BI Boardroom INSIDER

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The online resource for better boards and better directors — *Ralph Ward, Publisher/Editor*

WHY MOST BOARD EDUCATION IS USELESS

Corporate board and director training has faded in and out as a governance priority over the years. A decade ago, some of the major proxy advisory firms were grading boards on the training given their members, but ISS and the others shortly lost interest in the topic, and boards did likewise.

One reason may have been the lack of overall value in most board education programs. "Director education" as practiced by the big national governance groups or business schools tends to work along a few specific lines. There is discussion on fiduciary duties and corporate legalities. You'll get case histories on what went wrong at Enron, Steinhoff in South Africa, or other hot scandals depending on the country. You're told directors need to be brave, upright, and ethical. At the end, you get a suitable-for-framing certificate, sort of like the validation provided by the Wizard of Oz.

Aside from the shallowness of all this, it misses the mark on training directors for what they'll actually need when they actually need it. Missing governance knowledge usually doesn't find a board member asking herself "How can I fulfill my fiduciary duties?," but instead "How the hell do we get out of this jam?"

Stress points in board service can come from any number of directions, and often are very sudden. One example -- you get a call that a major accounting irregularity has been found, or the SEC has sent a subpoena, or insider trading uncovered. You'll need to launch a board internal investigation. The phrase "board investigation" is like the word "chemotherapy" -- no on wants to hear it, but when you need to know, it's urgent. And boards have to hope legal counsel can give them a fast training on the topic.

How can you get the board education that really meets these needs? As a *Boardroom INSIDER* subscriber, you can search our 22-year ***database of articles*** on board and governance topics, and download an instant report on what you need (if you've lost your password for this just send me an ***email***).

Also, make internal training a regular agenda item. The chair should consider adding a "what if…" thought exercise at each board meeting. If this issue arises *right now*, what would we do… what resources would we need? Never give up on training your board.

-- ***RDW***

HOW DIRECTORS DRIVE MANAGERS NUTS

Often I do a lot of calling and digging to develop research for articles here at *BI*, but sometimes a source offers such good, comprehensive information on a topic that the article practically writes itself. In researching a piece on the things board members do to make the lives of managers simpler (and also more difficult), I called Paul Winum, co-head of the board services practice at consultants RHR International. Turns out Paul works a *lot* with boards and managers wrestling with these very matters. Here is his list of "8 things board do that drive managers nuts."

- First is when directors “demonstrate they don’t understand the business in depth.” As an independent board member, you’ll never know the plumbing of the company as well as management, but you still have an obligation to learn about the drivers of the business, what shapes its P&L structure, and the current forces and challenges for the company, and its overall industry. The board members may bring their special expertise (finance, legal, tech, etc.), “but they still need to understand the core business.”
- While the item above is a major strategic headache for managers, a more specific tactical pain is “when directors show up for the board meeting unprepared. They haven’t read the board book, or at least haven’t gone through it in depth.” Managers put time and effort into these board materials. If you ask a question about an item on page 10 that was addressed on page 9, those managers will wonder why they bother.
- Yes, directors are supposed to ask questions and dig under the surface for better understanding… *but* know the cost of doing so, and ask accordingly. “Directors often ask the management team to do work or analysis without realizing what’s really involved.” If a result from this quarter varies from the same quarter last year, asking managers to launch an in-depth analysis of why could run up dozens of hours of staff time… and often add little insight. Smart board members perform a quick mental cost/benefit analysis before seeking a deep dig.
- “Don’t play ‘gotcha’ with staff presentations.” Managers have spent hours preparing board info before the meeting. While you need to hold management accountable, the staffers get frustrated when a director pounces on a minor error, misprint, or other minutiae. Putting someone’s inadvertent fat-fingering under a spotlight and grilling some poor exec assures bad blood. Use discretion when noting errors.
- Boards are valued for their top-level, strategic take on the company, but Winum finds directors sometimes burrow in and “miss the forest for the trees. They lose the big picture themes and dig into technical details.” While this may sound like good oversight, but independent directors will always be amateurs in dealing with these tactical items, and often frustrate the pros who work with them daily.
- Related to this is when “the board crosses the line into management.” Keeping fingers out and noses in is difficult for many directors, and failing to do so irritates the management team they’ve hired to handle those details. “For example, a director may suggest the company needs to beef up its cybersecurity firewall technology. That’s good… but if the director says we should hire this or that contractor, or becomes explicitly involved, that’s encroaching.”
- Director “grandstanding” at board meetings not only frustrates managers, but irritates the other board members. “Directors can try to dominate conversation, and show off how much they know.” Since members of the board are all high-level career alphas, the temptation to one-up each other is always there… but should be tightly controlled.
- Wimun’s last boardroom buzzkill is a minor one, but very common and a real enthusiasm damper. “Divided attention among the board is bad. Board members are on their smart phones, texting, or stepping out for calls.. That’s demoralizing all around.” If managers have invested time and effort in shaping a thorough, solid presentation for the board, you’re telling them they wasted their time.

7 RULES FOR BOARD TRANSACTION COMMITTEES

Forming a board special committee means that high-stakes company matters are in play, and never more so than when a big transaction is in the works. A going-private offer, a management buyout or other interested-party deal, major spinoffs or acquisitions… any of these could require forming a board special committee to review the proposition, and any can bring huge legal liabilities if mishandled.

A board transaction committee is made up of independent, disinterested board members who review and negotiate the deal at hand. Given the stakes (and the number of “interested” parties involved), assume *all* aspects of the committee’s membership, objectivity, procedures and decisions will face litigation. This also means that legal counsel or outside bankers will start out by carefully walking your board through the transaction committee process. Still, that doesn’t mean they’ll get every aspect right. Here are some often-overlooked do’s and don’t’s when your board is vetting a deal:

- Your company law firm may be very good, and may even have experience in M&A and similar structural matters. However, dealmaking with interested parties involved (and the governance protections needed) “requires the right advisors, ones who’ve been down this path before,” cautions Rick Lacher, co-head of the corporate finance practice for Houlihan Lokey. Your usual legal team may know the nuances and pitfalls of the transaction committee process -- or may just assume they do. “These transactions are highly scrutinized, so hire counsel with significant experience,” notes David Shiffman, co-head of the Global Retail Group for law firm P.J. Solomon. It’s worthwhile to spend extra for a legal team who’s guided other boards through this process.

■ Start early. Triggers for a deal, such as an unsolicited offer, often come suddenly. Forming a board deal committee may be on the to-do list of your legal counsel, but move it up on that list. From the moment an offer appears, all your actions, protections, structures and statements can come under a microscope, and forming a sound deal committee is a crucial early housekeeping step. "Committees are sometimes formed a little late," says Shiffman. "A good lawyer will tell you to form it right away."

■ Focus hard on committee structure. The ideal size would be 3 to 5 members, and preferably directors who have been involved in such deals before. Strong knowledge in your industry (particularly on valuations), legal expertise, finance, and governance background go into "a balance of skills that makes an all-star team," notes Shiffman. (Here is an ***online source*** for board deal committee charter language).

■ Also regarding membership, independence and disinterest in the deal at hand are obvious musts, but try to think a few chess moves ahead on this. Members could be untainted by the current offer group… but will someone be related to a new counter-bidder that arises? Suddenly, a director on your committee is not only conflicted, but knows all the confidential dish from inside the boardroom.

■ The transaction committee chair needs to be an all-star among all-stars to take on this tough, thankless task. Someone with former CEO or top management background, who's dealt with high-stress situations and can administer a complex, high-stakes process is needed. Shiffman cites the vitae of some best-practice transaction committee chairs he's worked with as including the president of a top 50 U.S. university, and the division head of a major retailer. Finally, make clear to all members that the chair is to act as the *only* spokesman for the committee.

■ Everyone involved with a deal committee typically misjudges the time involved. Although you should hurry to get the committee in motion, members should then practice patience. "Sometimes, you get a deal on the table and management wants to hurry and get it done," recalls Lacher. "Instead, the committee should say give us time, then get with its counselors and resist the pressure." As this suggests, the time (and effort) demands on the committee are often underestimated. The deal and bidding process can extend for months or even a year. A deal Shiffman worked on required 52 meetings of the special committee, and he knows of one that demanded over 80. Can your members handle a multi-month time suck like this?

■ *Final dealmaking tips…* prepare to sort through multiple sets of projections from all sides of the deal (and work on weighing the differences). Also, if detail gets too thick and technical, don't hesitate to demand plain English. "Assume that you'll end up being deposed," says Lacher. "Do you want to look stupid in court by saying you didn't understand something?"

COMP COMMITTEES - PAY TRENDS CHANGING YOUR ROLE

We've offered several articles on administration and best practices for board compensation committees recently. While this housekeeping info is valuable, what about the higher-altitude knowledge comp committees require on pay trends? What news do you need to know in setting CEO and other top pay plans?

■ The biggest structural change facing U.S. companies of late has been loss of the $1 million CEO pay deductibility cap under the 2017 tax reforms. Section 162(m) of the U.S. IRS code was launched in the early '90's to require that CEO pay over $1 million be "performance related" to be deductable (and, as we all know, never really worked). The 2017 changes gave up on this, but there are grandfathering and expansion of the "covered employees" clauses your committee must be familiar with going forward.

■ Also in the U.S., last year saw final SEC rules on the Dodd-Frank mandate for greater disclosure of employee hedging of equity compensation. The disclosure rules are quite broad, covering all employees (and board members), and defines "hedging" as *any* activity to offset any decrease in stock value. Companies don't necessarily have to *have* a hedging policy, but must disclose it if they do, and say so if they don't. The rule kicks in for larger companies this year, and for smaller ones in 2020.

■ Among ISS proxy advisory changes for this year will be a new grading for U.S. and Canadian exec pay using EVA (Economic Value Added) measures. ISS says it will review the match between company EVA and pay solely for informational purposes (for now), but EVA calculations are at once pretty basic and open to wide interpretation. Your comp committee will want to know how your numbers stack up. Meridian Compensation Partners offers a good ***summary*** on this shift.

■ Corporate social responsibility is nudging its way onto the comp committee agenda through a number of angles. The #MeToo movement is fueling more demands and disclosure on gender equity in compensation (driving comp committees to rewrite exec pay plans to cover clawback and severance issues for execs facing sex harassment complaints). Proxy filings and regulatory proposals increasingly seek to tie exec pay to sustainability, diversity, responsible use of technology, the gap between CEO and median employee pay, and related issues. Your comp committee can no longer set pay in isolation from the rest of the company's governance climate.

4 BOARD QUESTIONS ON STOCK BUYBACKS

For public companies, stock buybacks have become the hottest financial move that everyone loves to hate. U.S. corporations set a buyback record of over $1 trillion in 2018… a record likely to be eclipsed in 2019. Even Warren Buffett is jumping on the buyback train, proposing up to ***$100 million in repurchases*** this year.

But the pushback to buybacks is growing stronger among activists, and progressive and populist politicians. Several 2020 U.S. Democratic presidential contenders have called out buybacks as fueling wealth inequality. U.S. Rep. Tammy Baldwin (D-Wisconsin) has ***introduced legislation*** to sharply limit buybacks and tie their use to company ESG goals.

So, when management comes to your board with a share buyback proposal, you'll find yourselves in the middle of a hot business/social debate. What questions should you ask about the buyback plan to assure the deal makes sense?:

- *What are the prime motivators*?. Management may say that the stock price is undervalued, but "everyone thinks their stock is too low," says Gregory Milano, CEO at Fortuna Advisors shareholder advisory firm. You'll also be told that a buyback boosts earnings per share, but that a "well… duh" measure -- fewer shares outstanding will always mean higher EPS. Ask management to give a rationale beyond these basics. "Most managements don't integrate their thinking on uses of capital," notes Milano. "They never pull it all together into a strategy."
- Related to this, *what other uses could we make with this cash, and how do they compare*? "Is this really good capital allocation? What are other capital needs?" queries Bob Loesch, a partner in the Tucker, Ellis law firm. What other uses for the cash are on the horizon, such as mergers and acquisitions? This may be a smart use of liquidity today… but can the CEO convince the board that 2, 3 or 5 years down the road it won't be needed for something better? "Have we exhausted all the other, better ways to spend the money?" adds Milano.
- *Are these really the best mechanics for a buyback*? If the big, top-down answers above seem good, dig into the timing and structure of the buyback plan. Research at Milano's Fortuna Advisors finds that too many buybacks fumble the basics of good investment -- "they buy too much stock when the price is high, and too little when the price is low." Good cash flow gives the company a nest egg to buy with -- but that good cash flow in *itself* is making the stock price higher. Fortuna's research also found that buybacks tend to buy more stock at once than is really wise. Management should be able to show you how *this* plan to buy *this* much stock back on *this* schedule is really the optimum.
- Finally, probe the side impacts and repercussions of the buyback plan. "What will the effect be on our overall float?" Loesch suggests. "Will it change our beneficial ownership, and will we push anyone over 5% ownership?" What are the immediate and long-term tax and accounting implications? And, seek details on how the buyback will have an impact on executive compensation. Yes, a buyback typically benefits the metrics used to set exec rewards. But what precisely will they be (and how much are they a factor in launching the buyback)?

BI ONLINE FINDS - 5/19

- We've offered a number of recent articles on how novice directors can prepare for their first board meeting, and the topic is now gaining traction with other valuable info sources. The Corporate Directors Forum in California is offering a 6-hour program on "***Preparing for Your First Board Seat***" May 15 in San Diego. (The CDF is an excellent networking resource for any readers on the West Coast).
- Or, 8 time zones to the east, the U.K firm Board Intelligence is offering a series of "board breakfast" seminars in London over the spring and summer. The topics to be covered sound particularly valuable (board info packs, power agendas, board reporting). The next program is May 9. For details and registration, stop by the ***Board Intelligence website***.
- The Weinberg Center for Corporate Governance at the University of Delaware is one of America's foremost governance think tanks (being located at ground zero for U.S. corporate law no doubt helps). The Center has just released the results of its comprehensive ***survey of governance practices*** at the biggest U.S. corporations, and it's definitely worth a download..

Q&A: Onboarding Our New CEO - What is the Board Role?

Q: *One of my board roles is as an outside director with a contract manufacturing company in the southwest. I chair the governance and nominating committee. Our current CEO is retiring, and, as part of a shift in strategy, we've hired a new chief executive from outside the company. While the new chief has strong operational experience, he'll be new to a CEO role, to our company, and to our team. What should our board do to help this new CEO during the transition?*

A**:** You're wise to not just give the new CEO a handshake, say "good luck," and walk away. Onboarding a new CEO, especially a freshman chief from outside the company is tricky. You may assume that most of the hard work is done (vetting, strategic review, shaping a compensation package and job description), but further support is still crucial. As a first step, the board needs to assure that the nuts-and-bolts of the CEO's job are all in place, with no gaps. Stuff like filling out all the proper HR and legal forms, bank signatures, administrative and office support, and personal needs (family, housing, etc.) may seem like minutiae… but do you really want your new leader stressing over such things?

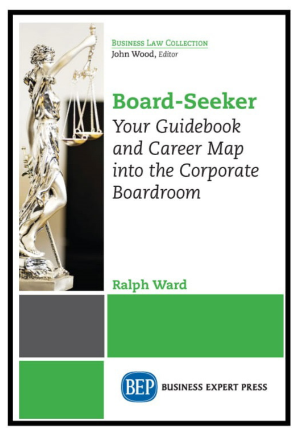
The next phase of onboarding is often the most difficult, and your role as chair of the governance committee puts you in a good position to make a difference. Designate a point person on the board to act as mentor and sounding board for the new chief. The board chair or lead director can assume this role, but it may be better for a less "boss-like" boardroom intermediary (such as yourself) to handle the role. "Schedule monthly half-day check-ins with the CEO -- discussion should be informal, anything-goes," says Dan Hawkins, founder of Summit Leadership Partners strategic advisors. Making this informal and confidential allows the CEO to ask anything under the sun on structure, personalities, company politics. "The CEO's job is a lonely one," notes Hawkins.

As mentor, you (or other board members who may be appropriate) should also provide introductions to other CEOs in your company's network, who can offer their own mentoring advice. Plus, intro the new CEO to major customers, key investor relations contacts, top suppliers, and so on. The novice CEO needs to rebuild the outgoing chief's contact list, and you can help smooth the process.

Hawkins has worked on many CEO transitions, and also suggests some more structured tools to make the process more effective. First, a CEO transition is a marathon, not a sprint -- the first 90 or 100 days is not enough. Hawkins suggests that board make regular check ins over the first year, with scheduled steps baked into board meeting agendas. "At the CEO's first board meeting, ask for observations on the business. At the second, ask for a report on the CEO's new strategy. At the third, a strategy review."

Also, 6 to 9 months in, consider investing in an outside, confidential 360-degree review of the CEO's performance from the board and staff. But Hawkins suggests a twist -- "The feedback and results should be for the CEO's eyes only." The CEO can then choose what and how much to share with the board (Hawkins finds "99% of the time they share everything.")

"BOARD SEEKER" PAPERBACK AND AUDIOBOOK



My new book, ***Board Seeker****: Your Guidebook and Career Map into the Corporate Boardroom*, was published last year by ***Business Expert Press***, and is proving a strong seller. Over the past few years, we've developed a lot of great information to help the executive "board wannabe" turn hopes for a board seat into reality. Now, I've collected and expanded on these insights to develop a road map for your board search. The link above has more detail, check out my ***video*** introduction, or follow up at ***Amazon***.

The ***audiobook*** edition of *Board Seeker* is now also available through Amazon Audible. Stop in at the ***Audible order page*** for 5 hours of board-wannabe wisdom, read by Yours Truly.

COMING IN BOARDROOM INSIDER --

- *BOARD ENGAGEMENT WITH INVESTORS - BEST PRACTICES*
- *YOUR FAMILY BUSINESS BOARD'S NEXT GENERATION*

Ralph Ward's upcoming Boardroom Masterclass and speaking engagements:

Our March ***Boardroom Masterclass*** session for ***PWC Ghana*** was a big success! I'll be heading back soon, and also to India this summer for the ***Medici Institute***, as well as in South Africa.

Visit the ***speaker*** page on the *Boardroom INSIDER* site for links to keynote speech videos, and also my listing on the ***eSpeakers*** site.

Pending webinars through *GRCEducators* and *AudioSolutionz* - check their websites for details and to register.

RALPH WARD'S *BOARDROOM INSIDER* is published monthly for directors, CEOs, those who work with corporate and nonprofit boards (corporate secretaries, corporate counsel, support staff, and consultants), and those who are board prospects.
Ralph Ward is author of the books *BOARD SEEKER*, *BOARDROOM Q&A*, *THE NEW BOARDROOM LEADERS*, *SAVING THE CORPORATE BOARD*, *IMPROVING THE CORPORATE BOARD* and *21st CENTURY CORPORATE BOARD*, and a speaker on corporate board issues. Keep up with us on Twitter at ***@boardroominside***.

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