be prior CEOs. There are many highly qualified women who are not CEOs, but boards continue to look for people based on title. They have to broaden the pool to people who don’t necessarily have titles, but are qualified—there is no shortage of qualified women for boards.

TCB: How do you achieve that?

Ellig: I’d like to see something like the blind auditions used now for symphony orchestras. In the 1970s, conductors switched to auditioning new players who were behind a screen, so they were heard but not seen. This has almost doubled the percentage of women players in American symphony orchestras since 1970. Or, boards should consider something like the NFL’s Rooney Rule, requiring that any slate of coaching candidates include minority prospects.

TCB: How will this work within the board nominating committee process?

Ellig: When the CEO or board chair or search committee chair wants to ensure better, more diverse governance, and they’re committed, it will happen over time. It may take three or five years. The board leadership should say that names submitted have to reflect our marketplace. Boards that do this will reflect a commitment to get there. Simply committing to fill every other board opening with a woman would get us to parity within a decade.

TCB: Are boards ready for such a commitment?

Ellig: I believe some boards are better prepared than others. I think, as boards look at their own composition, they see real room for improvement on the majority of them. When boards evaluate themselves they say there’s great room for improvement on the quality of their membership.

TCB: Do boards need to reach out to other resources for candidates, such as search firms?

Ellig: Boards can definitely broaden their pool of talent with search firms. They can reach out to the consultants they work with already. If they’re doing it on their own, they just need to make sure that whoever is leading the process is going to different pools, people who they don’t already know.

Just tell your consultants and search firms—insist that they bring you new, diverse names. We don’t want the people we already know, and we don’t want people who look like us. These firms can play a pivotal role.

I know one female CEO at a tech company who was explicit about adding a woman to her all-male board. The search firm she worked with kept coming back with only men until she said “If you don’t bring me qualified women, you’re fired.” The end result was a highly talented woman who now sits on her board.

TCB: It still comes down to commitment by the board.

Ellig: Yes. You have to commit at the company, board and consultant level to bring in new names, and focus on the effort. Make a company commitment to increase the number of women on your board and say so in your annual report—you won’t get there any other way. Each company, each board, needs to recognize that they fall short on reflecting their marketplace in the boardroom.
# Index

**November/December 2015 – 2016**

<table>
<thead>
<tr>
<th>Title</th>
<th>Authors</th>
<th>Issue/Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>As Global Business Transforms, Boards Must Keep Pace</td>
<td>N. Olson, T. Remick &amp; A. Tapia</td>
<td>Nov/Dec 2016</td>
</tr>
<tr>
<td>Board Decisions On Share Buybacks And Dividends</td>
<td>Paula Loop</td>
<td>Jul/Aug 2016</td>
</tr>
<tr>
<td>Board-Centric Annual Meeting</td>
<td>John C. Wilcox</td>
<td>May/Jun 2016</td>
</tr>
<tr>
<td>Bylaw Wars: Boards Awaken</td>
<td>B. Boland, M. Kirwan &amp; N. Sharifi</td>
<td>Mar/Apr 2016</td>
</tr>
<tr>
<td>Challenge Of The Disruptive Director</td>
<td>P. Browning &amp; W. Sparks</td>
<td>Mar/Apr 2016</td>
</tr>
<tr>
<td>Continuous Improvement In The Boardroom</td>
<td>T. Paton &amp; S. McGlashan</td>
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Democracy is the art and science of running the circus from the monkey cage.

— H. L. Mencken